



**EIILM UNIVERSITY**  
S I K K I M

## **COMPENSATION MANAGEMENT**

**Subject: COMPENSATION MANAGEMENT**

**Credit: 4**

## **SYLLABUS**

### **Objectives of Compensation**

Introduction to Compensation and Rewards; Objective of Compensation and Rewards; Introduction to Framework of Compensation Policy; Labor market characteristics and pay relatives

### **Wage Determination:**

Introduction to Compensation, Rewards, Wage Levels and Wage Structures; Introduction to Wage Determination Process and Wage Administration rules; Introduction to Factors Influencing Wage and Salary Structure and Principles of Wage and Salaries Administration; Introduction to the Theory of Wages: Introduction to Minimum, Fair and Living Wage

### **Wage Differential**

Introduction to Minimum Wages; Introduction to Basic Kinds of Wage Plans; Introduction to Wage Differentials & Elements of a Good Wage Plans; Introduction to Institutional Mechanisms for Wage Determination

### **Executive Compensation**

Legalistic Framework for Wage Determination; Introduction to Importance of Wage Differentials; Introduction to Executive Compensation and Components of Remuneration

### **Job Evaluation**

Introduction to Nature and Objectives of Job Evaluation; Introduction to Principles and Procedure of Job Evaluation Programs; Introduction to Basic Job Evaluation Methods; Introduction to Implementation of Evaluated Job; Introduction to Determinants of Incentives; Introduction to Classification of Rewards; Incentive Payments and its Objectives.

### **Wage Incentives**

Introduction to Wage Incentives in India; Introduction to Types of Wage Incentive Plans; Introduction to Prevalent Systems & Guidelines for Effectives Incentive Plans; Introduction to Non- Monetary Incentives

### **Profit Sharing**

Introduction to Cafeteria Style of Compensation; Introduction to Problems of Equity and Bonus; Profit Sharing & Stock Options; Introduction to Features of Fringe Benefits; Introduction to History and Growth Factors; Coverage of Benefits; Introduction to Employee Services & Fringe Benefits in India

### **Benefit Programs**

Introduction to Benefit Programs; for Management & Administration of Benefits & Services; Introduction to Compensation Survey & Methodology; Introduction to Planning Compensation for Executives & knowledge Workers

**Tax Planning**

Introduction to Tax Planning; Comparative International Compensation; Introduction to Downsizing; Voluntary Retirement Scheme; Pay Restructuring in Mergers & Acquisition

**Suggested Readings:**

1. Human Resource Management, by L.M Prasad, Sultan Chand & Sons.
2. Personal & Human Resource Management, by P. Subba Rao, Himalaya Publishing House.
3. Human Resource Management, by K. Aswathappa, Tata McGraw Hill Publishing Company Ltd.
4. Bhawdeep singh & Prem Kumar- Current Trends in HRD: Challenges & Strategies in a changing scenario.

## COURSE OVERVIEW

Accurate and updated information is the primary need of any management practice. Study offers one such means of gathering realistic information. A detail Study of such information and its accuracy presents the usefulness of the information. The study of compensation management is one of the basic facet of Human huresource management.

The aim of this subject is to develop students' understanding of the concepts of compensation and rewards in the organization . In particular the subject is designed to develop the underpinning knowledge and skills required to understand the one of the complex management functions i.e. compensating employees and its importance. This subject introduces the student to the basics compensation structure and differentials. It familiarizes the students with the practice of various management techniques and it's expected results like job evaluation etc. The learner is apprised about the latest issues in management related to compensation in order to make the students abreast about the recent trends in the area.

The students on completion of the course shall develop the following skills and competencies:

- a. Should know the nature and scope of Compensation management
  - b. Knowledge about essential elements of compensation
  - c. Awareness about the compensation structure and differentials.
  - d. Techniques of job evaluation
  - e. Understanding the importance of fringe benefits
- Awareness of the latest trends in compensation

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## LESSON 1: ROLE OF COMPENSATION AND REWARDS IN THE ORGANIZATION

### Learning Objectives

- Understand the meaning of Compensation
- Know the role of Compensation management
- Importance and purpose of Compensation management in organizations

If the abilities of employees have been developed to the point where they meet or exceed job requirements, it is now appropriate that they be equitably compensated for their contributions. The factors affecting the determination of equitable compensation are many, varied and complex. And management must come to some decision concerning the basic wage or salary. To motivate improved performance on the job many systems of variable compensation have been devised and finally organizations have developed numerous ways of providing supplementary compensation in the form of fringe benefits.

### Now Students Lets Try to Define Exactly What

#### Compensation Is?

Compensation is a systematic approach to providing monetary value to employees in exchange for work performed. Compensation may achieve several purposes assisting in recruitment, job performance, and job satisfaction.

#### Now lets Discuss how is Compensation used?

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

#### Compensation may be used to

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

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

Morale and job satisfaction are affected by compensation. Often there is a balance (equity) that must be reached between the monetary value the employer is willing to pay and the sentiments of worth felt by the employee. In an attempt to save money, employers may opt to freeze salaries or salary levels

at the expense of satisfaction and morale. Conversely, an employer wishing to reduce employee turnover may seek to increase salaries and salary levels.

Compensation may also be used as a reward for exceptional job performance. Examples of such plans include: bonuses, commissions, stock, profit sharing, gain sharing.

Employee compensation refers to all forms of pay or rewards going to employees and arising from their employment, and it has two main components. There are direct financial payments in the form of wages, salaries, incentives, commissions and bonuses and there are indirect payments in the form of financial benefits like employee paid insurance and vacations.

So in nutshell we can say that employee compensation refers to all the forms of pay or rewards going to employees and arising from their employment

Compensation includes direct cash payments, indirect payments in the form of employee benefits & incentives to motivate employees to strive for higher levels of productivity is a critical component of employment relationship.

Compensation is affected by many factors like labour market factors, collective bargaining, government legislation & top management philosophy regarding pay benefits.

### What is Compensation Management?

Process of compensation management is to establish & maintain an equitable wage & salary structure & an equitable cost structure .it involves job evaluation, wage & salary survey, profit sharing & control of pay costs.

Two important functions of compensation

- Equity function
- Motivation function

Equity is based on past & current performance & motivation with which the work has been performed in the past & current performance.

### Nature and Purpose of compensation management

The basic purpose of compensation management is to establish and maintain an equitable reward system. The other aim is the establishment and maintenance of an equitable compensation structure, i. e, an optimal balancing of conflicting personnel interests so that the satisfaction of employees and employers is maximized and conflicts minimized. The compensation management is concerned with the financial aspects of needs, motivation and rewards. Managers, therefore, analyze and interpret the needs of their employees so that reward can be individually designed to satisfy these needs. For it has been rightly said that people do what they do to satisfy some need. Before they do anything, they look for a reward or pay-off.

The reward may be money or promotion, but more likely it will be some pay-off-a smile, acceptance by a peer, receipt of information, a kind word of recognition etc.

### Lets Talk About The Significance of Compensation

From individual standpoint -remuneration is a major source of an individual's purchasing power. It determines his or her status, prestige & worth in society.

From enterprise stand point- compensation is a crucial element in the cost of production, which is expected to permit adequate profits leading to increase in new capital, expansion production, and capacity.

From national point of view –dissatisfied work force hampers equitable distribution of aggregate real income among various group involved .it causes inflation.

### A Sound Compensation Structure Tries to Achieve These Objectives

- To attract manpower in a competitive market.
- To control wages & salaries & labour costs by determining rate change & frequency of increment .
- To maintain satisfaction of employees by exhibiting that remuneration is fair adequate & equitable.

To induce & reward improved performance, money is an effective motivator.

#### a. For employees

1. Employees are paid according to requirements of their jobs, i.e., highly skilled jobs are paid more compensation than low skilled jobs. This eliminates inequalities.
2. The chances of favoritism (which creep in when wage rates are assigned) are greatly minimized.
3. Job sequences and lines of promotion are established wherever they are applicable.
4. Employees' morale and motivation are increased because of the sound compensation structure.

#### b. To Employers

1. They can systematically plan for and control the turnover in the organization.
2. A sound compensation structure reduces the likelihood of friction and grievances over remuneration
3. It enhances an employee's morale and motivation because adequate and fairly administered incentives are basic to his wants and needs.
4. It attracts qualified employees by ensuring and adequate payment for all the jobs.

### Now we come to the principles of Compensation

- Differences in pay should be based on differences in job requirements.
- Wage & salary level should be in line with those prevailing in the job market.
- Follow the principle of equal pay for equal work.
- Recognize individual differences in ability & contributions.

- The employees & trade unions should be involved in while establishing wage rates.
- The wages should be sufficient to ensure for the worker & his family reasonable standard of living.
- There should be a clearly established procedure for redressal of grievances concerning wages
- The wage & salary structure should be flexible .
- Wages due to employees should be paid correctly & promptly.
- A wage committee should review & revise wages from time to time.

### What are the components of a compensation system?

Employees as fair if based on systematic components will perceive compensation. Various compensation systems have developed to determine the value of positions. These systems utilize many similar components including job descriptions, salary ranges/structures, and written procedures.

The components of a compensation system include:

- **Job Descriptions:** A critical component of both compensation and selection systems, job descriptions define in writing the responsibilities, requirements, functions, duties, location, environment, conditions, and other aspects of jobs. Descriptions may be developed for jobs individually or for entire job families.
- **Job Analysis:** The process of analyzing jobs from which job descriptions are developed. Job analysis techniques include the use of interviews, questionnaires, and observation.
- **Job Evaluation:** A system for comparing jobs for the purpose of determining appropriate compensation levels for individual jobs or job elements. There are four main techniques: Ranking, Classification, Factor Comparison, and Point Method.
- **Pay Structures:** Useful for standardizing compensation practices. Most pay structures include several grades with each grade containing a minimum salary/wage and either step increments or grade range. Step increments are common with union positions where the pay for each job is pre-determined through collective bargaining.
- **Salary Surveys:** Collections of salary and market data. May include average salaries, inflation indicators, cost of living indicators, salary budget averages. Companies may purchase results of surveys conducted by survey vendors or may conduct their own salary surveys. When purchasing the results of salary surveys conducted by other vendors, note that surveys may be conducted within a specific industry or across industries as well as within one geographical region or across different geographical regions. Know which industry or geographic location the salary results pertain to before comparing the results to your company.
- **Policies and Regulations**

### What are Different Types of Compensation?

Different types of compensation include:



- Base Pay
- Commissions
- Overtime Pay
- Bonuses, Profit Sharing, Merit Pay
- Stock Options
- Travel/Meal/Housing Allowance

Benefits including: dental, insurance, medical, vacation, leaves, retirement, taxes...

In a layman's language the word Compensation means something, such as money, given or received as payment or reparation, as for a service or loss. On the other hand, the word Reward means something given or received in recompense for worthy behavior or in retribution for evil acts.

### **Now students let us try to demarcate between compensation and rewards**

In a layman's language the word Compensation means something, such as money, given or received as payment or reparation, as for a service or loss. On the other hand, the word Reward means something given or received in recompense for worthy behavior or in retribution for evil acts.

The word Compensation may be defined as money received in the performance of work, plus the many kinds of benefits and services that organizations provide their employees.

On the other hand, the word Reward or Incentive means anything that attracts an employees' attention and stimulates him to work. An incentive scheme is a plan or a programme to motivate individual or group performance.

An incentive programme is most frequently built on monetary rewards (incentive pay or monetary bonus), but may also include a variety of non-monetary rewards or prizes.

### **Compensation or rewards (incentives) can be classified into**

1. Direct compensation and
2. Indirect compensation.

Money is included under direct compensation (popularly known as basic salary or wage, i.e. gross pay) where the individual is entitled to for his job, overtime-work and holiday premium, bonuses based on performance, profit sharing and opportunities to purchase stock options.

While benefits come under indirect compensation, and may consist of life, accident, and health insurance, the employer's contribution to retirement (pensions), pay for vacation or illness, and employer's required payments for employee welfare as social security.

While French says, the term "Incentive system" has a limited meaning that excludes many kinds of inducements offered to people to perform work, or to work up to or beyond acceptable standards. It does not include:

1. Wage and salary payments and merit pay;
2. Over-time payments, pay for holiday work or differential according to shift, i.e. all payments which could be

considered incentives to perform work at undesirable times; and

### **3. Premium pay for performing danger tasks.**

It is related with wage payment plans which tie wages directly or indirectly to standards of productivity or to the profitability of the organization or to both criteria. Compensation represents by far the most important and contentious element in the employment relationship, and is of equal interest to the employer, employee and government.

1. To the employer because it represents a significant part of his costs, is increasingly important to his employee's performance and to competitiveness, and affects his ability to recruit and retain a labor force of quality.
2. To the employee because it is fundamental to his standard of living and is a measure of the value of his services or performance.
3. To the government because it affects aspects of macro-economic stability such as employment, inflation, purchasing power and socio – economic development in general.

While the basic wage or pay is the main component of compensation, fringe benefits and cash and non-cash benefits influence the level of wages or pay because the employer is concerned more about labor costs than wage rates per se. The tendency now is towards an increasing mix of pay element of executive compensation has substantially increased in recent years.

### **Basic Purpose for Establishment of a Sound**

#### **Compensation and Reward Administration**

The basic purpose of establishment of a sound compensation and reward administration is to establish and maintain an equitable compensation structure.

Its secondary objective is the establishment and maintenance of an equitable labor-cost structure, an optimal balancing of conflicting personnel interests so that the satisfaction of employees and employers is maximized and conflicts minimized.

### **A sound wage and salary administration tries to achieve these objectives**

#### **a. For employees**

1. Employees are paid according to requirements of their jobs, i.e., highly skilled jobs are paid more compensation than low skilled jobs. This eliminates inequalities.
2. The chances of favoritism (which creep in when wage rates are assigned) are greatly minimized.
3. Job sequences and lines of promotion are established wherever they are applicable.
4. Employees' morale and motivation are increased because a wage programme can be explained and is based upon facts.

#### **b. To Employers**

1. They can systematically plan for and control their labor costs.

1. Discuss the concept of compensation. What factors affect compensation of employees in industrial organizations?
2. What is the basic purpose behind the establishment of a sound Compensation and Reward administration system in the organizations?

## Roshans Limited-Transport Facility

The personnel Manager of Roshans Limited have received an application for the introduction of company conveyance for employees staying in town. Although Roshans Limited has provided living facilities to its employees about 60 percent of its 1000 employees still have to commute an average of 10 km to come to work. The union and some of the employees living on campus have supported the demand. Though the management might favour such a move some sections of the work force are concerned that the introduction of the company conveyance facility may cut down their wages, the company under disguise of compensation allowance pays Rs.20/- per month for traveling to employees staying more than 8 km away from the company premises.

1. What factors would you take into account in evaluation of this demand from the workers?
2. Provide the rationale for implementing or not implementing this demand.

[illegible]

## LESSON 2: OBJECTIVES OF COMPENSATION AND REWARDS

### Learning Objectives

- To know the objectives of compensation and rewards.
- To learn about the Determinants of Incentives.

An incentive or reward can be anything that attracts a workers attention and stimulates him to work. An incentive programme is most frequently built on monetary rewards but may also include a variety of non-monetary rewards. The term reward has been used both in the restricted sense of participation and the widest sense of financial motivation. The concept of reward implies the increased wiliness or motivation to work and not the capacity to work.

Compensation and Rewards determination may have one or more objectives, which may often be in conflict with each other. The objectives can be classified under four broad headings.

### Objectives of Compensation

1. The first is equity, which may take several forms. They include income distribution through narrowing of inequalities, increasing the wages of the lowest paid employees, protecting real wages (purchasing power), the concept of equal pay for work of equal value compensation management strives for internal and external equity. Internal equity requires that, pay be related to the relative worth of a job so that similar jobs get similar pay. External equity means paying workers what comparable workers are paid by other firms in the labor market. Even compensation differentials based on differences in skills or contribution are all related to the concept of equity.
2. Efficiency, which is often closely related to equity because the two concepts are not antithetical. Efficiency objectives are reflected in attempts to link a part of wages to productivity or profit, group or individual performance, acquisition and application of skills and so on. Arrangements to achieve efficiency may be seen also as being equitable (if they fairly reward performance) or inequitable (if the reward is viewed as unfair).
3. Macro economic stability through high employment levels and low inflation, of instance, an inordinately high minimum wage would have an adverse impact on levels of employment, though at what level this consequence would occur is a matter of debate.  
Though compensation and compensation policies are only one of the factors which impinge on macro-economic stability, they do contribute to (or impede) balanced and sustainable economic development.
4. Efficient allocation of labor in the labor market. This implies that employees would move to wherever they receive a net gain, such movement may be from one geographical location to another or from one job to another (within or outside an

enterprise). The provision or availability of financial incentives causes such movement.

For example, workers may move from a labor surplus or low wage area to a high wage area. They may acquire new skills to benefit from the higher wages paid for skills. When an employer's wages are below market rates employee turnover increases. When it is above market rates the employer attracts job applicants. When employees move from declining to growing industries, an efficient allocation of labor due to structural changes takes place.

### Other Objectives of Compensation

1. Acquire qualified personnel – compensation needs to be high enough to attract applicants. Pay levels must respond to the supply and demand of workers in the labor market since employers compete for workers. Premium wages are sometimes needed to attract applicants already working for others.
2. Retain current employees- Employees may quit when compensation levels are not competitive, resulting in higher turnover.
3. Reward desired behaviour- pay should reinforce desired behaviors and act as an incentive for those behaviors to occur in the future. Effective compensation plans reward performance, loyalty, experience, responsibility, and other behaviors.

### Control Costs

a rational compensation system helps the organization obtain and retain workers at a reasonable cost. Without effective compensation management, workers could be over paid or under paid.

4. Comply with legal regulations- a sound wage and salary system considers the legal challenges imposed by the government and ensures the employer's compliance. Facilitate understanding- the compensation management system should be easily understood by human resource specialists, operating managers and employees.
5. Further administrative efficiency- wage and salary programs should be designed to be managed efficiently, making optimal use of the HRIS, although this objective should be a secondary consideration compared with other objectives.

### Rewards

The use of Incentives or Rewards assumes that people's actions are related to their skills and ability to achieve important longer-run goals. Even though many organizations, by choice, or tradition or contract, allocate rewards on non-performance criteria, rewards should be regarded as a "payoff" for performance.

## An Incentive Plan has The Following Important Objectives

1. An incentive plan may consist of both 'monetary' and 'non-monetary' elements.
2. Mixed elements can provide the diversity needed to match the needs of individual employees.
3. the timing, accuracy and frequency of incentives are the very basis of a successful incentive plans.
4. The plan requires that it should be properly communicated to the employees to encourage individual performance, provide feedback and encourage redirection.

### Determinants of Incentives

These feature are contingencies, which affect the suitability and design of incentives to varying degrees. The effective use of incentives depends on three variables-the individual, work situation, and incentive plan.

#### i. (I and III) The Individual and the Incentives

Different people value things differently. Enlightened managers realize that all people do not attach the same value to monetary incentives, bonuses, prizes or trips. Employees view these things differently because of age, marital status, economic need and future objectives.

However, even though employee reaction to incentives vary greatly, incentives must have some redeeming merits. For example, there might be a number of monetary and non-monetary incentive programmes to motivate employees. Money, gift certificates, praises, or merit pay are of the continuous parade of promotion.

#### ii. The Work Situation

This is made up of four important elements:

- A. Technology machine or work system, if speed of equipment operation can be varied, it can establish range of the incentive.
- b. Satisfying job assignments, a workers' job may incorporate a number of activities that he finds satisfying. Incentives may take the form of earned time-off, greater flexibility in hours worked, extended vacation time and other privileges that an individual values.

Feedback, a worker needs to be able to see the connection between his work and rewards. These responses provide important reinforcement.

Equity, worker considers fairness or reasonableness as part of the exchange (or his work). Incentives, in general, are important motivators. Their effectiveness depends upon three factors: drives, preference value, and, satisfying value of the goal objects.

Beyond subsistence level, becoming needs (self-actualization needs) possess greater preference value and are more satisfying than deficiency needs (which are necessary for survival). Below the subsistence level, however, the reverse holds true." He makes the following generalizations:

- i. Incentives, whether they are monetary or non-monetary, tend to increase the level of motivation in a person.

- ii. Financial incentives relate more effectively with basic motivation or deficiency needs.
- iii. Non-financial incentives are linked more closely with higher motivation, or becoming needs.
- iv. The higher the position of a person in an organization's hierarchy, the greater is his vulnerability to non-financial incentives.

"While budgetary restrictions and temporary improvements in performance place a limit on the potency of money as a motivator, non-financial incentives involve only human ingenuity as investment and also insure a relatively stable acceleration in output.

Monetary incentive imply external motivation, non-monetary incentives involve internal motivation. Both are important. It is a judicious mix-up of the two that tends to cement incentives with motivation. "

### Assignments

1. Discuss the objectives of compensation and Rewards.
2. Discuss the determinants of compensation and Rewards.
3. When and why would you pay a sales person a salary? A commission? Salary and commission combined?
4. Working individually or in groups, develop an incentive plan for the following positions: chemical; engineer, plant manager, used-car sales person. What factors n did you have to consider in reading your conclusions

### Case study

#### Nature's Dilemma

"Sriram Industries" is a mechanical engineering establishment situated in Bombay. It has 15,000 workmen employed in first shift between 8-16 hours. This is a major shift and known as general shift.

The workmen of Sriram Industries report for work from distance places such as Pune, Virar and also Karjat, which are miles away from the place of work. The workers travel by Central Railway, Western Railway (Suburban Services) and by BEST buses (BEST is the local Municipal bus transport organisation). Some also travel by petrol driven vehicles or their own bicycle. A small number staying in surrounding areas of the factory, report for duty on foot.

On 27 June 1990, there was a very heavy downpour, which is not uncommon in Bombay. Vast areas were submerged under water. Central and western sub urban railway services, therefore, were completely dislocated. As a result of the heavy rains, train services were suspended between 7 – 8 am.. BEST buses were less frequently run and in some areas there was no bus service at all. A few timekeepers who somehow managed to attend took attendance. It was found that out of the total complement, 4000 attended in time, 2600 attended two hours late, 4800 attended four hours late and the remaining 3600 did not attend.

As was obvious, neither the management nor the workmen was responsible for the aforesaid happening and the trade union, operating in the establishment requested the management to deal sympathetically with the employees. They requested that

since it was beyond the control of workmen, even those who could not attend should not be marked absent.

The union leader had produced a certificate from Railway authorities and also BEST authorities about the complete dislocation between 7-8.30 am and a partial dislocation till 2.30 pm.

As will be seen from the case, 4000 employees worked for the whole day, 2600 worked for six hours, 4800 worked for four hours only and 3600 did not report for duty at all. The issue was how to adjust the wages for the day.

The General Manager called a meeting of the officers to discuss the issue. It was found that a good number of officers who stayed in long distance suburbs or were staying in remote areas could not also attend to work. Some of the officers who participated in the meeting, opined that 'no work no pay' should be the only principle and at best the only thing that the management should do is not to take any disciplinary action as such. Others expressed different views and there was no near-consensus even in the meeting. The General Manager adjourned the meeting without coming to any decision.

Relation between the management and the three unions operating in the company were generally satisfactory. Only one of the three unions that had mainly white coloured staff as members had a legalistic approach in all matters and was not easily satisfied.

How can this issue be sorted out?

## Notes

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## LESSON 3: FRAME WORK OF COMPENSATION POLICY

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### Learning Objectives

- To understand the concept of Framework.
- To know the Framework of a Compensation Policy

A compensation framework that supports a long-term strategic vision for compensation and implements new initiatives, will provide the needed direction, changes will involve moving towards solving special salary problems using innovative concepts.

The way we do compensation is undergoing major change towards a more flexible and timely corporate compensation systems. The new system will have increased delegation to managers and will be driven by the business needs of Government and ministries. It will be faster, more efficient and eliminate duplication, focus on a long term approach to compensation management.

Move from being highly centralized to a decentralized approach whereby deputy ministers and senior managers will have increased authority to make decisions.

Integrate compensation with the other areas of human resource management. And Emphasize transparency, monitoring, reporting and accountability.

The vision for compensation will assist the public service in attracting and retaining key employees.

Managers will have more accountability for the compensation of their employees, and will be profiled with the required tools, systems and support. Senior managers will approve, within the framework, exceptional compensation changes, based on sound business decisions. Senior managers will also have authority to approve the classification levels of pre-identified jobs within their organization.

### Framework of a Compensation Policy

Employee motivation and performance management depend on good systems that offer both financial and non-financial rewards (non-monetary rewards). This performance management article applies to all organizations.

Constant change and high expectations are taking their toll in some organisations, as well as in industry and government generally. Sometimes this is shown in employee turnover.

Sometimes it is hidden because of job insecurity. Many employees make a New Year's resolution to seek other employment. Many are also seeking more balance in their life.

Rewards and remuneration must be scrutinised. Employee motivation and performance are critical. Non-monetary rewards can be as important as monetary rewards.

In some organisations, a multitude of different salary and pay arrangements exist. It is time to bring these different systems into a new framework. Employees at all levels need to have confidence in the salary administration system. Employees want

the rewards to be shared fairly and equitably. If they are not, dissatisfaction can cause severe morale and performance problems.

If they haven't done so already, leading organisations will need to establish an improved salary administration structure.

It is possible to develop a simple structure that overcomes the difficulties of the past, yet is simple enough for everyone in the organisation to understand. This structure can be tied to a completely new performance management approach, including better performance appraisal mechanisms.

Some industry's remuneration systems have been dominated by the industrial relations system. Enterprise bargaining and local area work agreements, individual performance based contracts, and the effect of competition on organisational structures, have had a big impact.

A good rewards and remuneration system ensures that each person receives appropriate financial and nonfinancial recognition to account for the personal contribution they are making and the overall value of their position to the organisation.

### This includes

- Creating and maintaining an organisational structure and culture that facilitates both employee and organisational performance.
- Recognising and rewarding individual and team performance, financially and otherwise, in relation to the overall contribution made.
- Implementing compensation systems that fairly treat and recognise all employees,

regardless of their level within the organisation. This is the equity issue. It involves matching remuneration with the contribution made, particularly where job requirements can change rapidly.

The best performance appraisal system in the world will not work if it is linked to a rewards and remuneration system that employees do not trust or support.

A motivated employee will achieve a great deal. A demotivated employee will be slow, prone to error and not likely to achieve.

Motivation influences performance. It also suggests that the 'lack of', 'promise of', or receipt of either financial or non-financial rewards may also influence motivation. A feedback loop between motivation and performance exists, with each potentially impacting the other.

Remuneration is a component of both financial and non-financial reward; financially, in terms of cash and benefits received; non-financially in terms of recognition, status and esteem, e.g. the status of full private use of a motor vehicle.

Job evaluation is a process to determine the contribution of a position to an organisation. It needs to be seen by both the employee and organisation as fair and equitable.

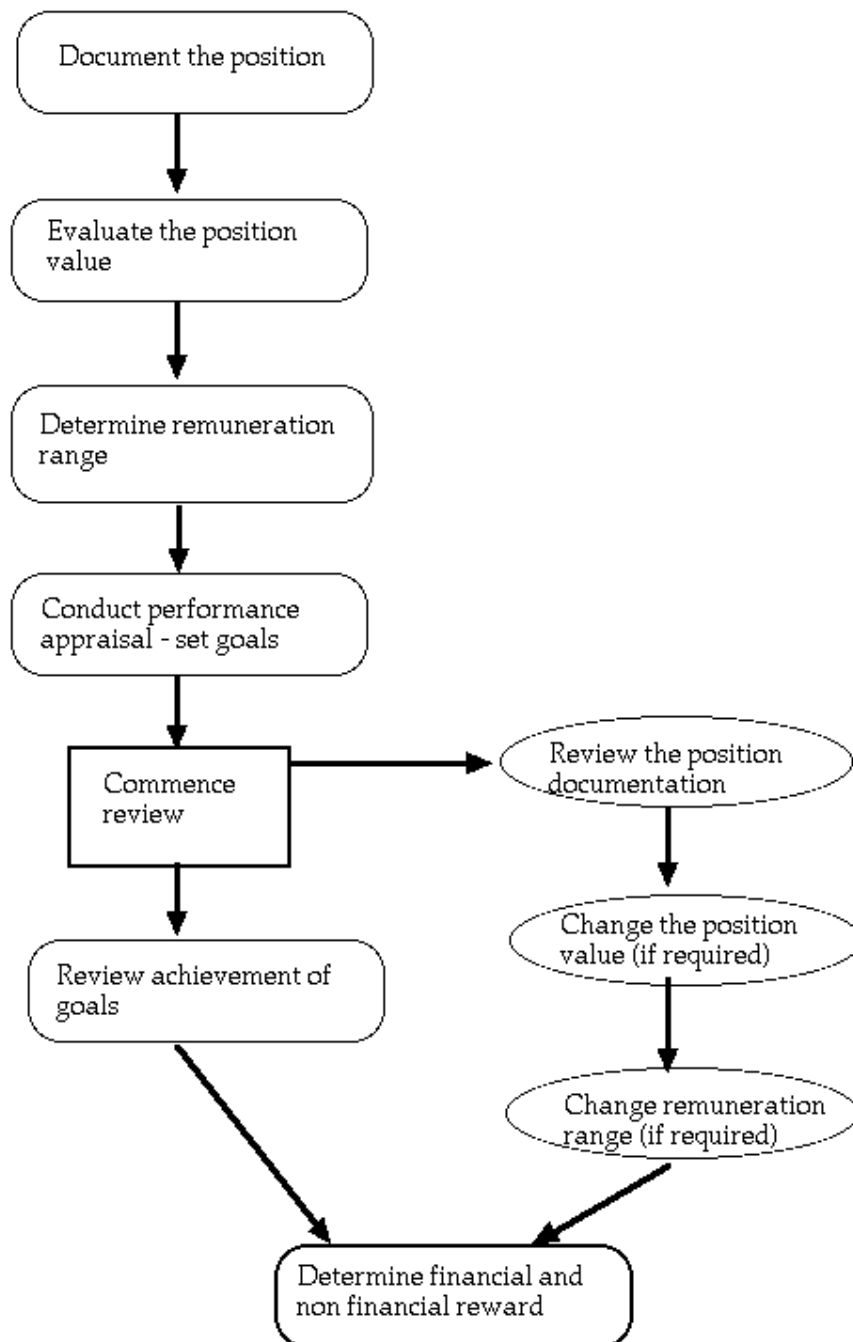
Good salary administration requires that employees should receive financial recognition for the contribution that they make, and that positions of equal value should be entitled to equal compensation. If organisations handle this incorrectly, or manipulate it in some way, the impact on the employee is significant.

Past pay systems often paid little attention to incentives. It is only in recent years that some systems have provided for differentiation based on performance. The concept of fair incentives should be on the agenda. An integrated system is required such as the following diagram represents.

Perception is the reality. If the current system is not working as intended, then the organisation has a real problem.

### Some Key Questions

- Does the documentation give a full, comprehensive description of each position?
- Is the evaluation system used soundly based and rigorously applied?
- Is consideration given to market competitiveness in setting the remuneration range?
- Is the performance appraisal system well designed and accepted by all employees?



- Is the review process conducted fairly and within agreed time limits? As well as checking goal achievement, does the review reconsider the job and changes that may have occurred?
- Are non-financial rewards considered along with financial rewards?

The system should not be bureaucratic, but it has to be perceived as fair. It also has to be actually administered fairly.

Where do you rate your system on a scale of 1 to 10?

1. Employees are showing their total disenchantment by leaving as quickly as they can. Morale and motivation are non-existent.
2. Employees are unhappy and grumble frequently about the non-existence of a remuneration system. They openly talk about the problems instead of getting on with their work.
3. Employees are unhappy and comment frequently about the remuneration system that is supposed to be in place but doesn't work. However, a work ethic exists and they do some work.
4. Employees believe that 'management' controls and manipulates the system. They continue on regardless, but they do not like it.
5. Employees are aware of a remuneration system but do not see it working for them. It causes some dissatisfaction.
6. Employees believe the remuneration system only works for 'management'.
7. Some employees believe the remuneration system is working, others believe it could be better targeted to their particular situation.
8. A comprehensive system is in place. Position value and remuneration is fairly evaluated and most are well compensated. Areas for improvement are recognising individual and team contributions fairly. The system is reviewed regularly.
9. A comprehensive system is in place. Position value and remuneration is fairly evaluated and nearly all are well compensated. Individual and team contributions are recognised. Higher achievement will come from better implementation.
10. Everyone from the CEO down believes that the remuneration system is working well and being equitably administered. Individual and team contributions are recognized and rewarded accordingly. Although some would like more pay, no one is unhappy with the system. They are motivated and productive.

## Case Study

Let us analyze the following case study regarding compensation framework:

### Company Background

The purpose of CalPERS' policies on executive compensation is to raise the level of accountability of Boards and Compensation Committees to shareowners. CalPERS feels it will benefit shareowners in the long-term if shareowners can provide an enhanced level of oversight in relation to Compensation Committee actions. This results in more

shareowner friendly compensation programs.

Compensation programs are one of the most powerful tools available to companies to attract, retain and motivate key employees, as well as align their interests with those of shareowners. Poorly designed compensation packages may have disastrous impacts on the company and its shareowners by incentivising short-term oriented and self-interested behavior.

Conversely, well-designed compensation packages may help align management with owners and drive long-term superior performance. Since equity owners have a strong interest in long-term performance and are the party whose interests are diluted by stock option plans, CalPERS believes shareowners should provide stronger oversight of executive compensation programs.

In recognition of this, CalPERS' believes that companies should formulate executive compensation policies and seek shareowner approval for those policies on a periodic basis. Since SEC's Release #34-48108, adopted on June 30, 2003 as listing standards, for the NYSE and NASDAQ, companies must give shareowners the opportunity to vote on all equity compensation plans and material revisions (with limited exemptions). The ability to vote on these plans provides the checks and balances on the potential dilution resulting from earmarking shares for equity-based awards.

With this in mind companies should design executive compensation policies to be comprehensive enough to provide shareowners with oversight of how the company will design and implement compensation programs, yet broad enough to permit the Compensation Committee flexibility in implementing the policy. CalPERS does not believe that it is optimal for shareowners to approve individual contracts at the company specific level.

CalPERS developed a model policy guideline designed to assist companies in formulating executive compensation policies. This also provides a framework by which interested parties may gauge the quality of company specific executive compensation programs and practices.

### General Policy Guidelines

This also provides a framework by which interested parties may gauge the quality of company specific executive compensation programs and practices.

### General Policy Guidelines

Executive compensation programs should be designed and implemented to ensure alignment of interest of management with the long-term interest of shareowners.

Executive compensation should be comprised of a combination of cash and equity-based compensation. Direct ownership should be strongly encouraged.

Executive compensation policies should be transparent to shareowners. The policies should contain, at a minimum, compensation philosophy, the targeted mix of base compensation and "at risk" compensation, key methodologies to ensure alignment of interest, and parameters for guidance of employment contract provisions, including severance packages.



Companies under new SEC guidelines must provide shareowners the opportunity to vote on any material revisions to these plans.

Executive contracts should be fully disclosed, with adequate information to judge the “drivers” of incentive components of compensation packages.

### Executive Compensation Policies

In particular, executive compensation policies should contain, at a minimum, the following components:

1. The company’s desired mix of base, bonus and long-term incentive compensation This section should include adequate detail to shareowners regarding the company’s philosophy of base pay components versus “pay at risk” components of the program. Details should include reasonable ranges based on total compensation within which the company will target base salary as well as other components of total compensation. Overall targets of total compensation should also be provided.

This section should also provide an overview of how the company intends to structure the compensation program, such as how much of overall compensation is based on peer relative analysis and how much of it is based on other criteria. The policy should clearly articulate how the company ensures optimal alignment of interests with shareowners through the design and implementation of its executive compensation program.

2. The company’s intended forms of incentive and bonus compensation, including what types of measures will be used to drive incentive compensation.

In addition to the relative mix of base salary and any form of incentive compensation, the company should provide a breakdown of the types of incentive compensation and reasonable ranges based on total compensation targets for each type of incentive compensation within the program.

The policy should include the company’s philosophy related to the major components of incentive compensation, including the strengths and weaknesses of each and how the overall incentive component of the plan provides optimal alignment of interests with shareowners.

CalPERS believes that in the case of option plans and restricted stock, a significant portion of the overall program should consist of performance-based plans. These include index-based options, premium-priced options and performance targets tied to company- specific metrics.

Performance-based plans should be constructed to reward true out-performance, and should include provisions by which options will not vest if hurdles are not obtained. Time-accelerated vesting is not considered a meaningful performance-based hurdle.

The policy should include the specific drivers the company will use in constructing the performance-based components of the plan. CalPERS suggests using metrics such as Return on Invested Capital (ROIC), Return on Assets (ROA), and Return on Equity (ROE), and the relative mix of how performance metrics will be weighted.

CalPERS believes that optimal plan design will utilize multiple performance metrics in a fashion that will tie small portions of vesting to individual metrics or larger portions of vesting to multiple metrics.

CalPERS believes that if metrics are used in combination, the plan should require that each component be satisfied to achieve vesting as opposed to one of several that must be achieved.

3. The company’s intended distribution of equity-based compensation. The policy should include the company’s philosophy related to how equity-based compensation will be distributed within various levels of the company.

In the event that the company uses equity-based tools in its compensation program, the policy should articulate how the company will address the issue of dilution. For example, the company should provide a detailed plan with each option program addressing the intended life of the plan and the yearly run rate.

If the company intends to repurchase equity in response to the issue of dilution, the plan should clearly articulate how the repurchase decision is made in relation to other capital allocation alternatives. Calipers does not favorably view repurchase plans that are

4. The company’s philosophy relating to the dilution of existing equity owners simply targeted to mitigate and obfuscate dilution caused by stock option plans.
5. The parameters by which the company will use severance packages, if at all.
6. The parameters by which the company will utilize “other” forms of compensation, if at all.

The policy should provide broad guidelines by which the company will use alternative forms of compensation, and the relative weight in relation to overall compensation if “other” forms of compensation will be utilized.

The term and length for “other” forms of compensation should be disclosed. Other forms of compensation include but are not limited to pension benefits, deferred pay, perquisites and loans. In some cases, other forms of compensation can provide significant value to executives, which are not readily comparable to more basic forms of compensation such as salary, bonus and incentive.

Other forms of compensation are also more likely to be perceived by shareowners as not providing meaningful alignment of interests or incentive value. To the degree that the company will provide other forms of compensation, it should clearly articulate its philosophy for utilizing these tools with specific treatment of how shareowners should expect to realize value from including these forms of compensation

Executive compensation programs should be designed and implemented to ensure alignment of interest of management with the long-term interest of shareowners. Executive compensation should be comprised of a combination of cash and equity-based compensation. Direct ownership should be strongly encouraged.

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Calipers believes that if metrics are used in combination, the plan should require that each component be satisfied to achieve vesting as opposed to one of several that must be achieved.

- What is the purpose behind Calipers' policies on executive compensation?
- Based on the above case study how can you say that compensation programs are one of the most powerful tools available to companies?
- Discuss the components of executive compensation.

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## LESSON 4: LABOR MARKET CHARACTERISTICS

### Learning Objectives

- To know the Labour Market
- To understand Labour Market Characteristics
- To know Labour and Labour Welfare

So students what do you understand by a labour market.

Labor Market is a place where labour is exchanged for wages. These places are identified and defined by a combination of the following factors:

1. Geography (local, regional, national, international),
2. Industry,
3. Education, licensing or certification and
4. Function or occupation.

**Labour market characteristics** are also social matters.

Sociological and demographic change; social class movements, gender awareness, youth cultures, attitudes to age, family size and employment heritage, ethic and cultural background - may all influence who enters, leaves or is restricted from taking up and keeping particular kinds of employment.

These are relevant to **labour** markets. Overall we should be concerned to understand

- structures and processes influencing how work is distributed in the “defined **labour market**”.
- how pay is distributed and pay levels and relativities between various jobs and groups
- how patterns of work are changing and the level, structure and distribution of employment

The “economic labour market” model

Supply, demand and pricing concepts can be applied to labour market operations. Typically this paradigm assumes that wages regulate supply/demand for labour affecting inflation and employment within an economy. But there is no single, homogeneous and perfect market for labour. Rather there are many differentiated, interrelated markets based on skill, occupation, geographical location and institutional/social frameworks.

### Assumptions of the model include

- deriving income expectations from the person’s “utility function”. The supply of labour (how many offering themselves for work and for how long is determined by wages that are offered).
- Work as a “disutility” with wages being the reward/compensation for lost leisure and subordination under a contract to an employer. Sometimes - overtime premiums are paid - but why in only some cases?
- Wages are a cost and for employers wanting to maximise profits – labour’s marginal productivity value is significant.

With fixed level of capital, at some point the output of each extra unit of labour will start to fall off, so as the argument goes - the wage paid will be equal to the value of the marginal productivity of the last unit of labour. Supply and demand for labour (quantitatively and qualitatively) operate competitively through wages (pricing). At an “equilibrium point” everyone willing to work at that wage.

In reality, assumptions about free labour markets where supply, demand, price and individuals/firms interplay and compete to maximise their position - are too simple. Individuals and employers make choices within their labour markets. Results may be interrelated and interdependent but the choices are constrained by many social and other factors – including “labour market” institutionalisation. Formal and informal rules, regulations and practice prevail over the marginal productivity of labour formula. Salomon points out that the free market wages may be constrained by:

### Reservation wage Levels

Unemployment benefit and a national minimum wage fix income points below which few will be prepared to work.

### Efficiency wage Levels

There is little evidence that organisations generally use a lowest wage mechanism as a regulator - indeed some may adopt a high wage strategy. A range of pay rates for a given labour market will apply rather than one price. Employers, in one way or another, survey prevailing rates for the type of work they have and the scarcity values they perceive. To secure the staff commitment, effort and talent they need, they may pay above what they regard as “the going rate” or minimum level.

Company wage and salary surveys may identify the firm’s position relative to similar jobs/rewards in rival organisations. To attract and retain the best employees an employer (finance and competitive health permitting) may make a decision to be high in the survey league table. Of course, if the company’s financial and competitive position deteriorates, it is more difficult (institutional reasons) to reduce contracted pay other than by regulating overtime. Off-loading staff by making redundancies has costs.

Production needs (derived from technology and working methods) may be a more significant determinant of the numbers to be employed than the wage level at any given time.

### A political perspective

Such dynamics require a political economic perspective when studying labour markets. Some national or regional labour markets may be dominated by “power” groups e.g.

### Socially oriented political parties

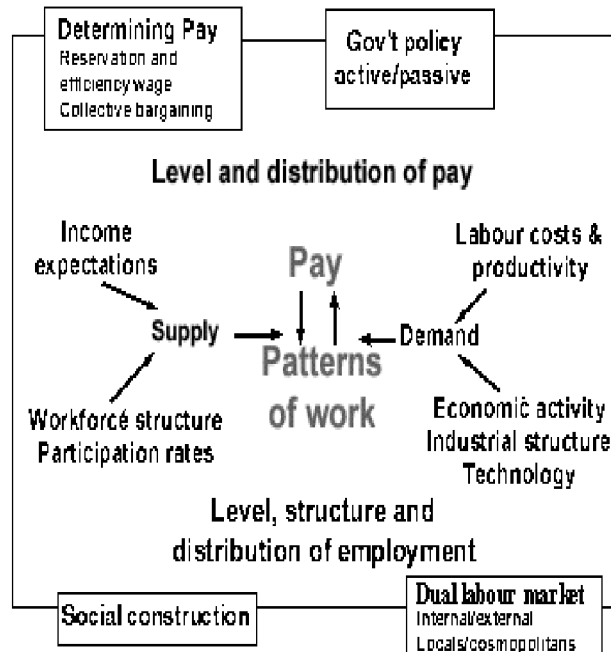
- Large groups of workers that can bring bargaining power to bear
- Companies that can switch production and close factories/offices

Some labour markets are perceived to be freer and less regulated than others. Such perceptions may influence the flows of inward investment - thus bringing new jobs into the labour market. But note the word “perception”. Detailed analysis only will discern how far one national labour market is really “freer” than another.

Labour markets are substantially affected by growth or recession in world trade. Industrial restructuring e.g. from heavy, male dominated industries to lighter, information-based and service to customers oriented industries where women for various reasons are about to compete better. Changes in technology substantially affect jobs. Some disappear. Employers may need fewer staff and the skills required of computer literate employees take on greater significance. Those who are not computer literate may indeed be excluded from a significant area of employment growth.

### Collective Bargaining

Where trade unions are established, within an employing organisation and/or a wider institutional framework, collective bargaining processes may determine wage structures for a “class” of employees. Management become less able to treat labour as individual, replaceable units. Collectively negotiated and regulated wage structures may also apply to the individual who, whilst entering into an employment contract as an individual and indeed not necessarily a trade union member, becomes subject to the terms and conditions of employment agreed between an employer and a trade union for that class of employees e.g. railway workers.



### Some Labour Market Relationships

Collective negotiation will typically involve comparability with other groups (internal and external) not just supply and demand factors. Comparability may lead to one group through their trade union or word of mouth or the media to argue e.g. “

nurses were awarded 7.5%, teachers now deserve at least this in their next pay award - and more because of past slippage against inflation”. There is a ratchet effect - always upward from such pay comparability arguments. Dual (external and internal) labour markets Hiring and firing are interactions between organisations, individuals and the external labour market. There are internal labour market effects also.

Employers with a large work forces and organisation structures have internal labour markets characterised by

- rules governing points of entry into jobs, required qualifications and starting salaries
- salary structures and job evaluation
- internal mechanisms for enabling progression
- various modes of training provision

### Labour Theory of Value

The notion that the value of any good or service depends on how much labour it uses up. First suggested by ADAM SMITH, it took a central place in the philosophy of KARL MARX. Some neoclassical economists disagreed with this theory, arguing that the price of something was independent of how much labor went into producing it and was instead determined solely by supply and demand

A flexible labour market is one in which it is easy and inexpensive for firms to vary the amount of labor they use, including by changing the hours worked by each employee and by changing the number of employees.

This often means minimal regulation of the employment (no minimum wage, say) and weak (or no) trade unions. Such flexibility is characterized by its opponents as giving firms all the power, allowing them to fire employees at a moment's notice and leaving working feeling insecure.

Opponents of labor market flexibility claim that labor laws that make workers feel more secure encourage employees to invest in acquiring skills that enable them to do their current job better but that could not be taken with them to another firm if they were let go.

Supporters claim that it improves economic efficiency by leaving it to market forces to decide the terms of employment. Broadly speaking, the evidence is that greater flexibility is associated with lower rates of unemployment and higher GDP per head.

### Labour Market Characteristics

Labor, one of the factors of production, with land, capital and enterprise. Among the things that determine the supply of labor are the number of able people in the population, their willingness to work, labor laws and regulations, and the health of the economy and firms, labor laws and regulations, as well as the price and supply of other factors of production.

In a perfect market, wages (the price of labor) would be determined by supply and demand, but the labor market is often far from perfect. Wages can be less flexible than other prices in particular, they rarely fall even when demand for labor declines or supply increases. This wage rigidity can be a cause of unemployment.



## LESSON 5: COMPENSATION STRUCTURE AND DIFFERENTIALS

### Learning Objectives

- To further understand the concept of Compensation and Reward
- To understand Methods of Compensation
- To know the concept of Wage Level and Wage Rate
- To understand the concept of Wage Structure
- To know the Determinants of the wage structure

It is extremely important to have a well-designed compensation system. A properly planned and administered salary system is one of the most important aspects of order management. Deciding how and what people should be paid is what is covered under salary administration.

In this unit we shall pay special attention to the process offering salary levels, and designing salary structures. More dynamic aspects such as rate ranges, salary progression policies and procedures will also be examined.

### Compensation and Rewards

Compensation may be defined as money received in the performance of work, plus the many kinds of benefits and services that organizations provide their employees.

Money is included under direct compensation (popularly known as wages, i.e., gross pay); while benefits come under indirect compensation, and may consist of life, accident, and health insurance, the employer's contribution to retirement, pay for vacation or illness, and employer's required payments for employee welfare as social security.

A 'wage' (or pay) is the remuneration paid, for the service of labour in production, periodically to an employee/worker. "Wages" usually refer to the hourly rate or daily rate paid to such groups as production and maintenance employees ("blue-collar workers").

On the other hand, 'Salary' normally refers to the weekly or monthly rates paid to clerical, administrative and professional employees ("white-collar workers").

### Methods of Compensation

The operating companies need to develop a compensation package for their employees depending on the size and type of business, employers may choose to compensate their employees in a number of different ways.

Below is given the different methods of compensation:

#### 1. Wages and Salaries

Although we use the terms wages and salaries interchangeably, in payroll accounting, the two terms have different definitions

Wages refers to the earnings of employees whose pay is calculated on an hourly basis.

Salary refers to the earnings of employees whose pay is calculated on a weekly, bi-weekly, semi-monthly, or monthly basis.

#### 2.Commissions

Sales commission plans vary greatly from company to company, but are generally based on the dollar amount of sales made during a payroll period. Commission income is considered the same as wages or salaries for withholding and reporting purposes. Commissions are usually computed on a certain percentage or commission rate.

Some commissioned employees may not be exempt from the minimum wage requirement. The employer must determine the regular, hourly rate for each non-exempt salesperson during the week and make sure this rate is at least equal to the current minimum wage.

#### 3.Piece-Rate Plan

Workers paid on a piece-rate plan receive a certain amount for each item produced. Gross earnings equal the rate per item multiplied by the number of items produced during the payroll period

#### 4.Combination Plan

Many businesses pay sales people both a salary and a commission. Such a combination plan provides some regular income and offers an incentive for superior sales.

#### 5.Draws

Draws are often given to salespeople who work only for commission. A draw is an advance given to a salesperson that will be collected when future sales transactions are closed. Draws will be subtracted from a salesperson's commissions after any applicable taxes and deductions have been withheld. The draw is subject to all payroll withholding taxes.

### Other Types of Earnings

#### 6.Bonuses

Businesses offer bonuses in many different ways. Some bonuses are based on profitable operations of the business and are paid at year-end. A common type of bonus may be offered to salespeople for selling a specific item. Another type of bonus plan, one that may be part of an employment agreement, pays managers if the yearly sales or profits reach a certain level.

#### 7.Profit Sharing Payments

A profit sharing plan, like a bonus plan, can be structured in a number of different ways. An employer may elect to pay cash to employees, give them stock in the business, or set up a deferred compensation fund for retirement.

#### 8. Other Taxable Forms of Compensation

Sometimes other payments to employees are required that are equivalent to wages. These include non-cash fringe benefits, reimbursed expenses, sick pay, supplemental unemployment

benefits, and tips. As with any form of compensation, these payments are subject to federal taxes.

### 9. Non-Cash Fringe Benefits

Non-cash fringe benefits must be included in an employee's gross earnings.

Fringe benefits include the following:

- Personal use of company cars
- Free or discounted airline flights
- Vacations
- Discounts on property or services
- Memberships in country clubs or other social clubs
- Tickets to entertainment or sporting events

### 10. Reimbursed Expenses

Payments made to employees for travel and other necessary business expenses are taxable only if:

The employee does not have to substantiate those expenses with receipts or other documentation. The employer advances an amount to the employee for business expenses and the employee does not return any unused amount.

Travel and entertainment reimbursements, or other expense allowances, paid to an employee under a non-accountable plan are also included as wages. Under a non-accountable plan, the employee is given a certain amount of money toward expenses, but does not have to substantiate them or return any excess cash.

Under an accountable plan, travel advances paid to the employee prior to travel in excess of substantiated expenses must be repaid to the employer within a reasonable and specified period of time.

### 11. Sick Pay

In general, sick pay is any amount paid to an employee because of illness or injury under a plan providing for such benefits. The amounts are disbursed by the insurance company or the employee's trust, and are referenced as third party payments.

### 12. Tips

In certain businesses, employees receive compensation in the form of gratuities or tips. A tip is an additional amount from a customer for services rendered. Bartenders and restaurant servers usually receive tips in addition to wages. Hair stylists and taxi drivers also depend on tips as a major source of income.

### 13. Supplemental Wages

Supplemental wages differ from regular wages only in that they may be based on a different payroll period, computed on a different compensation plan or rate, or paid at a different time than regular wages.

In addition, certain payments are, by their nature or timing, supplemental wages. Such payments include retroactive pay increases, severance pay, bonuses, commissions, taxable fringe benefits, awards and vacation pay on termination.

The distinction between regular and supplemental wages is important because special rules apply to withholding on supplemental wages.

### 14. Exempt Payments:

Compensation not considered wages includes sickness and injury payments under a workers' compensation law, and other payments that are likely to be tax deductible such as qualified moving expense reimbursements.

### Wage level

We have already discussed before that wages are something received by a worker or paid by an employer for time on the job; money received or paid usually for work by the hour, day, or week, or month; a calculation or statement of money earned for a period of time from one hour (hourly wage) up to one year (annual wages). Now let us discuss about wage level.

### What is a Wage Level?

The 'wage levels' represent the money an average worker makes in a geographic area or in his organization. It is only an average; specific markets or firms and individual wages can vary widely from the average.

### How are Wage Levels Set?

Wage levels are calculated using position importance and skill required as criteria. Consult your trade association and accountant to learn the most current practices, cost ratios and profit margins in your business field. While there is a minimum wage set by federal law for most jobs, the actual wage paid is entirely between you and your prospective employee.

### What is "Stagnated" Wage Levels?

An add to Housing Woes of Poor. The continuing stagnation of the income levels for the most disadvantaged...

The continuing stagnation of the income levels for the most disadvantaged households is causing serious housing challenges for people in the lowest 20 percent of the income scale. This is one of the findings of "The State of the Nation's Housing 2002," issued by the Joint Center for Housing Studies at Harvard University.

Furthermore, the current high home prices, while good for sellers, work against the lowest income households, driving up both purchase prices and rents for twenty million families.

"Although the plight of renters receives much attention, the vast majority of lowest income owners also face severe housing affordability problems," said the report. "Overall, some 8.6 million renters and 6.4 million owners in this group pay more than 30 percent of their limited incomes for housing and/or live in structurally inadequate or overcrowded homes."

The 2002 report, based on 2000 census data, indicates a large disparity between even middle-income and high-income households. The top category has shot up from slightly below \$100,000 in 1975 to just under \$150,000 in 2001, while the lowest income has stayed constant at below \$20,000. Incomes at the \$50,000 level in 1975 have increased but lag far behind the actual dollar and percentage increases of the highest level.

The report shows that the lowest income households are white, own their own homes, and are either employed or retired.

A growth in the overall percentage of homeownership somewhat offsets the negative figures. Home ownership continues to increase, especially among minority groups. Minorities accounted for 40 percent of the net new owners during the last five years, the report states. A large part of this may be accounted for by the increase of homeowners among immigrant populations.

An expanding market for low-income borrowers has resulted in a “dual” mortgage market, according to the Harvard report. Higher income borrowers continue to use conventional mortgages keyed to the prime interest rate. Low-income borrowers turn more toward government-backed and subprime mortgages and to manufactured homes.

Sub prime rates can be higher than conventional mortgages and often expose borrowers to greater risks.

### What is a Wage Rate?

A **wage** is an amount of money paid to a worker for some specified quantity of labor. When expressed with respect to time, it is typically called the wage rate.

The wage rate is the pre-tax amount of payment, usually monetary, paid per unit of labor. It is the main monetary item that the worker and the employer focus on.

## Definition and Concept of Compensation Structure

As it has been discussed in the earlier chapters that compensation is the act of compensating or the state of being compensated or something, such as money, given or received as payment or reparation, as for a service or loss.

### What is Compensation Structure?

A Histogram of what people earn. Although money isn't everything, it certainly is one of the top issues potential employees look at when interviewing new companies. (Yes, face it, they are interviewing YOU.) Whether you're offering a straight basic salary structure or an incentive-based pay structure may make or break you in the eyes of top job candidates.

Compensation structure consists of the various salary grades and their different levels of single jobs or groups of jobs.

The term wage structure' is used to describe wage/salary relationships' within a particular grouping. The grouping can be according to occupation, or organization, such as wage structure of craftsman (carpenters, mechanics, bricklayers, etc.)

The wage structure or 'grade' is comprised of jobs of approximately equal difficulty or importance as determined by' job evaluation. If the 'point' method of job evaluation is used, the 'pay-grade' consists .of jobs falling within a range of points.

If the 'factor comparison' plan is used, the grade consists of a range of evaluated wage rates (or points, if the wage rates are converted to points). If the 'ranking' plan is used, the grade consists of a specific number of ranks. If 'classification' system is used, the jobs are already categorized into 'class' or 'grades.

So the term Compensation structure means the pattern or the break up of the salary paid to the employees in their respective organization.

Please remember that while determining the compensation structure of employees, it is not only the mathematics but other subjects such as biology and psychology play a major role in compensation determination.

Biology, the increase in size or activity of one part of an organism or organ that makes up for the loss or dysfunction of another. Psychology, behavior that develops either consciously or unconsciously to offset a real or imagined deficiency, as in personality or physical ability.

Hence we can realize that compensation management is an integral part of the labor market characteristics in order to attract capable employees by respective organizations.

### Determinants of the wage structure

Before discussing the wage determination process in detail let us first discuss the determinants of wage structure.

#### 1.Economic Determinants

In the labor market there commonly exists, known as Occupational Wage Differentials.

The reason for it's existence is that in different occupations require different qualifications, different wages of skill and carry different degrees of responsibility, wages are usually fixed on the basis of the differences in occupations and various degrees of skills.

Adam Smith explains occupational wage differentials in terms of :

1. Hardship,
2. Difficulty of learning the job,
3. Stability of employment,
4. Responsibility of the job, and
5. Chance for success or failure in the work. This is a theory of wage structure. But his standards of worth are equally useful in explaining the complexity of wage structure decisions. The market value of an item is the price it brings in a market where demand and supply are equal. Use value is the value an individual buyer or seller anticipates through use of the item. Use value obviously varies among individuals and over time.

#### 2.Job worth

These two concepts of worth and the concept of internal labor markets combine to explain important differences among employers in wage structure decisions.

Organizations with relatively open internal labor Markets (organizations in which most jobs are filled from outside) make much use of market value. They also make much use of wage and salary surveys in wage structure decisions.

Conversely, organizations with relatively closed internal labor markets (most jobs are filled from inside) emphasize use value. Their analysis of job worth relies more heavily on perceptions of organization members of the relative value of jobs.



### 3.Training

Some other wage structure determinants derived from economic analysis may be noted. Training requirements of jobs in terms of length, difficulty, and whether the training is provided by society, employers, or individuals constitute a primary factor in human-capital analysis and thus job worth.

The interaction of ability requirements with training requirements can yield different job values depending on the scarcity of the ability required and the number of people who try to make it in the occupation and fail.

### 4.Employee Tastes

Employee tastes and preferences are another economic factor. People differ in the occupations they like and dislike. In like manner, occupations have non-monetary advantages and disadvantages of many kinds.

## Case Study

### Two Tier Pay Structure

IN 1976, the Indian subsidiary of a multinational refinery became a government of India Company.

The government company had announced an ambitious expansion program, which meant doubling the work force in less than four years in 1977 at the time of wage revision, the union and management agreed to a two tier structure. Those already employed will be eligible for a higher grade and those who are recruited fresh will get a lower grade though jobs are similar in skill, responsibility and effort. Both the union and the management justified that this is an innovative practice widely followed in deregulated companies abroad, particularly the airlines in north America

Answer the following Questions:

- Is it a fair agreement?
- Would it contravene with the concept of equal pay for equal work?

### Notes

## LESSON 6: WAGE DETERMINATION PROCESS

### Learning Objectives

- To understand the Wage Determination Process
- To know the Concept of Wage Surveys
- To understand the Preparation of a Wage Structure

### What is the Wage Determination Process?

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.

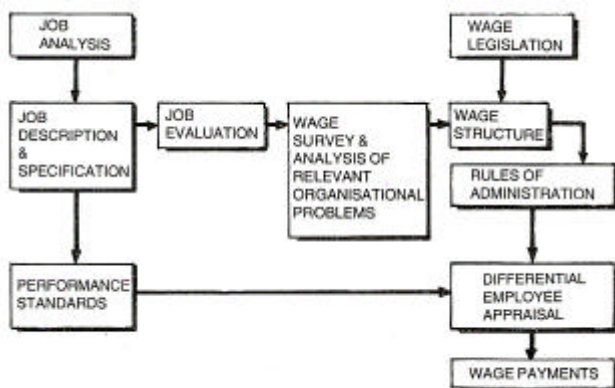


Fig.1 Steps Involved in Determination of Wage Rate

### The Process of Job Analysis

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.

### 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.

### Relevant Organizational Problems

In addition to the results of job analysis and wage surveys, several other variables have to be given due consideration in establishing wage structure.

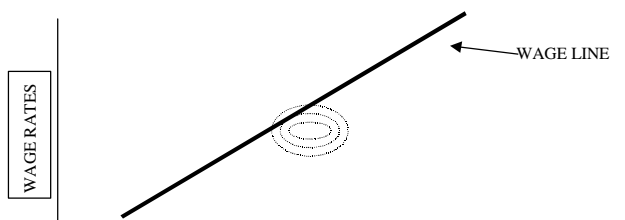
For example, whether there exists well-established and well-accepted relationships among certain jobs which can upset job evaluation, whether the organization would recruit new employees after revised wage structure; are the prevailing rates in industry or community inconsistent with the results of job 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

### Preparation of Wage Structure

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

- whether the organization wishes, or is able, to pay amounts above, below, or equal to the average in the community or industry;
- whether wage ranges should provide for merit increases or whether there should be single rates;
- the number and width of the 'pay grades' and the extent of overlap;
- which jobs are to be placed in each of the pay grades;
- the actual money value to be assigned to various pay grades



### Plotting jobs on a curve (Some points fall well off wage line)

- differentials between pay plans; and
- 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.

In the above figure, wage rates are shown on the vertical axis while pay grades (in points)

along the horizontal axis. The '**wage curve**' shows the relationship between:

- the "value" of the job; and
- the "average wage rates" of these grades (or jobs).

### The following steps are involved in drawing a wage curve

- 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.
- Plotting the wage rate for each pay grade.
- 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.
- 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.<sup>7</sup> 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:

- To freeze the rate paid until general salary increases bring the other jobs into line with it, or
- To transfer or promote the employee to a job where -he can legitimately be paid his current rate; or
- 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:

- 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.
- 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).

### 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. The maximum and minimum

### 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 reflects 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 longer 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.

### 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

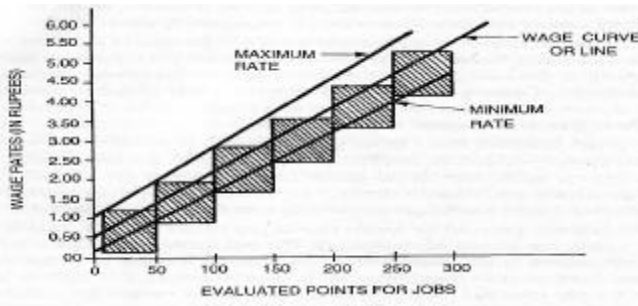
Any wage structure has a number of rate ranges and pay grades. This number can be a matter of the policy of the organization. Small organizations tend to have a small number of pay grades accompanied by wide pay ranges, broad definition of job titles, a great deal of movement within pay grades, little 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 (see figure 16-2). 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.

### Range Breadth

The breadth of the rate range is the distance from the top to the bottom of the range a to b in figure 16-2. It is the vertical dimension of the range. The breadth may be stated in dollar amounts or in percentages. The latter is more common and will be used here. The breadth of the range should vary with the criteria for movement within the range.

Assuming that performance is the criterion, the breadth would represent the opportunity for performance differences in the job. Where ranges are narrow, the assumption is that performance differences are narrow and vice versa. In practice, hourly jobs have ranges of 10 to 20 percent, office jobs 15 to 35 percent, and managerial jobs 25 to 100 percent.



**Fig. 16.2 Parts of a wage structure**

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.

### 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.

The number of pay grades is reflected in the horizontal dimension of **figure (a to c)**. 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.

### Overlap

The final pay range determinant is the degree of overlap between any one pay grade and the adjacent grade (c to d in figure 16-2). 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.

## 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.

### 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.

## Assignments

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.

## Notes

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## LESSON 7: WAGE AND SALARY STRUCTURE

### Learning Objectives

- To know the Factors Influencing Wage and Salary Structure
- To understand the Principles of Salary Administration

### What are the Factors Influencing Wage and Salary Structure?

The wage policies of different organizations vary somewhat. Marginal units pay the Minimum necessary to attract the required number and kind of labour. Often, these units pay only the minimum wage rates required by labour legislation, and recruit marginal labour.

At the other extreme, some units pay well above the going rates in the labour market. They do so to attract and retain the highest caliber of the labour market. They do so to attract and retain the highest caliber of the labour force. Some managers believe in the economy of higher wages.

They feel that, by paying high wages, they would attract better workers who will produce more than the average worker in the industry. This greater production per employee means greater output per man-hour.

Hence, labour costs may turn out to be lower than those existing in firms using marginal labour. Some units pay high wages because of a combination of favorable product market demand, higher ability to pay and the bargaining power of a trade union.

But a large number of them seek to be competitive in their wage programme, i.e., they aim at paying somewhere near the going rate in the labour market for the various classes of labour they employ.

Most units give greater weight to two wage criteria, viz., job requirements and the prevailing rates of wages in the labour market. Other factors, such as changes in the cost of living, the supply and demand of labour, and the ability to pay are accorded a secondary importance.

In the short run, the economic influence on the ability to pay is practically nil. All employers, irrespective of their profits or losses, must pay no less than their competitors and need pay no more if they wish to attract and keep workers. In the long run, the ability to pay is very important.

During the time of prosperity, employers pay high wages to carry on profitable operations and because of their increased ability to pay. But during a period of depression, wages are cut because funds are not available. Marginal firms and non-profit organizations (like hospitals and educational institutions) pay relatively low wages because of low or no profit.

If the demand for certain skills is high and the supply is low, the result is a rise in the price to be paid for these skills. When prolonged and acute, these labour-market pressures probably force most organizations to "reclassify hard-to-fill jobs at a higher level" than that suggested by the job evaluation.

The other alternative is to pay higher wages if the labour supply is scarce; and lower wages when it is excessive. Similarly, if there is great demand for labour expertise, wages rise; but if the demand for manpower skill is minimal, the wages will be relatively low.

"The supply and demand compensation criterion is very closely related to the prevailing pay, comparable wage and on-going wage concepts since, in essence, all of these remuneration standards are determined by immediate market forces and factors. This is done for several reasons:

**First**, competition demands that competitors adhere to the same relative wage level;

**Second**, various government laws and judicial decisions make the adoption of uniform wage rates an attractive proposition;

**Third**, trade unions encourage this practice so that their members can have equal pay, equal work and geographical differences may be eliminated;

**Fourth**, functionally related firms in the same industry require essentially the same quality of employees, with the same skills and experience. This results in a considerable uniformity in wage and salary rates;

**Finally**, if the same or about the same general rates of wages are not paid to the employees as are paid by the organization's competitors, it will not be able to attract and maintain a sufficient quantity and quality of manpower.

Belcher and Atchison observe: "Some companies pay on the high side of the market in order to obtain goodwill or to insure an adequate supply of labour, while other organizations pay lower wages because economically they have to, or because by lowering hiring requirements they can keep jobs adequately manned.

**A sound wage policy** is to adopt a job evaluation programme in order to establish fair differentials in wages based upon differences in job contents. Besides the basic factors provided by a job description and job evaluation, those that are usually taken into consideration for wage and salary administration are:

1. The organization's ability to pay;
2. Supply and demand of labour;
3. The prevailing market rate;
4. The cost of living;
5. Living wage;
6. Productivity;
7. Trade union's Bargaining power;



Fig. 16.4 Criteria for Wage Fixation

8. Job requirements;
9. Managerial attitudes; and
10. Psychological and sociological factors;
11. Levels of skills available in the market.

### Description in Detail

#### 1. The Organization's Ability to Pay

Organization decisions on job and wage structures represent a balancing of the aforementioned forces. But the strength of these forces varies by organization type and within organizations by job clusters.

Organizations made up largely of members of craft unions have wage structures almost completely determined by the union. Organizations in construction, printing and publishing, the railroads, long shoring and maritime work, and entertainment offer examples of union-oriented wage structures.

Organizations whose members come largely from a well-organized and competitive labor market but are not unionized have what might be called market-oriented wage structures.

Organizations of this type have only limited choices, because jobs are easily identified and are quite uniform throughout the market.

Banks, insurance companies, department stores, and restaurants are organizations with primarily market-oriented wage structures. Professionals are groups of employees whose jobs have been designed largely by the educational process they have been through. This makes for a commonality between organizations in the design of professional jobs.

Organizations having many specialized jobs, dealing in labor markets too disorganized to provide adequate grading and pricing, and lacking unionization have primarily internally determined wage structures.

Product markets may influence such wage structures, but only if labor cost is high relative to total cost. Internally determined wage structures result from management decisions and may range from highly rational structures flowing from job evaluation to a system of personal rates.

Organizations in small towns, isolated locations, or nonunion communities provide examples, as do unique organizations in larger communities, and government employment.

Most large, unionized organizations have what might be called union-and-product-oriented wage structures. In these organizations, wage structures represent management decisions shaped and restrained by technology, unions, and cost-price relationships, and the product market.

Technology provides some uniformity in job structures in organizations engaged in common lines of production. Unions, through their insistence on traditional relationships, establish some key jobs and job clusters and provide an upward thrust to the entire structure.

Cost-price relationships and the product market compel the organization to resist this upward push and to make changes in jobs and job relationships in line with such resistance. Low ratios of labor cost to total cost and inelastic product demand, however, reduce competitive pressures on organizations.

Organizations in many branches of manufacturing, in mining, and in some service industries are examples of organizations with union-and-product-oriented wage structures.

Organizations with this kind of wage structure can eventually get into a competitive bind.

Organizations with internally determined or union-and-product-market-determined wage structures leave large portions of wage structure decisions to management. Wage structure determination in these organizations follows closely Dunlop's theory of key jobs, job clusters, and wage contours.

Key jobs acquire their status from labor markets, product markets, and comparisons with other organizations, often fostered by unions. Job clusters come from technologies and employee skill groupings. Wage contours originate in customary comparisons with other organizations, again often fostered by unions. Custom strongly influences all three.

But although organizations can be classified as having wage structures that are oriented primarily in one of the four ways just outlined, organizations of any considerable size have job clusters that fall more comfortably into one or more of the other categories.

Organizations employing artisans, unless they are members of an industrial union, are usually forced to develop a union-oriented wage structure for this job cluster. All organizations employ clerical workers, and the wage structure of the clerical job cluster is largely market-oriented.

Professional employees (such as engineers and scientists) have salary structures that combine market orientation and internal determination, regardless of the major activity of the organization. Managerial salary structures are primarily internally determined except in very tight labor markets, without regard to organization type.



Thus the typical organization develops and administers at least four or five of the following separate wage structures: shop, clerical, craftsmen and technicians, administrators, engineers and scientists, sales, supervision, and executives.

Although, obviously, there will be relationships among these separate wage structures, the strength of these relationships varies by organization and over time.

Wage increases should be given by those organizations, which can afford them. Companies that have good sales and, therefore, high profits tend to pay higher wages than those which running at a loss or earning low profits because of the high cost of production or low sales.

In the short run, the economic influence on the ability to pay is practically nil. All employers, irrespective of their profits, or losses, must pay no less than their competitors and need pay no more if they wish to attract and keep workers. In the long run, the ability to pay is very important.

During the time of prosperity, employers pay high wages to carry on profitable operations and because of their increased ability to pay. But during a period of depression, wages are cut because funds are not available. Marginal firms and non-profit organizations (like hospitals and educational institutions) pay relatively low wages because of low or no profits.

### Supply and Demand of Labour

The labour market conditions or supply and demand forces operate at the national, regional and local levels, and determine organizational wage structure and level.

If the demand for certain skills is high and the supply is low, the result is a rise in the price to be paid for these skills. When prolonged and acute, these labour-market pressures probably force most organizations to "reclassify hard-to-fill jobs at a higher level" than that suggested by the job evaluation. The other alternative is to pay higher wages if the labour supply is scarce; and lower wages when it is excessive. Similarly, if there is great demand for labour expertise, wages rise; but if the demand for manpower skill is minimal, the wages will be relatively low.

"The supply and demand compensation criterion is very closely related to the prevailing pay, comparable wage and on-going wage concepts since, in essence, all of these remuneration standards are determined by immediate market forces and factors."

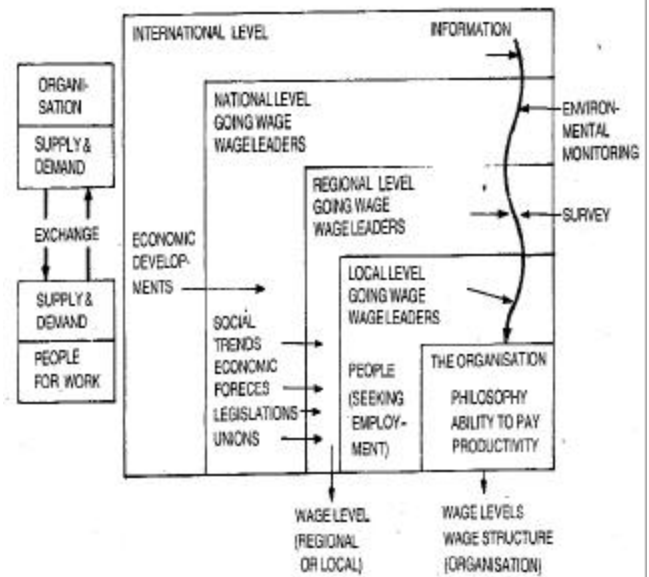


Fig. 16.5 Factors Affecting Compensation Plans

Please note that the labor market influences the wage and salary structure through the supply of labor. But organizations differ greatly on how many of their jobs are highly market-oriented, particularly in those organizations in which the labor supply is mostly provided from within the organization.

As discussed earlier, most organizations replace the external labor market with an internal labor market that makes decisions by administrative means rather than according to supply and demand. These organizations have restricted ports of entry, which are highly sensitive to the labor market but rely on the organization's internal labor supply to fill most job openings.

The exception occurs when there is an internal and external shortage of people to fill vacancies for specific skills. In fact, any job for which qualified people are in short supply becomes a market-sensitive job. But given relatively adequate labor supplies, the labor market determine wages only if the labor market: is structured by unions, is otherwise well organized, or is designed to fill openings from outside the organization. Shortages in the labor market provide those who are qualified to fill the jobs an opportunity to negotiate better terms of employment. A part of this negotiation is for a relative increase in pay greater than other groups are obtaining. This, of course, runs into the problem of customary relationships already discussed.

But another part of the negotiations is for a "better job." Workers in jobs where there is a shortage of qualified workers will demand changes in job content that will increase the job's value to the organization and in the eyes of other workers.

Computer programmers are an example of a group of workers with a skill in short supply in a new and expanding industry. The independence of action and discretion allowed this group of employees is based, at least partially, on the continuing shortage of this skill.

The product market also affects wage structures through cost-oriented jobs. Such jobs exist where profit margins are sensitive to changes in unit labor cost. If the ratio of unit labor cost to price is critical, the jobs involved become cost-oriented jobs, and organizations will strongly resist changes in their wage rates, especially changes not made by other organizations.

Organizations that compete in the same product market, those whose prices are interrelated, or those experiencing or anticipating increased competition or decreased demand may regard any increase in unit labor costs as a threat, especially when labor cost is a significant proportion of total costs.

On the other hand, employees in these areas often recognize the advantageous position they are in and seek maximum advantage.

### 3. Prevailing Market Rate

This is also known as the 'comparable wage' or 'gain wage rate', and is the most widely used criterion. An organization's compensation policies generally tend to conform to the wage-rates payable by the industry and the community.

This is done for several reasons:

- **First**, competition demands that competitors adhere to the same relative wage level.
- **Second**, various government laws and judicial decisions make the adoption of uniform wage rates an attractive proposition.
- **Third**, trade unions encourage this practice so that their members can have equal pay, equal work and geographical differences may be eliminated.
- **Fourth**, functionally related firms in the same industry require essentially the same quality of employees, with the same skills and experience. This results in a considerable uniformity in wage and salary rates.
- **Finally**, if the same or about the same general rates of wages are not paid to the employees as are paid by the organization's competitors, it will not be able to attract and maintain a sufficient quantity and quality of manpower.

Belcher and Atchison observe: "Some' companies pay on the high side of the market in order to obtain goodwill or to insure an adequate supply of labour, while other organizations pay lower wages because economically they have to, or because by lowering hiring requirements they can keep jobs adequately manned."

### 4. The Cost of Living

The cost-of living pay criterion is usually regarded as an Auto minimum equity pay criterion. This criterion calls for pay adjustments based On increases or decreases in an acceptable cost of living index.

In recognition of the influence of the cost of living, "escalator clauses" are written into labour contracts. When the cost of living increases, workers and trade unions demand adjusted wages to offset the erosion of real wages. However, when living costs are stable or decline the management does not resort to this argument as a reason for wage reductions.

### 5. The Living Wage

This criterion states that wages paid should be adequate to enable an employee to maintain himself and his family at a reasonable level of existence

However, employers do not generally favour using the concept of a living wage as a guide to wage determination because they prefer to base the wages of an employee on his contribution rather than on his need. Also, they feel that the level of -living prescribed in a worker's budget is open to argument since it is based on subjective opinion.

### 6. Productivity

It is a criterion, and is measured in terms of output per man-hour. It is not due to labour efforts alone. Technological improvements, better organization and management, the development of better methods of production by labour and management, greater ingenuity and skill by labour are all responsible for the increase in productivity.

Actually, productivity measures the contribution. of all the resource factors - men, machines, methods, materials and management. No productivity index can be devised which will measure only the productivity of a specific factor of production.

Another problem is that productivity can be measured at several levels - job, plant, industry or national, economic level. Thus, although theoretically it is a sound compensation criterion, operationally many problems and complications arise because of definitional measurement and conceptual issues.

### 7. Trade Union's Bargaining Power

Trade unions do affect rate of wages. Generally, the stronger and more powerful the trade union, the higher the wages. A trade union's bargaining power is often measured in terms of its membership, its financial strength and the nature of its leadership.

A strike or a threat of a strike is the most powerful weapon used by it. Sometimes trade unions force wages up faster than increases in productivity would allow and become responsible for unemployment or higher prices and inflation. However, for those remaining on the pay roll, a real gain is often achieved as a consequence of a trade union's stronger bargaining power.

Unions affect wage structure, but the differential effects of craft and industrial unionism and the type of bargaining relationship are considerable. Craft unions tend to determine craft rates as well as the design of craft jobs for all organizations employing members of the craft.

The limit of craft rates is the cost-price resistance of employers. Industrial unions, on the other hand, are more concerned than craft unions with employing organizations, but less concerned with product markets because they often bargain with organizations in many product markets.

Thus, industrial unions may attempt to impose a common wage structure on organizations, even if the wage structure clashes with product-market realities.

Within organizations, industrial unions are concerned with equalities and differentials among particular groups of jobs. They often serve to reinforce custom and tradition in jobs and wage structures, while they resist changes that might decrease employee security.

If the industrial union deals with organizations in a common product market, it may attempt to impose a common job design and wage structure by comparing rates of a number of reasonably comparable jobs. But even in such cases, the influence of industrial unions on wage structure is light compared with that of craft unions.

Please note that the unions also affect wage structures by resisting lower wage rates for jobs downgraded by technological change and by demanding that increased productivity arising from any source results in wage increases.

Typically this means that wages of changed jobs are not cut but often increased when the changes result in increased productivity. Such job rates distort rational job and wage structures, and a series of them can so impair an organization's cost-profit position that management is forced to fight for a revised, rational wage structure.

Union strategy, with respect to general increases, can also affect wage structures. Flat cents-per-hour or dollars-per-month increases maintain absolute differentials, but compress the structure in relative terms, whereas flat percentage increases maintain relative differentials and increase absolute differentials.

Industrial unions especially may follow a policy of cents-per-hour increases because most of their members are in lower-paid groups. But unions cannot maintain this strategy in the face of opposition from higher-paid groups. In fact, worker preferences and resulting labor-supply shortages force restoration of relative differentials in both union and nonunion situations.

But probably the strongest influence of unions on wage structures is the quality of the union-management relationship. As mentioned, some unions take an active part in job evaluation, and their interest in a rational wage structure results in reduced grievances over wage inequities.

Other unions, most of them craft unions, seek to preserve customary relationships and job security, resist changes in job content and structure, and are uninterested in the employer's problems of maintaining economic efficiency.

Still other unions seem totally uninterested in job designs and the wage structure of the organization and they

1. Insist on no wage cuts when job content changes,
2. Demand wage increases for all increases in job productivity,
3. Strongly resist job-content and other changes calculated to increase productivity, and

Encourage wage-inequity grievances. In such cases job, and wage structures become chaotic, and correcting the irrationalities may require long and bitter strikes, which are often prolonged by political struggles within the union resulting from the wage inequities.

### **8. Job Requirements**

Generally, the more difficult a job, the higher are the wages. Measures of job difficulty are frequently used when the relative value of one job to another in an organization is to be ascertained. Jobs are graded according to the relative skill, effort, responsibility, and job conditions required.

### **9. Managerial Attitudes**

These have a decisive influence on the wage structure and wage level since judgment is exercised in many areas of wage and salary administration - including whether the firm should pay below average, or above average rates, what job factors should be used to reflect job worth, the weight to be given for performance or length of service, and so forth, both the structure and level- of wages are bound to be affected accordingly.

These matters require the approval of the top executives. Lester observes, "Top management's desire to maintain or enhance the company's prestige has been a major factor in the wage policy of a number of firms.

Desires to improve or maintain morale, to attract high-caliber employees, to reduce turnover, and to provide a high living standard for employees as possible also appear to be factors in management's wage-policy decisions.

### **10. Psychological and Social Factors:**

These determine in a significant measure how hard a person will work for the compensation received or what pressures he will exert to get his compensation increased.

Psychologically, persons perceive the level of wages as a measure of success in life; people may feel care have an inferiority complex, seem inadequate or feel the reverse of all these.

They may not take pride in their work, or in the wages get. Therefore, the management in establishing wage rates should not overlook these things. Sociologically and ethically, people feel that "equal work should carry equal wages," that "wages should be commensurate with their efforts," that "they are not exploited, and that no distinction is made on the basis of caste, color, sex or religion." To satisfy the conditions of equity, famines and justice, a management should take these factors into consideration.

Please note that people and institutions both have a hand in designing jobs and wage structures. Craft unions, for example, determine the kinds of work their members do and expect employing organizations to adjust to these decisions.

The institutions that train them, with the result that clerical jobs are often quite similar in different organizations, structure jobs for clerical workers.

Professional employees and managers insist on having a say in the design of their jobs, and the result is influenced in part by the institutions that train them. At the other extreme are semiskilled factory employees.

Organizations employing these workers are subject to little influence on job design by either employees or unions, except in job-redesign decisions. Unions of semiskilled factory workers typically insist, however, on participating in the latter decisions.

This participation is guided by customary relationships among and within employee groups. Custom also operates in nonunion situations, causing resistance to change in job design. A further societal influence on jobs and wage structures is the technology used by the organization and changes in that technology. But technology seldom provides rigid boundaries. It typically provides choices within which management, unions, and competitive pressures can operate in designing jobs and job relationships.

### 11. Skill Levels Available in the Market

With the rapid growth of industries, business trade, there is shortage of skilled resources. The technological development, automation has been affecting the skill levels at faster rates. Thus the wage levels of skilled employees are constantly changing and an organization has to keep its level up to suit the market needs.

From the last lessons, it is clear that organizations determine the pay for jobs by taking a number of considerations into account. Furthermore, they have considerable choice as to how much emphasis to place on various determinants.

These choices lead in turn to variations in the wage structures that organizations create. But organizations do not have total freedom in the design of wage structures. Besides the determinants so far considered, there are a number of other influences on the design of wage structures that will be considered in this section.

These influences are often indirect in that they influence the design of jobs and therefore the way the organization is likely to evaluate it in relation to other organization jobs.

### Introduction to Salary Administration

It comprehends systems and procedures designed for purposes of efficiently managing the compensation of organizational members.

The wage policies of different organizations vary somewhat. Marginal units pay the minimum necessary to attract the required number and kind of labour. Often, these units pay only the minimum wage rates required by labour legislation, and recruit marginal labour.

At the other extreme, some units pay well above the going rates in the labour market. They do so to attract and retain the highest caliber of the labour market. They do so to attract and retain the highest caliber of the labour force.

Some managers believe in the economy of higher wages. They feel that, by paying high wages, they would attract better workers who will produce more than the average worker in the industry. This greater production per employee means greater output per man-hour.

Hence, labour costs may turn out to be lower than those existing in firms using marginal labour. Some units pay high wages because of a combination of favourable product market demand, higher ability to pay and the bargaining power of a trade Union.

But a large number of them seek to be competitive in their wage programme, i.e., they aim at paying somewhere near the going rate in the labour market for the various classes of labour they employ.

Most units give greater weight to two wage criteria, viz., job requirements and the prevailing rates of wages in the labour market. Other factors, such as changes in the cost of living, the supply and demand of labour, and the ability to pay are accorded a secondary importance.

In the short run, the economic influence on the ability to pay is practically nil. All employers, irrespective of their profits or losses, must pay no less than their competitors and need pay no

more if they wish to attract and keep workers. In the long run, the ability to pay is very important.

During the time of prosperity, employers pay high wages to carry on profitable operations and because of their increased ability to pay. But during a period of depression, wages are cut because funds are not available. Marginal firms and non-profit organizations (like hospitals and educational institutions) pay relatively low wages because of low or no profit.

If the demand for certain skills is high and the supply is low, the result is a rise in the price to be paid for these skills. When prolonged and acute, these labour-market pressures probably force most organizations to "reclassify hard-to-fill jobs at a higher level" than that suggested by the job evaluation.

The other alternative is to pay higher wages if the labour supply is scarce; and lower wages when it is excessive. Similarly, if there is great demand for labour expertise, wages rise; but if the demand for manpower skill is minimal, the wages will be relatively low.

"The supply and demand compensation criterion is very closely related to the prevailing pay, comparable wage and on-going wage concepts since, in essence, all of these remuneration standards are determined by immediate market forces and factors.

### This is done for several reasons

**First**, competition demands that competitors adhere to the same relative wage level.

**Second**, various government laws and judicial decisions make the adoption of uniform wage rates an attractive proposition.

**Third**, trade unions encourage this practice so that their members can have equal pay, equal work and geographical differences may be eliminated.

**Fourth**, functionally related firms in the same industry require essentially the same quality of employees, with the same skills and experience. This results in a considerable uniformity in wage and salary rates.

**Finally**, if the same or about the same general rates of wages are not paid to the employees as are paid by the organisation's competitors, it will not be able to attract and maintain a sufficient quantity and quality of manpower.

Belcher and Atchison observe: "Some companies pay on the high side of the market in order to obtain goodwill or to insure an adequate supply of labour, while other organisations pay lower wages because economically they have to, or because by lowering hiring requirements they can keep jobs adequately manned.

### Control or Administration of wages and salaries

Wage and salary administration should be controlled by some proper agency. This responsibility may be entrusted to the personnel department or to some job executive. Since the problem of wages and salary is very delicate and complicated, it is usually entrusted to a Committee composed of high-ranking executives representing major line organizations.

The major functions of such Committee are:

- (i) Approval and /or recommendation to management on job evaluation methods and findings;
- (ii) Review and recommendation of basic wage and salary structure;
- (iii) Help in the formulation of wage policies from time to time;
- (iv) Co-ordination and review of relative departmental rates to ensure conformity; and
- (v) Review of budget estimates for wage and salary adjustments and increases.

This Committee should be supported by the advice of the technical staff. Such staff committees may be for job evaluation, job description, merit rating, wage and salary survey an industry, and for a review of present wage rates, procedure and policies.

Alternatively, the over-all plan is first prepared by the Personnel Manager in consensus and discussions with senior members of other departments. It is then submitted for final approval of the top executive.

Once he has given his approval, for the wage and salary structure and the rules for administration, its implementation becomes a joint effort of all heads of the departments.

The various managers, who in turn submit their recommendations to higher authority and the latter, in turn, to the personnel department, carry out the actual appraisal of the performance of subordinates.

The personnel department ordinarily reviews recommendations to ensure compliance with established rules of administration. In unusual cases of serious disagreement, the president makes the final decision.

### Principles of salary formulation

The main factors affecting salary levels within an organisation are:

**External relativities:** market rates as affected by supply and demand and general movements in pay levels.

**Internal relativities:** salary relativities between jobs within the organisation depending on the values attached to different jobs.

**Individual worth:** the value of the individual's performance to the organisation.

### Description

#### External Relativities

A salary is a price indicating, like any other price, the value of the service to the buyer and seller; the employer and the employed. The going rate 'for a job is its market rate, and many will claim that a job is worth what the market says it is worth. External equity is a fundamental aim of any salary system.

If insufficient attention is given to market rates your organisation may not be able to attract and retain good quality personnel. Although internal salary structure is not directly and instantaneously responsive to market forces at all points, the general structure must reflect the changing pressures of the market.

#### Internal Relativities

The value of a job within an organisation is relative. Within your own organisation, pay levels will be affected by real or

perceived differences between the value of jobs. In this sense, the value of a job is comparative.

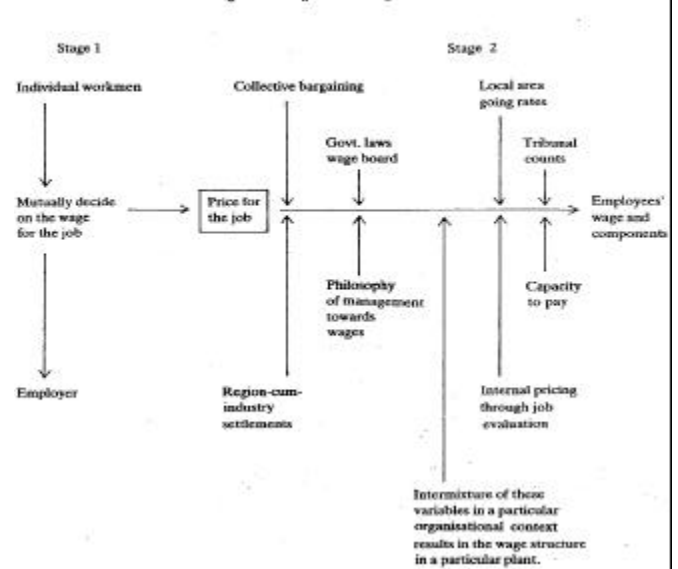
The ideal salary structure should establish and maintain appropriate differentials based on an objective system of measuring relative internal values. As we have seen in an earlier unit, we must take recourse to job evaluation to arrive at this internal relative values of jobs. However I when you design such an ideal structure you must also take account of external as well as internal pressures.

### Individual Worth

Although the value of a job is relative to other jobs inside and outside the organisation, the value of a person in the job is something very specific to that individual. Hence, his salary should be influenced by his performance.

The salary system should, as far as possible, enable the individuals to be rewarded according to the contribution and not restricted by the artificial barriers contained in a rigid salary structure.

Figure 1: Wage Influencing Variables



### Stage 1:

Self contained model where external influence is marginal

### Stage2:

Depicting the interplay of external and internal influence.

The salary structure of an enterprise is built on the premise that each job has its own price. This is determined by the scientific job evaluation method and/or by the going rate in the area.

Besides this, there are many region-cum-industry settlements like the agreement between the management and the union of an industry in a particular geographic region, which may form the basis for wage fixation.

The wages that an employer is willing to pay depends on his philosophy, his capacity to pay, his competitive position and his

ability to attract and retain a workforce by factors other than wages.

The government has always played a significant role in the determination of wages in the organized sector. You are probably aware that there are a number of laws to ensure payment of a minimum wage and payment on time.

Moreover, given the imbalanced positions of the employer and the employee, the government has had often to appoint wage boards to determine the wages in particular industries: You are also perhaps aware of the labour courts and industrial tribunals set up by the government to settle wage disputes by adjudication.

In unionized industries/organizations wages/salaries can be determined through the bilateral process of collective bargaining. However, when such processes break down or reach a deadlock, recourse is taken to government machineries of labour tribunals and law courts.

### Principles of Wages and Salary Administration

The generally accepted principles governing the fixation of wages and salary are:

- (i) There should be definite plan to ensure that differences in pay for jobs are based upon variations in job requirements, such as skill effort, responsibility or job or working conditions, and mental and physical requirements.
- (ii) The general level of wages and salaries should be reasonably in line with that prevailing in the labour market. The labour market criterion is most commonly used.

The plan should carefully distinguish between jobs and employees.

A job carries a certain wage rate, and a person is assigned to fill it at that rate. Exceptions sometimes occur in very high-level jobs in which the job holder may make the job large or small, depending upon his ability and contributions.

Equal pay for equal work i.e., if two jobs have equal difficulty requirements, the pay should be the same, regardless of who fills them.

An equitable practice should be adopted for the reorganization of individual differences in ability and contribution.

For some units, this may take the form of rate ranges, with in – grade increases, in others, it may be a wage incentive plan. In still others, it may take the form of closely integrated sequences of job promotion.

There should be a clearly established procedure for hearing and adjusting wage complaints. This may be integrated with the regular grievance procedure, if it exists.

The employees and the trade union, if there is one, should be informed of his own position, and of the wage and salary structure. Secrecy in wage matters should not be used as a cover-up for haphazard and unreasonable wage programme.

The wage should be sufficient to ensure for the worker and his family reasonable standard of living. Workers should receive a guaranteed minimum wage to protect them against conditions beyond their control.

The wage and salary structure should be flexible so that changing conditions can be easily met. Prompt and correct payments of the dues of the employees must be ensured and arrears of payment should not accumulate.

For revision of wages, a wage committee should always be preferred to the individual judgment, however unbiased, or a manager.

The wage and salary payments must fulfill a wide variety of human needs, including the need for self-actualization. It has been recognized that “ money is the only form of incentive which is wholly negotiable, appealing to the widest possible range of seekers.... Monetary payments often act as motivators and satisfiers interdependently of other job factors.

### Summary of Wage Determination Process and

#### Administration Rules

Organizations wish to pay for more than just the job that the employee does. Employees contribute both in terms of membership (staying on the job) and being productive while on the job. Both of these sets of contributions need to be rewarded by the organization.

Wage structures deal with rewarding these sets of contributions by establishing rate ranges for jobs. This allows for variable pay rates for employees on the same job and/or in the same pay grade.

The breadth of the rate range (distance from top to bottom) is a matter of judgment for the designer of the wage structure. Further, the decision is interrelated with other factors in the wage structure, namely the distance from top to bottom of the entire wage structure, the number of pay grades, and the amount of overlap between grades.

The design of rate ranges may vary from a structured set of steps a given percentage apart to an open range in which only the minimum, midpoint and maximum are defined. Picking the type of range depends largely on the factors that the organization wishes to reward.

Step systems do a good job of rewarding membership and seniority. Open ranges allow the organization to more clearly recognize variable performance. There is an aspect of rewarding both in either case, so the choice is one of emphasis and not of kind.

In administering the movement of employees within rate ranges, compensation specialists face a number of problems. Recruitment in the labor market may require the organization to hire new employees at advanced positions on the range. This in turn can lead to compression, as current employees are paid less than new employees.

Keeping employees within the rate range is a constant problem. One of the most pervasive problems is keeping the focus of increases on performance; supervisors and employees alike are more comfortable with seniority increases.

Last, while other aspects of compensation administration are often centralized in the hands of compensation staff, the determination of pay increases within grade must involve all supervisors in the organization.



## LESSON 8: INTRODUCTION TO THE THEORY OF WAGES

### Learning Objectives

- To further understand the concept of wages
- To understand different Theory of wages
- To know the relation between Labour and Wages

### Wages

Wages in the widest sense mean any economic compensation paid by the employer under some contrast to his workers for the services rendered by them. Wages, therefore, include family allowance, relief pay, financial support and other benefits.

But, in the narrower Sense wages are the price paid for the services of labor in the process of production and include only the performance wages or wages proper. They are composed of two parts - the basic wage and other allowances.

The basic wage is the remuneration, by way of basic salary and allowances, which is paid or payable to an employee in terms of his contract of employment for the work done by him. Allowances, on the other hand, are paid in addition to the basic wage to maintain the value of basic wages over a period of time.

Such allowances include holiday pay, overtime pay, bonus and social security benefits. These are usually not included in the definition of wages.

However, in India, different Acts include different items under wages, though all the Acts include basic wage and dearness allow come under the term wages. For example, under the Workmen's Compensation Act, 1923, Section 2 (m), "wages for leave period, holiday pay, overtime pay, bonus, attendance bonus, and good conduct bonus" form part of wages.

Under the payment of wages act, 1936 section 2 (VI) "any award of settlement and production bonus, if paid, constitutes wages."

But under the Payment of Wages Act, 1948, "retrenchment compensation, payment in lieu of notice and gratuity payable on discharge constitute wages."

The following type of remuneration, if paid, do not amount to wages under any of the Acts:

- (i) Bonus or other payments under a profit-sharing scheme which do not form a part of the contract of employment.
- (ii) Value of any house accommodation, supply of light, water, medical attendance, traveling allowance; or -payment in lieu thereof or any other concession.
- (iii) Any sum paid to defray special expenses entailed by the nature of the employment of a workman.
- (iv) Any contribution to pension, provident fund, or a scheme of social security and social insurance benefits.

- (v) Any other amenity or service excluded from the computation of wages by a general or special order of an appropriate governmental authority.

A wage level is an average of the rates paid for the jobs of an organization, an establishment, a labour market, an industry, a region or a nation. A wage structure is a hierarchy of jobs to which wage rates have been attached.

### Labor and Wages

The type of job one does and the financial compensation he or she receives are very important in our society. Job type is linked to status as is wealth. While the type of job one performs is arguably more important status wise then wealth, both are important to Americans.

In the past we used to use other descriptions to classify workers. The terms blue collar or white collar employees were used to describe the type of vocation.

Blue Collar - Manual laborers

White Collar - Officer workers

Pink Collar - Jobs associated with women like nursing, secretarial, etc. This being a rather sexist term, is no longer used.

Today we classify our work roles into three categories called labor grades. The se labor grades are described below:

### Skilled Labor

These are workers who have received specialized training to do their jobs. They have developed and honed a special skill and may or may not need to be licensed or certified by the state. Some examples of skilled labor are: carpenters, plumbers, electricians, business executives and managers, artisans, accountants, engineers, police, mechanics, etc. These may be blue or white collar workers.

### Unskilled Labor

These are workers who have received no special training and have few specific skills. As our society has grown into an increasingly technological one, the members of this group have developed more and more skills. A mechanic, for example, used to be considered unskilled labor.

Today that is no longer the case. Mechanics require a great deal of skill and training to work with today's modern engines. Examples of unskilled laborers are construction workers, sanitation and custodial workers, painters, factory assembly line workers, etc. These are blue collar workers.

### Professionals

Arguably the elite of the labor grades, these are those workers who need an advanced degree to do their jobs. The three primary groups of professional are doctors, lawyers and teachers. These are white collar workers.



These labor grades are often said to be non competing labor grades because workers rarely move from one grade to another and do not compete salary wise with each other. There are reasons why they do not compete with each other.

The cost of education and training may be a significant obstacle. They might lack the opportunity to make such a move and they might also have a lack of initiative.

### Theory of wages

There are two key theories that explain why salaries are the way they are in a particular field. These two theories are:

#### 1.Traditional Theory of Wage Determination

In this theory the law of supply and demand dictates salary. These days programmers are in short supply and are in great demand thus they will command a higher salary.

Likewise doctors and lawyers whose specialized skills people need command a high wage. If you looked at the bill my electrician gave me you would know he is in demand!

#### 2.Theory of Negotiated Wages

Those employees who work in unions where the union negotiates salary on behalf of all workers fit into this theory. Since I am a teacher my salary is set by collective bargaining with my union. I may be the best teacher in the world sought after by many students and parents but it wouldn't matter.

However, different methods of wage payment are prevalent in different industries and in various countries. There may be payment by time or payment by results, including payment at piece rates.

Wages are fixed mainly as a result of individual bargaining, collective bargaining or by public or State regulation. How wages are determined has been the subject of several theories of wages. The main elements in these theories may be summed up as follows:

**Below is mentioned the theory of Wages:**

- (1) Subsistence theory
- (2) Wages fund theory
- (3) The surplus value theory of wages
- (4) Residual claimant theory
- (5) Marginal productivity theory
- (6) The bargaining theory of wages
- (7) Behavioural theories

Now let us discuss the theory of Wages in detail:

#### (1) Subsistence theory

This theory, also known as 'Iron Law of Wages,' was propounded by David Ricardo (1772-1823). This theory (1817) states that: "The laborers 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; 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.

In economics, the subsistence theory of wages states that wages in the long run will tend to the minimum value needed to keep workers alive. The justification for the theory is that when wages are higher, more workers will be produced, and when wages are lower, some workers will die, in each case bringing supply back to a subsistence-level equilibrium.

The subsistence theory of wages is generally attributed to David Ricardo, and plays a large role in Marxist economics. Most modern economists dismiss the theory, arguing instead that wages in a market economy are determined by marginal productivity

#### 2. Wages fund Theory

This theory was developed by Adam Smith (1723-1790). 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 savings.

This fund could be utilized for employing laborers 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.

#### 3.The Surplus value theory of Wages

This theory owes its development to Karl Marx (1818-1883). According to this theory, the labour was an article of commerce, which could be purchased on payment of 'subsistence. price.'

The price of any product was determined by the labour time needed for producing it. The labourer was 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.

Marx himself considered his theory of surplus-value his most important contribution to the progress of economic analysis (Marx, letter to Engels of 24 August 1867).

It is through this theory that the wide scope of his sociological and historical thought enables him simultaneously to place the capitalist mode of production in his historical context, and to find the root of its inner economic contradictions and its laws of motion in the specific relations of production on which it is based.

#### 4.Residual claimant Theory

Francis A. Walker (1840-1897) propounded this theory. According to him, there were 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.

#### 5.Marginal productivity Theory

This theory was developed by Phillips Henry Wicksteed (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.

#### 6. The bargaining theory of wages

John Davidson propounded this theory. Under 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 organization and the trade union.

#### 7. Behavioural theories

Many behavioral scientists - notably industrial psychologists and sociologists like Marsh and Simon, Robert Dubin, Eliot Jacques have presented their views on wages and salaries, on the basis of research studies and action programmes conducted by them. Briefly such theories are:

#### The 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.

#### The Internal Wage Structure

Social norms, traditions, customs prevalent in the organization 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 organization.

#### Wage and Salaries 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 and salaries.

Merit increases, bonuses based on performance, and other forms of monetary recognition for achievement are genuine motivators. However, basic pay, cost of living increases, and other wage increases unrelated to an individual's own productivity typically may fall into maintenance category.

#### Assignments

1. Explain the importance of the theory of wages.
2. State the difference between blue collar, white collar and pink-collar employees.
3. What are the different types of theory of wages? Explain in detail.

## Case Study

### Breaking The Bargaining Pattern

Gilson steel is a local fabricating and supply firm. Situated in open country, far from the large steel making centers. The firm has been in business many years.

About the third of employees have worked in the organization for more than ten years. Top management would like to get away from the current practice in which negotiations on wage matters and fringes follow the pattern.

The firm's president feels that industry-wide bargaining tends to divorce employees from the firm. He thinks they feel that their employer is a combination of U.S. steel and Bethlehem steel instead of Gilson. He argues that the local firm which has prospered, can do better by employees than is possible in national pattern. He says that the local conditions should be taken into account. His basic objection to current practice, however, is his conviction that it tends to divorce its employees from local employer. The labour relations manager has been urged to try negotiating terms at variance with the national pattern.

Answer the following questions:

- What theory and policy do you read into the president's suggestion?
- How will his ideas fit into the existing pattern of public union policy?
- Can you suggest a promising innovative approach?

## LESSON 9: INTRODUCTION TO MINIMUM, FAIR AND LIVING WAGE

### Learning Objectives

- To know the concept of Statutory, Bare or Basic Minimum Wage
- To understand Fair Wage
- To understand Living Wage
- The Need-Based Minimum Wage

The term wages may be used to describe one of the several concepts, including wage rates, straight time average hourly earnings, gross average hourly earnings, weekly earnings; weekly take home pay and annual earnings. Money paid to the workers is considered as wages. The wage is the payment made to the workers for placing their skill and energy at the disposal of the employer. The method of use of that skill and energy being at the employer's discretion and amount to the payment being in accordance with terms stipulated in an contract of service. Various terms that are currently in use in the payment system are wages, pay, compensation and earnings.

### Statutory Minimum Wage

It is the wage determined according to the procedure prescribed by the relevant provisions of the Minimum Wages Act, 1948. Once the rates of such wages are fixed, it is the obligation of the employer to pay them, regardless of his ability to pay. Such wages are required to be fixed in certain employments where "sweated" labour is prevalent, or where there is a great chance of exploitation of labour.

### Bare or Basic Minimum Wage

It is the wage, which is to be fixed in accordance with the awards and judicial pronouncements of Industrial Tribunals, National Tribunals and Labour Courts. They are obligatory on the employers.

Minimum wage, and fair wage and living wage are the terms used by The Report of the Committee on Fair Wages, set up by the Government in 1948 to determine the principles on which fair wages should be based and to suggest how these principles should be applied. According to this Committee, the minimum wage should represent the lower limit of a fair wage. The next higher level is the fair wage, and the highest level of the fair wage is the living wage.

### A Minimum Wage

It has been defined by the Committee as "the wage, which must provide not only for the bare sustenance of life, but for the preservation of the efficiency of the worker. For this purpose, the minimum wage must provide for some measure of education, medical requirements and amenities."

In other words, a minimum wage should provide for the sustenance of the worker's family, for his efficiency, for the education of his family, for their medical care and for some amenities.

The question of determining the minimum wage is a very difficult one for more than one reason. Conditions vary from place to place, industry to industry and from worker to worker. The standard of living cannot be determined accurately.

What then should be the quantum of the minimum wage?

What is the size of the family it should support?

Who should decide these questions?

These issues are very difficult to decide. Moreover, since the cost of living varies with the price level, it follows that this index should be periodically reviewed and modified.

However, the principles for determining minimum wages were evolved by the Government and have been incorporated in the Minimum Wages Act, 1948, the important principle being that minimum wages should provide not only for the bare sustenance of life but also for the preservation of the efficiency of the workers by way of education, medical care and other amenities.

There is a distinction between a bare subsistence or minimum wage and a statutory minimum wage. The former is a wage which must be sufficient to cover the bare physical needs of a worker and his family if an industry is unable to pay to its worker at least a bare minimum wage it has the right to exist. The statutory minimum wage is however is the minimum wage which is prescribed by the statute and it may be higher than the bare subsistence or minimum wage. The courts and tribunals laid emphasis upon fulfillment of needs of an industrial labour irrespective of the capacity of the industry or of his employer to pay. For instance in *Hindustan Times Limited Vs. their workmen*, the Supreme court held that at the bottom of the ladder there is the minimum basic wage which the employer of any industrial labour must pay in order to be allowed to continue an industry.

### Living Wage

This wage was recommended by the Committee as a fair wage and as ultimate goal in a wage policy. It defined a Living Wage as "one which should enable the earner to provide for himself and his family not only the bare essentials of food, clothing and shelter but a measure of frugal comfort, including education for his children, protection against ill-health, requirements of essential social needs and a measure of insurance against the more important misfortunes, including old age."

In other words, a living wage was to provide for a standard of living that would ensure good health for the worker, and his family as well as a measure of decency, comfort~ education for his children, and protection against misfortunes. This obviously implied a high level of living.

Such a wage was so determined by keeping in view the national income, and the capacity to pay of an industry. The Committee was of the opinion that although the provision of a living

wage should be the ultimate goal, the present level of national income did not permit of the payment of a living wage on the basis of the standards prevalent in more advanced countries.

The goal of a living wage was to be achieved in three stages. In the first stage, the wage to be paid to the entire working class was to be established and stabilized. In the second stage, fair wages were to be established in the community-cum-industry. In the third stage, the working class was to be paid the living wage.

The living wage may be somewhere between the lowest level of the minimum wage and the highest limit of the living wage, depending upon the bargaining power of labour, the capacity of the industry to pay, the level of the national income, the general effect of the wage rise on neighboring industries, the productivity of labour, the place of industry in the economy of the country, and the prevailing rates of wages in the same or similar occupations in neighboring localities.

### Fair Wage

According to the Committee on Fair Wages, "it is the wage which is above the minimum wage but below the living wage." The lower limit of the fair wage is obviously the minimum wage; the upper limit is set by the "capacity of the industry to pay." The committee envisages that while the lower limit of the fair wage must obviously be the minimum wage, the upper limit is equally set by what may broadly be called the capacity of the industry to pay. This will depend not only on the present economic position of the industry but on its future prospects.

Between these two limits, the actual wages should depend on considerations of such factors as:

- (a) The productivity of labour;
  - (b) The prevailing rates of wages in the same or neighboring localities;
  - (c) The level of the national income and its distribution; and
  - (d) The place of industry in the economy of the country.
- The committee observed that it was not possible to assign any definite weights to the work factors in the actual calculation of the fair wage and that the wage fixation machinery should relate a fair wage to a fair load of work and a needs of a standard family consisting of three consumption units inclusive of the earners. In a specified region the capacity of the particular industry should be taken in to account to determine the capacity to pay which in turn could be ascertain by taking a fair cross section of the industry of the region. It was recognized that the present level of the National income does not permit the payment of a living wage on standards prevalent in more advanced countries. It also observed that at almost any level of the national income there should be a certain level of minimum wages which society can afford; what it can not afford are minimum wages fixed at a level which will reduce employment itself and there by diminish the national income.

Fair wage is something above the minimum wage which may roughly be said to approximate to the need based minimum in the sense of a wage which is adequate to cover the normal need of the average employee regarded as a human being in a civilized society.

### The Need-Based Minimum Wage

The Indian Labour Conference, at its 15th session held in July 1957, suggested that minimum, wage fixation should be need-based, and should meet the minimum needs of an industrial worker.

For the calculation of the minimum wage, the Conference accepted the following norms and recommended that they should guide all wage-fixing authorities, including the Minimum Wage Committee, Wage-Boards, and adjudicators:

- (i) The standard working class family should be taken to consist of 3 consumption units for the earner; the earnings of women, children and adolescents should be disregarded;
- (ii) The minimum food requirements should be calculated on the basis of the net intake of 2,700 calories, as recommended by Dr. Akroyd, for an average Indian adult of moderate activity.
- (iii) The clothing requirements should be estimated at a per capita consumption of 18 yards per annum, which would mean, for an average worker's family of four, a total of 72 yards;
- (iv) In respect of housing, the norms should be the minimum rent charged by the Government in any area for houses provided under the Subsidized Housing Scheme follow-income groups; and
- (v) Fuel, lighting and other miscellaneous items of expenditure should constitute 20 per cent of the total minimum wage.

The need based minimum wage is also a level of fair wage and represents a wage higher than the minimum obtaining at present in many industries, though it is only in the lower reaches of the fair wage. We therefore hold that in fixing the need based minimum, the capacity to pay will have to be taken in to account.

### Money and Real Wages

Wages earned by employees are normally expressed in terms of money. There are two aspects of wages. One is expressed by the term money wage while the other by real wage. Money wages give to the workers command over good and services. The actual goods and services for which wages can be exchanged constitute their real value. For this reason rise or fall in nominal wages does not necessarily mean a corresponding increase or decrease in real wages. In short money wages can be expressed by amount in terms of currency while the real wages refer to the goods and services that an worker can buy with these wages. Changes in money wages can most appropriately be compared with changes in the average price of a "market basket" of goods and services typically purchased by wage earners. Real wages are calculated by relating changes in money wages to changes in the consumer price index. Real wages in contrast to money wages depend on production.. It provides the real test as to whether or not the worker is improving his economic well being. It also serves as a index for measuring changes in the economic welfare of workers over long period of time.

### Assignments

1. What are the different types of wages?

2. What is the difference between minimum wage, living wage and fair wage?
3. What do you understand by the term need-based minimum wage and explain the importance of it in compensation management?
4. Identify an organization, study its compensation package and find out the kind of wage level offered by it to its employees.

## Case Study

## Sweetwater Match

Robin Welch, a computer programmer at the sweet maker company's first annual mixed –doubles tennis tournament. He and his lady friend , Gloria kovac, who works as an accountant in the company 's finance department, have become accomplished tennis player . They felt that they have a chance to win it all. Because of the growing interest in tennis by a large proportion of the firm's employees and their increased productivity at work' the company arranged the tournament to be played on Friday. This was declared as tennis holiday. By the company founder and the president Robert sweet water. Gloria and robin advanced to the tournament finals. Leading in the third and decisive set' robin tripped going back to play an opponent's lab shot. He twisted his ankle badly. Despite this injury ' robin and Gloria went on to win the game and the tournament. However, the ankle became worse and he was confined to bed. X-rays showed a hairline fracture. Robin had a to miss four days of work for medical attention. Company sick leave policy provides for only two days per month. Under state law, workers compensation provides payments if the worker is “ functioning within the scope of employment”.

## Problem

If Robin files for workers compensation, what are the points for and against allowing his claim? Are there any alternative possibilities for compensation?

## Notes

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## LESSON 10: INTRODUCTION TO THE MINIMUM WAGE

### Tutorial Activity

#### Asian Labour Update

##### Learning Objectives

- To study about minimum wage policy
- Does a minimum wage policy protect workers who are under pressure in the 'race to the bottom' of labor standards in a globalising world economy?
- Top know the role of Trade Union

Virtually everywhere in the world, there is on-going debate on the usefulness of minimum wage regulation. Since structural adjustment programmes were introduced in the 1980s to many developing countries, minimum wage regulation has been under attack on several grounds: proponents of the structural adjustment programme argued that minimum wage regulation did not help the poorest of poor workers, i.e. those in the informal sector, as the regulation covered only formal sector workers; furthermore, if a minimum wage is set at an unreasonably high level, it would have a negative impact on employment and therefore make its overall effect on income distribution at best ambiguous.

Particularly, as the accelerating process of globalisation forces nation states to compete against each other to attract more foreign investment, minimum wage regulation is seen as a possible barrier to more investment.

Before looking at the current debate on minimum wage policy, it is useful to have a brief look at the definition, aim, and history of minimum wage regulation.

A minimum wage is a minimum level of payment established by law for work performed. Its purpose is to protect vulnerable low wage workers from exploitation. It is a time-based wage that usually applies to unskilled adults entering work for the first time. As a minimum wage is established by a law, it is legally enforceable.

The key purpose of a minimum wage system is social to prevent labor exploitation and poverty. This means the minimum wage should provide sufficient purchasing power to enable a worker to have a basic standard of living. The minimum wage may also have an economic objective - to motivate workers, enable them to enjoy the benefits of economic growth, and contribute to the economy.

It is generally considered that minimum wage regulation was first developed in New Zealand (1896) followed by Australia (1899), and later Britain (1909). As the main objective of minimum wage regulation was the elimination of 'sweating', that is the payment of exceptionally low wages, its application was usually restricted to a limited number of particularly low-paying sectors or to selected categories of workers, such as

home-workers, women, children and indigenous workers judged to be particularly vulnerable.

A number of developing countries also carried out experiments with minimum wage regulation to protect categories of workers judged to be particularly vulnerable. For instance, Sri Lanka's Minimum Wage Ordinance was promulgated in 1927, while Argentina introduced the Home Work Act in 1918 with a view to protecting low paid home-workers.

However, with the exception of a few countries, minimum wage fixing remained a rarely used and limited instrument of government policy in both industrialised and developing countries before the Second World War.

Towards the end of the economic depression of the 1930s and after the Second World War, the number of countries adopting minimum wage regulation grew rapidly. There was also a trend towards extending wage protection to more and more groups of workers and in many cases was more universal.

The early development of minimum wage regulation and subsequent expansion since the 1920s are well reflected in a series of International Labour Conventions on minimum wage regulation by the International Labour organisation (ILO): Minimum Wage Fixing Machinery Convention (No. 26) 1928, the Minimum Wage Fixing Machinery (Agriculture) Convention (No. 99) 1951, and the Minimum Wage Fixing Convention (No. 131) 1970.

In spite of impressive development of the minimum wage system in many countries, however, it should be noted that as with industrial relations, both the exact nature and the scope of minimum wage protection reflect the particular historical and institutional development of the country concerned.

Some countries in Asia, for example Thailand, Indonesia, China, and Japan, have decentralised minimum wage systems, while others like South Korea and Vietnam have a single minimum wage for the entire country. Cambodia has minimum wage fixing machinery only for the country's garment and textile sector.

As seen above, minimum wage regulation had been adopted by more and more industrialised and developing countries as a major social policy tool to protect low-skilled workers by establishing a minimum wage floor under which no payment should be made.

But the usefulness of a minimum wage is now under question by policy-makers and economists, as both developing and developed countries have faced a serious under-employment and unemployment crisis since the 1980s.

The standard argument against the minimum wage system was based on the assumption that a minimum wage above a certain level will cause unemployment and therefore inadvertently work against poverty reduction. In the specific context of

informalisation in developing economies, a minimum wage system in the formal sector was blamed for crowding out formal sector jobs into the informal sector.

But empirical [= practical, as opposed to theoretical] research undertaken recently did not show a negative effect on employment by moderate increases in the minimum wage. Also, recently the ILO undertook a multi-country statistical analysis of the effect of minimum wages on poverty, employment, and informalisation in developing countries.

The study found that if other things were equal, the level of the minimum wage has an insignificant effect on the level of employment. Also, the study concluded, after analysing economic data in Latin American countries, that changes in the ratio between the minimum wage and the average wage exert no significant impact on the share of the informal economy in South and Central America.

This result supports the view that labour market rigidity, and more specifically low wage rigidity, is not the major factor behind the informalisation of Latin American economies. Regarding the effect of minimum wage on poverty, ILO analysis found that for a constant level of GDP per capita and average wage in manufacturing, in one locality, a higher minimum wage is associated with a lower national level of poverty.

In sum, the research findings strongly support the idea that the minimum wage may bring positive results in poverty alleviation by improving the living conditions of workers and their families while having no negative results in terms of employment. Also, no evidence indicated that the level of the minimum wage relative to the average wage affected the size of the informal economy in Latin America.

The above studies suggest that the argument against a minimum wage system in developing countries on the grounds of employment and poverty is not convincing.

Let us examine another important argument against minimum wage regulation which is often put forward in the context of globalisation and competitive edge. Often it is alleged that a high minimum wage is responsible for weakening competitiveness of industries.

But is it really true?

Take the case of Thailand. At the peak of the Asian financial crisis in 1997 - 1998, there was a heated debate on the role of the minimum wage in Thailand. One view argued that the minimum wage was one factor responsible for falling competitiveness of Thai industries which triggered the crisis. The ILO conducted research to investigate relations between wages and other economic variables. The ILO's research revealed that it was not primarily the level of the minimum wage but other macroeconomic factors such as a fixed exchange rate and falling productivity of Thai industries which caused falling competitiveness, eventually leading to the economic crisis. At the same time, however, it should be emphasised that without developing a sound enterprise wage structure, which encourages a cycle of skill development and productivity enhancement, there could be a minimum wage 'trap' for both employers and workers.

During the pre-crisis period in Thailand, the ratio of minimum wage to average wage in non-metropolitan regions was extremely high (around 70 percent). Because of this Thai trade union officials complained that workers, often with several years experience and skills, were 'stuck' on the minimum wage.

Available evidence confirmed this to be the case. For such workers, the minimum wage had thus drifted from its usual intent - to provide a wage floor for unskilled, new entrants to the labour market.

But there are other possible consequences. For one, the function of the wage to motivate is disrupted when the link between pay and performance is weakened. While minimum wage increases might be seen as 'rewarding' workers with seniority, it remains possible that the motivation of the wage is disturbed when there is no obvious link between pay and performance after years on a job.

On the contrary, it is possible that higher increases in the minimum wage than in average wages could reduce the incentive to improve skills. If either is true, labour productivity could suffer. Thai employers, on the other hand, argued the complete opposite - that generous increases in the minimum wage had deprived them of the ability to control their own wage structures and to devise wage policies suited to the enterprise.

There is some evidence to support this view; employers often abandon their own wage decisions to the government's annual announcement of the minimum wage adjustment. Efforts to link wages more closely to enterprise performance were frustrated.

The example of Thailand illustrates the importance of developing a sound enterprise wage structure through enterprise pay negotiations and a good human resource management policy, which should activate a cycle of pay increases, more motivation, skill development, and higher productivity. Actually, when workers have no bargaining power at enterprise level, there is a real danger that a legal minimum wage turns into an effective maximum wage.

In Cambodia for example, the majority of workers in garments and textiles receive just a minimum wage, which is currently US\$45 per month. As trade unions are very weak at the enterprise level, the fragmented trade union movement tends to concentrate efforts on increasing minimum wages through tripartite negotiation with the National Labour Council. It may be an inevitable, logical choice for an emerging trade union movement, which has very weak roots in the work place.

However, it is very clear that unions should make great efforts to improve pay bargaining capacity at the enterprise level to achieve settlements above the level of minimum wages. Otherwise there is a real danger that minimum wage effectively becomes maximum wage and union organisations in the workplace will find it difficult to recruit rank-and-file workers and convince them of the value of union membership.

This situation may suggest that the most appropriate role for a minimum wage is to provide a defined floor to the wage structure to provide a 'safety net' protection for the lowest income groups.

If minimum wages are too low the objective of poverty reduction will not be achieved. People will continue to work because they have no alternative but the result is a society of 'working poor'.

In this regard, the fact that minimum wage fixing through tripartite discussion - either negotiation or consultation - is common in many countries is important. This introduces an element of negotiation between government, workers, and employers in the wage setting process. Where there is good quality information and the parties genuinely desire a common-interest outcome, tripartite deliberation could offer a mutually beneficial compromise.

As illustrated above, in a number of countries where trade unions at the workplace have very weak bargaining power, national trade union centres tend to concentrate excessive effort on the minimum wage fixing process, unintentionally resulting in further weakening trade union organisations and collective bargaining in the workplace.

Another typical problem in least developed countries is that there is often no reliable data on economic variables to be taken into account for minimum wage fixing and adjustment. Even if there are economic data for it, trade unions often lack the capacity to analyse them and engage in meaningful joint discussions.

Developing power and abilities of trade unions at both workplace and national levels is an urgent task in many countries.

After years under attack for alleged negative effect on low-paid employment, the minimum wage regulation seems to be back in favour as a means of providing unskilled workers with decent living conditions.

Several factors are responsible for the renewed interest in the minimum wage as a tool of market policy.

First, several studies in the 1990s showed that the minimum wage had little, if any, effect on creating unemployment.

Second, there is a new human rights approach that focuses on the right to have decent employment. In developing countries, policy makers are not only concerned with the impact of the

minimum wage on employment, but also with its impact on the level of poverty.

However, trade unions in many Asian countries face an uphill battle to win a minimum wage system, as the globalisation process and mobility of capital put great downward pressures on working conditions and in particular on minimum wage systems. This is a battle for decent work for all working men and women, which will continue.

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## This image shows a full page of white paper with horizontal grey ruling lines. The lines are evenly spaced and run across the width of the page, providing a template for handwriting practice or general writing. There are no margins, text, or other markings on the page.



## LESSON 11: INTRODUCTION TO BASIC KINDS OF WAGE PLANS

### Learning Objectives

- To know concept of Wage Plans
- To understand the different Types of Wage Plans

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.

### Types of Wage Plans

#### 1. 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.

#### 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.

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.

#### 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 easy-going 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.

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. Piece Rate

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 proportion 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. I

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.

### 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.

### 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 zealotry 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.

### 3. 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 are 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 debit 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 to 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.

**Notes:**

## LESSON 12: INTRODUCTION TO WAGE DIFFERENTIALS & ELEMENTS OF A GOOD WAGE PLAN

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### Learning Objectives

- To learn the meaning and definition of wage differential
- To understand the concept of wage differential
- To know the types of wage differential
- To understand the reasons for wage differential
- To know the need of a good wage plan
- To understand the essentials of a good wage plan

### Wage Differentials

Wage differentials are a necessary concomitant of the wage system in modern industrial organization. They are directly related to the economic resources of a country, including manpower, growth of national income, the pace of economic development. Economic and social welfare activities depend on a large major on such wage differentials. Wage differentials reflect differences in physical and mental abilities of workers, in productivity and efficiency of management and in consumer preferences.

The word differential means relating to, or showing a difference, or making use of a specific difference or distinction. Wage differential is an element of location selection that is a wage scale reflecting the average schedule of workers' pay in an area that takes into account the performance of related tasks or services.

Wages differ in different employments or occupations, industries and localities, and between persons in the same employment or grade. One therefore comes across the terms as occupational wage differentials, inter-industry, inter-firm, inter-area or geo graphical differentials and personal differentials.

### Wage differentials has been classified into three categories

#### First

The differentials that can be attributed to imperfections in the employment markets, such as the limited knowledge of workers in regard to alternative job opportunities available elsewhere; obstacles to geographical, occupational or inter-firm mobility of workers; or time lags in the adjustment of resource distribution and changes in the scope and structure of economic activities. Examples of such wage differentials are inter-industry, inter-firm, and geographical or inter-area wage differentials.

#### Second

The wage differentials which originate in social values and prejudices and which are deeper and more persistent than economic factors. Wage differentials by sex, age, status or ethnic origin belong to this category.

#### Third

Occupational wage differentials, which would exist even if employment markets were perfect and social prejudices, were absent.

**In other words, wage differentials may be:**

- (i) Occupational differentials or differentials based on skill;
- (ii) Inter-firm differentials;
- (iii) Inter-area or regional differentials;
- (iv) Inter-industry differentials; and
- (v) Differentials based on sex.
- (vi) Sector differential

### Description of each wage differential in Detail:

#### i.Occupational Differentials

These indicate that since different occupations require different qualifications, different wages of skill and carry different degrees of responsibility, wages are usually fixed on the basis of the differences in occupations and various degrees of skills.

The basis functions of such differentials are:

- (a) To induce workers to undertake "more demanding," "more agreeable or dangerous" jobs, or those involving "a great chance of unemployment, or wide uncertainty of earnings."
- (b) To provide an incentive to young person to incur the costs of training and education and encourage workers to develop skills in anticipation of higher earnings in future.
- (c) To perform a social function by way of determining the social status of workers. In countries adopting a course of planned economic development, skill differentials play an important role in manpower and employment programmes, for they considerably help in bringing about an adequate supply of labour with skills corresponding to the requirements of product plans.

Inter-occupational differentials may comprise skilled, unskilled and manual wage differentials; non-manual and manual (white and blue-collar); and general skill differentials. Occupational wage differentials generally follow the changes in the relative supplies of labour to various occupations.

#### ii.Inter-firm Differentials

Inter-firm differentials reflect the relative wage levels of workers in different plants in the same area and occupation. The main causes of inter firm wage~ differentials are:

- (a) Difference in the quality of labour employed by different firms;
- (b) Imperfections in the labour market; and
- (c) Differences in the efficiency of equipment, supervision and other non-labor factors.

Differences in technological advance, managerial efficiency, financial capacity, age and size of the firm, relative advantages and disadvantages of supply of raw materials, power and availability of transport facilities - these also account for considerable disparities in inter-firm wage rates. Lack of co-ordination among adjudication authorities, too, is responsible for such anomalies.

### iii. Inter-area or Regional Differentials

Such differentials arise when workers in the same industry and the same occupational group, but living in different geographical areas, are paid different wages.

Regional wage differentials may be conceived in two senses. In the first sense, they are merely a part of inter-industry differentials in a particular region.

The industry mix varies from one area to another, and for this reason alone, the general average of wages would be expected to vary. In the second sense, they may represent real geographical differentials, resulting in the payment of different rates for the same type of work. In both cases, regional differentials affect the supply of manpower for various plants in different regions.

Such differentials are the result of living and working conditions, such as unsatisfactory or irksome climate, isolation, sub-standard housing, disparities in the cost of living and the availability of manpower. In some cases, regional differentials are also used to encourage planned mobility of labour.

### iv. Inter-industry Differentials:

These differentials arise when workers in the same occupation and the same area but in different industries are paid different wages. Inter-industry differentials reflect skill differentials. The industries paying higher wages have mostly been industries with a large number of skilled workers, while those paying less, have been industries with a large proportion of unskilled and semi-skilled workers.

Other factors influencing inter-industry differentials are the extent of unionization, the structure of product markets, the ability to pay, labour-capital ratio, and the stage of development of an industry.

### v. Personal Wage Differentials:

These arise because of differences in the personal characteristics (age or sex) of workers who work in the same plant and the same occupation. "Equal pay for equal work" has been recommended by the I.L.O. Convention (No. 100), as also by Industrial Courts, Labour Tribunals, the Minimum Wages Committee and the Fair Wage Committee.

But in practice this principle has not been fully implemented because in occupations, which involve strenuous muscular work, women workers, if employed, are paid less than men workers.

Lack of organization among women employees, less mobility among them, their lower subsistence and their weak constitution are other reasons which bring them lower wages than their male counterparts receive.

### vi. Sector Differentials:

Wage differential between agricultural sector and industrial sector is generally a characteristics of underdeveloped countries like India. The main reasons for such sectoral differences in wage rates are the nature of the workers groups whether they are an organized group or an unorganized group. And the level of economic development of the sector. Agricultural labour in India belongs to the unorganized sector of the economy. Agricultural workers are not able to better their living conditions as organized effort is lacking among them where as workers in the industrial sectors have their own unions to fight for them. Unlike industrial sector no industry cum region principle is followed while fixing wages in the agricultural sector. It is the strength of the industrial unions that gives them a higher level of wages as compared with their counter parts in the agricultural sector.

### Elements or Ingredients of a good wage plan

Before going ahead with the plans and elements of a good wage plan, first let us discuss why a good wage plan is required?

Ans. A good wage plan is a more or less a mandatory requirement by the operating firms in order to attract the most creamy work force. Also it helps in tackling retention management and employee motivation problems to a great extent.

So below is mentioned the following features of a good wage plan:

- (i) It should be easily understandable, i.e., all the employees should easily understand what they are to get for their work. They should be instructed in how the wage plan works.
- (ii) It should be capable of easy computation, i.e., it should be sufficiently simple to permit quick calculation. Mathematical tables may be supplied, be reference to which calculations can be quickly made.
- (iii) It should be capable of effectively motivating the employees, i.e., it should provide an incentive for work. If both the quality and quantity of work are to be stressed at the same time, a plan should be selected that will not unduly influence the worker to work too fast or to become careless of quality.
- (iv) It should provide for remuneration to employees as soon as possible after the effort has been made. Daily or weekly payment of wages would be preferable to induce employees to work.
- (v) It should be relatively stable rather than frequently varying so that employees are assured of a stable amount of money.

### Latest updates in labor welfare laws

India calls for new standards in labour welfare laws employment generation be given continued priority in ilo's agenda says dr. Jatiya

Labour minister addresses ilc session in geneva

India has urged the international labour organisation (ilo) to explore new methods of standards setting concerning labour welfare laws. It should have a discussion on the standard setting agenda in a two tier and a double discussion procedure, one at the regional level and the other at the International level.

This will give more opportunities to reflect the regional positions and better understanding and appreciation at the international level. This suggestion was made by the Indian Labour Minister, Dr. Satyanarayan Jatiya while addressing the 87<sup>th</sup> Session of the International Labour Conference in Geneva, today. He said many of the ILO conventions have been adopted ignoring realities of the situation obtaining in the developing countries and this two tier discussions will help remove the regional imbalances.

Turning to unemployment and under employment, Dr. Jatiya called for analysing and addressing effectively the present employment scenario so as to achieve socio-economic progress. The worsening employment situation all over the world demands urgent attention and a plan of action to find solution.

He stressed that employment generation must be kept on the top of the agenda of the ILO for the next decade. Any measures for employment should also be full, freely chosen and productive in terms of the Copenhagen Declaration, he averred.

The Labour Minister pointed out that every worker as human being deserves to be treated with dignity, equality and respect and these should be integrated in the employment and wage policies of the Governments. This is necessary to create a balance between employment generation on the one hand leading to the decent income, livelihood, equality of life and unavoidable corollary of the income generation, on the other.

Referring to social protection, Dr. Jatiya stated that it assumes vital importance for those unfortunate sections of the society and the working class discriminated and economically exploited for a long period. Among them are, bonded, contract, migrant and casual labourers.

Their protection has been a major commitment of the Indian Government, he said. Equally significant has been, India's commitment, to the ethos and culture of tripartism through social dialogue. In India all important policy decisions on Labour, including legislation are taken only after taking into confidence, the social partners namely, the State, Employers and Employees, as also after obtaining consensus through various tripartite fora.

The Labour Minister Dr. Jatiya also reiterated India's commitment to the principles in the ILO Constitution and the Philadelphia declaration. He expressed India's appreciation for the comprehensive report "Decent Work" of Dr. Juan Somavia, Director General of the ILO and said it provides the right direction and thrust for the policies and programmes of the ILO in the changing context of the social and economic environment, globally as well as nationally.

India also welcomes the strategic objective approach set in the report taking into account the economic, employment, emerging social conditions as well as the rapid technological changes. These are already embodied clearly and forcefully in the Constitution of India, Dr. Jatiya added.

## Assignments

1. What do you understand by the term wage differential and state the reasons for the existence of it?

2. What are the elements or ingredients of a good wage plan?

## Case Study

### Micro-Diversification Study

#### A Case of a Labour Contractor at Dharmaram

#### Introduction

This case focuses on the migration of labourers in search of daily wage during the dry season. Mr Prabhakar is one such labour contractor who has a tie up with a sugar factory. In addition to earning for himself, he provides daily wages to nearly 100 labourers during the lean season. .

#### The Village Context

Paidipally is a small village in the Narayankhed mandal of Medak district. It is situated five Kms away from the town of Narayankhed. The village has more of a Kannada influence as it lies very near to the state of Karnataka.

The town of Bidar in Karnataka is only 60 Kms away from Paidipally. Paidipally has nearly 300 households with around 1,000 people. Most of the people are engaged in agriculture. Majority of the people are small and marginal farmers who practice traditional agriculture. As agriculture is dependent on rainfall, often uncertain, people migrate to other places in search of wage labour.

The soil is black cotton type. People mostly grow jowar and pulses. Only one crop is grown due to scarcity of water. There is lack of irrigation facility and people mostly have to depend on rainfall which is less than 600 mm per year. Few farmers have bore-well and are engaged in cultivation of vegetables.

It is well connected with buses to Narayankhed every hour. The supply of electricity is very erratic although everybody has connections.

Since Narayankhed town is very near to the village, people mostly go there for all their needs. There is a hospital and both primary and high schools in Narayankhed.

#### Family Details

Prabhakar is now around 40 years of age. He has been staying in this village from his childhood. His family consists of his wife, three sons and one daughter who are dependent on him.

His parents stay in the neighbouring village. His children go to school and his wife looks after affairs of the house. The main income source for the family is earnings from the labour contract.

The family has three acres of agricultural land the value of which would be Rs. 45,000. Jowar and pulses are cultivated in this land during the kharif season. The family also has one cent of residential land with a house. The value of this property would be about Rs. 75,000.

#### Diversification History

Prabhakar's father used to work as a daily wage labourer. He often had to go out of his village in search of wage labour in the lean season. In this process, he came across a private sugar factory newly established near Narayankhed.



## LESSON 13: INSTITUTIONAL MECHANISM FOR WAGE DETERMINATION

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### Learning Objectives

- To know the Institutional Factors Influencing or determining Wage Rates
- To understand the Role of Wage Board
- To learn the concept of Wages and Social Security

Reward management involves the development of pay structures of varying degrees of formality, which define the rates of pay for jobs, the pay relativities between jobs and the basis upon which jobholders are paid.

Pay structures are designed by reference to judgments about job values as expressed by relativities with other jobs and external (market) rates of pay for comparable jobs.

These judgments are made against the background of the factors, which influence job values. Bearing these in mind, steps can be taken to establish internal job values by using some form of job evaluation.

External values are also established by surveying and analyzing market rates, and the information gained from job evaluation and market rate surveys is combined when developing the pay structure.

This chapter deals with the factors influencing job values and relativities and the basis upon which the rates of pay for individual jobs and job holders are determined.

#### **The Institutional Factors Influencing or determining wage rates are:**

- Intrinsic value,
- Internal relativities,
- External relativities and market practice,
- Inflation,
- The circumstances of the firm and trade union pressures,
- Job evaluation
- Performance management
- Legislation
- Wage Boards

#### **Intrinsic value**

The concept of intrinsic value is based on the apparently reasonable belief that the rate for a job should be determined by reference to the amount of responsibility involved or the degree of skill or level of competence required to perform it. The responsibilities of a job are the particular obligations that have to be assumed by any person who carries out the job.

Responsibility is exercised when job holders are accountable for what they do. The level of responsibility is related to the outputs job holders are expected to achieve and their contribution - the impact they can make on the end results of their section, department or the organization as a whole.

Responsibility involves the exercise of discretion in making decisions which commit the use of the organization's resources. Rates of pay are therefore influenced not only by the scope of the job in terms of its impact on results but also by the size of resources controlled, the amount of authority job holders possess, the degree of freedom they have to make decisions and to act, and the extent to which they receive guidance or instruction on what they should do.

Perception about the intrinsic value of jobs will be influenced not only by the outputs of job holders but also by the impact they can make on the results achieved by the organization as a whole. The scope or size of jobs and their rates of pay are therefore related to the accountability of job holders for achieving results.

The intrinsic value of jobs may also be related to the input and process factors of knowledge and skills and competencies. Knowledge, and skills refer to what job holders need to know and are able to do to meet the requirements of their jobs. Competencies are the behavioral characteristics which demonstrably differentiate between levels of performance in a given role.

#### **Internal relativities**

The problem with the concept of intrinsic value is that it does not take account of the other factors affecting value. It can be argued that there is no such thing as absolute value. The value of anything is always relative to something else and is affected by external economic factors as well as internal relativities.

Within an organization, job values will be determined by perceptions of the worth of one job compared with others. Internal differentials reflect these perceptions, which may be based on information relating to the inputs made by jobholders as reflected by the requirement to use different levels of knowledge or skill.

Or more importance may be attached to outputs- the added value they create. internal differentials will be strongly influenced by differentials established in the external market from which the organization recruits and to which existing employees may be tempted to return.

The organization structure will clearly influence differentials and methods of payment. A hierarchical structure with well-defined layers of responsibility will provide a clear indication of the pattern of differentials and produce a pay structure with fairly narrow bands.

A flatter, more flexible, structure will make it hard to establish a rigid rank order and differentials will be more fluid within broader pay bands and will depend more on relative levels of competence and contribution.

#### **External relativities**



A salary or wage is a price which, like any other price, represents the value of the service to the buyer and the seller: the employer and the employed. The external value of a job - the market rate - is primarily determined by the laws of supply and demand.

However, all the market does is to allow us to assume that people occupying equal positions tend to be paid equally and as Kanter puts it: "The process is circular... we know what people are worth because that's what they cost in the job market, but we also know that what people cost in the job market is just what they're worth."

The market rate concept is in any case an imprecise one. Market rate surveys always reveal a considerable range of rates which reflect the special circumstances of the organizations, including the level of people they employ and their policies on how they want their levels of pay to relate to market rates - their market stance or pay posture.

There will, however, be trends in market rates to which internal pay structures must respond if they are to remain competitive. Individual rates and differentials have to be adjusted in the light of changing market pressures if the organization needs good quality staff.

This will be particularly important at the intake points in a structure and in respect of individuals whose market worth is high and who are therefore vulnerable to the attractions of better paid jobs elsewhere.

It is also important to bear in mind the concept of individual market worth. In effect, this says that any employable individual has a price which is related to what other organizations are prepared to pay for his or her services. Organizations ignore at their peril the individual market worth of any employees they wish to retain whose talents are at a premium in the market place.

### **Inflation and market movement**

Inflationary pressures clearly affect general trends in rates of pay and earnings. They underpin pay market movements.

Organizations have been accustomed to taking into account inflation when adjusting their pay structures although, if their managements have any sense, they have refused to commit themselves to any semblance of index linking.

They have had to be prepared to increase rates by less than inflation in hard times and they have reserved the right to restrict increases to individuals to below the rate of inflation if their performance does not justify the retention of their real level of earnings.

Increasingly, however, employers are basing pay reviews on movements in market rates, which are, in any case, responsive to the rate of inflation.

### **Business performance and/or financial circumstances**

The business or strategic aims of the organization and its plans for achieving those aims will provide the basis for developing pay strategies and policies. The resulting business performance and/or the financial circumstances of the organization will influence the amount it can afford to pay and its pay policies on

such matters as how it wants to relate pay to performance and market rates.

### **Trade union pressures**

Depending on their bargaining power, trade unions will attempt to pressurize managements into increasing pay by at least the amount of inflation. They will press for higher rates on the grounds of the organization's ability to pay and trends in market movement and the going rate for specific jobs, and they may attempt to restore lost differentials.

### **Factors influencing pay levels for individuals**

The pay levels of individual job holders will be influenced by three factors in addition to the rate for their job:

1. their market worth as mentioned above;
2. the level of skills or competence they possess - their inputs;
3. their level of performance in the job - their outputs and the overall contribution they make to organizational success.

The amount of influence these factors exert will depend on the job and the internal environment of the organization. In a non-bureaucratic and flexible firm, where the level of technology is high and a large proportion of the staff are knowledge workers, individual worth will be more important than position in a job hierarchy.

As Kanter has stated: Major employing organizations are rethinking the meaning of worth itself. And as they are doing this, they are gradually changing the basis for determining pay from position to performance, from status to contribution.

How rates of pay for individual jobs and job holders are determined.

Overall levels of pay will be affected by business aims, plans and performance, external economic and union influences, reward policies and market rates.

These general considerations will, of course, affect individual rates for jobs and job holders. These rates will be determined by market relativities, the 'size' of the job within the structure, as measured by job evaluation, and individual levels of performance.

The latter will determine rates of pay above the base rate either by a performance management process or a pay for-performance scheme.

This process of individual pay determination takes place within the framework of job and role analysis and, apart from business and market rate considerations, is largely influenced by the interrelated processes of job evaluation and performance management for those in receipt of performance-related pay.

### **Job Evaluation**

Job evaluation is used to measure relativities and determine where the job should be placed in a pay structure (the rate for the job). Relative job size is assessed in terms of inputs (knowledge and skills), process (behavioral requirements involving the use of competences) and outputs (the level of responsibility for results and the impact the job makes on team or organizational performance).

The Bureau of Labour Statistics, U.S.A., says that “job evaluation is the evaluation or rating of jobs to determine their position in the job hierarchy. The evaluation may be achieved through the assignment of points or the use of some other systematic method for essential job requirements, such as skills, experience and responsibility.”

### Objectives of Job Evaluation

The general purpose of job evaluation may include a number of more specific goals:

1. To provide a basis for a simpler, more rational wage structure;
2. To provide an agreed-upon means of classifying new or changed jobs;
3. To provide a base for individual performance measurements;
4. To reduce pay grievances by reducing their scope and providing an agreed-upon means of resolving disputes;
5. To provide incentives for employees to strive for higher-level jobs;
6. To provide information for wage negotiations;

To provide data on job relationships for use in internal and external selection, personnel planning, career management, and other personnel functions.

### Performance Management

Performance management assesses the individual's performance in the job and in a performance-related pay environment, determines the rate of pay for that individual in the job - whether he or she is positioned within a pay range or on a pay scale.

Performance management is a strategic and integrated approach to delivering sustained success to organizations by improving the performance of the people who work in them and by developing the capabilities of teams and individual contributors.

As a manager one of our most important responsibilities to our organization is to manage performance well. We need to manage not only our performance but also the performance of the many individuals we supervise and develop over the years.

Our ability to manage performance effectively will contribute to our organization? Success and will positively affect the people who work in our organizations. This programme aims to equip the participants with understanding and skills so that they can motivate the employees to contribute their best to the organization

The performance management process will be based on precisely the same factors used in evaluating the job as recorded in a job description or role definition derived from job or role analysis: namely skills, competences and results. The starting point of performance management is an agreement on skill and competence requirements and on the principal accountabilities or main tasks of the job.

This leads to agreements on specific standards of performance, targets and work plans and personal development plans which form the criteria on which performance is reviewed and assessed.

For those on an incentive' or payment by results scheme, pay will be determined by reference to job evaluation and the quantified results achieved by job holders.

It has been very rightly said that Performance management is an ongoing communication process that involves both the performance managers (viz., Political and Sr.Civil Service Executives, Deputy Commissioners) and the employee in

- Identifying and describing essential job functions and relating them to the mission and goals of the organisation.
- Developing realistic and appropriate performance standards (i.e., a written statement describing how well a job should be performed.) to assess the progress toward determined goals. Giving and receiving feedback about performance and use of information either to confirm or change current policy or programme directions to meet those goals and report on the success in meeting goals.
- Writing and communicating constructive performance appraisals.
- Planning, education and development opportunities to sustain, improve or build on employee work performance.

### Legislation

#### Minimum Wages Act, 1948

##### Background

A tripartite Committee viz., "The Committee on Fair Wage" was set up in 1948 to provide 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. Its recommendations set out the key concepts of the 'living wage', 'minimum wages' and 'fair wage' besides setting out guidelines for wage fixation.

Article 39 | - The State shall, in particular, direct its policy towards securing (a) that the citizen, men and women equally shall have the right to an adequate livelihood and (b) that there is equal pay for equal work for both men and women.

Article 43 | - The State shall endeavour, by suitable legislation or economic organisation or in any other way, to give all workers, agricultural, industrial or otherwise, work, a living wage, conditions of work ensuring a decent standard of life and full enjoyment of leisure, and social and cultural opportunities.

#### Enactment of the Minimum Wages Act

##### Historical Backdrop

- The initiative started with the resolution placed by one Shri K.G.R.Choudhary in 1920 for setting up Boards for determination of minimum wages in each industry.
- The International Labour Conference adopted in 1928 Convention No.26 and Recommendation No. 30 relating to wage fixing machinery in trades or parts of trades.
- On the recommendation of the Standing Labour Committee and Indian Labour Conference, a Labour Investigation Committee was appointed in 1943 to investigate into the question of wages and other matters like housing, social conditions and employment.

- A draft bill was considered by the Indian Labour Conference in 1945.
- The 8th meeting of the Standing Labour Committee recommended in 1946 to enact a separate legislation for the unorganised sector including working hours, minimum wages and paid holidays.
- A Minimum Wages Bill was introduced in the Central Legislative Assembly on 11.4.46 to provide for fixation of minimum wages in certain employments. It was passed in 1946 and came into force with effect from 15.3.48.

Under the Act, Central and State Governments are appropriate Governments to

- (a) notify scheduled employment
- (b) fix/revise minimum wages

The Act contains list of all these employments for which minimum wages are to be fixed by the appropriate Governments.

There are two parts of the Schedule. Part I has non-agricultural employments whereas Part-II has employment in agriculture.

#### **Criteria for notification of scheduled Employment**

The appropriate Government fixes the minimum wage in respect of only those scheduled employments where the number of employees is 1000 or more.

#### **Fixation/revision of minimum wages**

##### **Norms**

The norms include those which were recommended by the Indian Labour Conference in its session held in 1957 at Nainital.

- (i) 3 consumption units for one earner.
- (ii) Minimum food requirements of 2700 calories per average Indian adult.
- (iii) Clothing requirements of 72 yards per annum per family.
- (iv) Rent corresponding to the minimum area provided for under Government's Industrial Housing Scheme.
- (v) Fuel, lighting and other Miscellaneous items of expenditure to constitute 20% of the total Minimum Wages.

##### **Other Parameters**

- (i) "Children education, medical requirement, minimum recreation including festivals/ceremonies and provision for old age, marriage etc. should further constitute 25% of the total minimum wage." This judgment was delivered by the Supreme Court of India in 1991 in the case of Reptakos Brett and Co.Vs.its workmen.
  - (ii) Local conditions and other factors influencing the wage rate.
- Methods for fixation/revision of minimum wages

##### **Fixation**

We will discuss about the wage fixation in the next lesson in detail.

Section 3 empowers appropriate Government to fix the minimum rates of wages in the scheduled employments.

##### **Revision**

Revise the Minimum rates at an appropriate interval of not exceeding five years.

#### **Procedure for Fixation/Revision**

In Section 5 of the Minimum Wages Act,1948, two methods have been provided for fixation/revision of minimum wages. They are Committee method and Notification method.

##### **Committee Method**

Under this method, committees and sub-committees are set up by the appropriate Governments to hold enquiries and make recommendations with regard to fixation and revision of minimum wages, as the case may be.

##### **Notification method**

In this method, Government proposals are published in the Official Gazette for information of the persons likely to be affected thereby and specify a date not less than two months from the date of the notification on which the proposals will be taken into consideration.

After considering advice of the Committees/Sub-committees and all the representations received by the specified date in Notification method, the appropriate Government shall, by notification in the Official Gazette, fix/revise the minimum wage in respect of the concerned scheduled employment and it shall come into force on expiry of three months from the date of its issue.

##### **Variable Dearness Allowance (VDA)**

It was recommended in the Labour Ministers' Conference held in 1988, to evolve a mechanism to protect wages against inflation by linking it to rise in the Consumer Price Index. The Variable Dearness Allowance came into being in the year 1991. The allowance is revised twice a year, once on 1st April and then on 1st October. In the State Sphere, 22 States/Union Territories have provisions for Variable Dearness Allowance, at present.

##### **Enforcement Machinery**

The enforcement of the provisions of the Minimum Wages Act in the Central Sphere, is secured through the officers of Central Industrial Relations Machinery. In so far as State Sphere is concerned, the enforcement is the responsibility of the respective State Government/Union Territory.

##### **National Wage Policy**

Though it is desirable to have a National Wage Policy it is difficult to conceive a concept of the same. The National Wage Policy has been discussed on many occasions in different fora. Because fixation of wages depends on a number of criteria like local conditions, cost of living and paying capacity also varies from State to State and from industry to industry, it would be difficult to maintain uniformity in wages. The Indian Labour Conference, held in November, 1985 expressed the following views-

"Till such time a national wage is feasible, it would be desirable to have regional minimum wages in regard to which the Central Government may lay down the guidelines. The Minimum Wages should be revised at regular periodicity and should be linked with rise in the cost of living"

The Government has assumed responsibility for securing a minimum wage for certain sections of workers, in industry and agriculture, who are economically weak and stand in need of protection. Towards this end the Minimum Wages Act provides for the fixation and revision of wage rates in these occupations. These measures have not proved effective in many cases.

For better implementation of the law, the machinery for inspection has to be strengthened. Wage determination in major industries is left to the process of collective bargaining, conciliation, arbitration and adjudication. The Second Plan recommended the setting up of Wage Boards as the most suitable method of settling wage disputes where large areas of industry are concerned. This has so far been applied to the cotton and jute textiles, cement, sugar and plantation industries; and will be extended to other industries according to circumstances.

It has been decided to appoint a Board soon for the iron and steel industry. The representatives of employers and workers have agreed that unanimous recommendations of a wage board should be implemented fully.

An encouraging trend has been noticed in the coal mining industry where employers and workers have agreed to set up a bipartite committee to examine the entire question of wage revision in the industry; alternative wage-fixing machinery will be considered only if the bipartite committee fails to arrive at a settlement.

Some broad principles of wage determination have been laid down in the Report of the Fair Wages Committee. On the basis of agreement between the parties, the Indian Labour Conference had indicated the content of the need-based minimum wage for guidance in the settlement of wage disputes. This has been reviewed and it has been agreed that the nutritional requirements of a working class family may be re-examined in the light of the most authoritative scientific data on the subject.

Apart from the minimum wage, care should be taken in fixing fair wages for different classes of workers, that adequate incentives are provided for the acquisition and development of skills and for improvements in output and quality. There are, however, wide disparities between the wages of the working class, on the one hand, and the salaries at the higher management levels, on the other.

Owing to the uncertainty attaching to it, the question of bonus has become a source of friction and dispute. It has been decided to appoint a Commission which will include representatives of both parties to study the problems connected with bonus

claims and to evolve guiding principles and norms for the payment of bonus.

## This image shows a vertical rectangular sheet of white paper with horizontal ruling lines. The lines are evenly spaced and extend across the width of the page. There are no margins, text, or other markings on the paper.

## LESSON 14: WAGE FIXATION

### Learning Objectives:

- To understand the concepts of wage fixation.
- To know the various methods of determining Wage and salary in India

The history of wage fixation in India is of a recent phenomenon. There was practically no effective machinery until the Second World War for the settlement of disputes for the fixation of wages. Under the Industrial Disputes Act, 1947, various tribunals have passed awards regulating wages in a number of important industries. Immediately after the attainment of Independence, industrial relations in our country started deteriorating -rapidly.. There was a phenomenal increase in the number of industrial disputes, mostly over wages, leading to a substation of production. Realizing that industrial peace was a sine-qua-non for progress on the industrial as well as economic front, the Central Government convened in 1947 a tripartite conference consisting of the representatives of the employers, labour and government. The spirit of truce was incorporated by the Government of India in its declaration of Industrial Policy Resolution of 1948. In the statement embodied in the Resolution, the Government included two items, which have bearing on wages, namely, (institutor fixation of minimum wages in sweated industries; and promotion of fair wages agreement in more organised industries. To achieve the first objective, the Minimum Wages Act, 1948 was passed to lay down certain norms and procedures for the determination and fixation of wages by the Central and State Governments in sweated scheduled employments. To fulfill the second objective, -the Government of India appointed in 1949 a tripartite Committee on fair wages to determine the principles on which fair wages should be fixed and to suggest lines on which these principles should be applied.

Wage and salary incomes in India are determined through several institutions. These are collective bargaining, industrial wage boards, government-appointed pay commissions, and adjudication by courts and tribunals. The institutional framework of wage setting in India is discussed below:

### Collective Bargaining

This term relates to those arrangements under which wages and conditions -of employment generally are decided by Agreements negotiated between the parties. Collective bargaining practices vary in accordance with such factors as the historical development of unions within an industry and economic characteristics of the Indusny-sometimes, groups of employers will bargain together as a unit. Bargaining may also take place at the enterprise level or the plant level. It may be conducted through a union {or a group of unions ( or a group of unions ) and an association representing some of all of the employers in an industry in an area, a region, or a nation. Through the mechanism of collective bargaining. Workers'

representatives achieve a voice in the establishment of wages and other conditions of employment. Wages and related questions are usually the central issues of collective bargaining. The agreements actually arrived at reflect the play of many forces. Unionism is one such factor. Variation in regional and local labour conditions, methods of wage payment establishment size, technical efficiency of firms general business conditions, capacity to pay, company wage policies, union wage policy and union power, help to determine the structure and level of money wages. In the matter of wage bargaining, unions are particularly concerned with the

- (i) General level of wage rates;
- (ii) Structure-.of wage rates; that is, differentials among occupations
- (iii) Bonus, incentives and fringe benefits; and
- (iv) Administration of wages. .

It is quite encouraging to note that the parties to industrial relationships in our country are coming closer to the idea that direct negotiations provide a better approach? To revolving key differences over wages, hours, and conditions of employee instead of the complex adjudication system. In the process, collective bargaining has emerged as an important institution of wage fixation in our country.

Single plant or company bargaining is more widespread as compared to industry-wide bargaining. A review of collective agreements undertake by the employers' Federation of India shows that the collective bargaining system has been adopted in almost all industries. These agreements cover such subjects expectation of mutual rights an cress possibilities by the management and workers, systems of wage payment, dearness allowance, bonus, incentive wages, and fringe benefits.

A few of these agreements also deal with personnel issues such as recruitment, promotion and transfer. The EFI study also revealed that industry level agreements were concluded in jute, textiles, engineering and tea plantations in West Bengal, cotton textile in Mumbai , Gujrat and Tamil Nadu, and plantation in Tamil Nadu, and Karnataka states. The Bureau of Public Enterprise has increasingly exerted unifying influence on collective bargaining in public sector undertakings. The National Commission on Labour believed that despite the inhibiting influence of state intervention in the regulation of wages and the conditions of employment, evidence appears to favour the increasing adoption of collective bargaining to settle disputes, and a gradual replacement and adjudication.

Of late, however, collective bargaining has been substituted by coercive bargaining with the result that there is a wide distortion in the wage structure and ad holism in wage fixation, ignoring all the well-recognised principles of wage fixation. Because of organised violence and go-slow which are the tools of coercive

bargaining, the workmen in some concerns have succeeded in obtaining, exorbitant increase in wages.

In this connection, it is quite pertinent to refer to the broad guidelines issued by the Bureau of Public Enterprise to the public sector undertakings. These units have been asked to keep the following points in view which negotiating future wage agreements

- (a) wage grants should not exceed ten per cent of the existing level;
- (b) dearness allowance neutralization should be at the rate of one rupee per point
- (c) there should not be any retrospective operation of wage agreements; and
- (d) the agreements should be for a period of three years.

The parties concerned in collective bargaining need detailed statistics of wage rates, earnings, bonuses and other supplementary benefits, compensation of employees, labour cost, the share of wages in the value added by economic activity- vis-a-vis profits. Factual, impartial and authentic statistical data reduce the areas of uncertainty and enable meaningful discussion between the different parties, thereby facilitating the collective bargaining process. Conversely, the lack of relevant and reliable statistics has often proved a serious handicap to efforts for the settlement of industrial disputes.

### Productivity Bargaining

Recently, the concept of productivity bargaining has gained considerable momentum in addition to conventional wage bargaining. In wage negotiations, emphasis is given primarily to output-per man-hour rather than to productivity. The positive outcome of productivity bargaining is productivity agreement. Productivity agreement is a systematic attempt at securing greater efficiency and economy in the utilization of.. resources, both physical and human.

#### The features of productivity bargaining

**Firstly**, it is based on the concept of exchange and self-interest which is beneficial to both parties.

**Secondly**, it lays down specific and direct contribution of labour towards improving productivity.

**Thirdly**, it differs from conventional collective bargaining agreement as it is based on cost benefit analysis.

**Fourthly**, it is a "package deal" between the workers and management wherein a number of changes in the work practices are made in exchange for a variety of rewards.

A comprehensive productivity agreement will often have as a major objective the rationalisation of the wage structure, and the introduction of more appropriate and more effective bonus systems. The productivity agreements pose certain problems for managements and unions. In the short-term, the problems of adapting to a changed climate. Furthermore, there is a problems of sharing the gains of productivity between labour and capital. This often leads to industrial unrest or dispute between workers and employers, loss of work time, and loss of production. Nevertheless, managements must take the lead in productivity agreements because they are basically concerned with the efficient use of resources to produce the best results.

Moreover, they can make a contribution towards the development of improved industrial relations practices which will lead not only to a substantial improvement in the utilisation of physical resources but to more satisfying working lives. Negotiation of a comprehensive productivity agreement gives management, perhaps for the first time, an opportunity to restructure its industrial relations in a company or plant. It also provides the basis for an improved managerial control and can be the starting point of a managerial policy designed to create a positive motivational framework for management and employees.

### Statutory Wage Fixation

The Minimum Wages Act was passed in 1948 to provide for machinery for statutory fixation and revision of minimum wages in the scheduled employments, including plantations and agriculture. It is a piece of social legislation, which provides protection to workers in employments in which they are vulnerable to exploitation on account of the lack of organization and bargaining power.

The main object of the Act is to prevent the payment of unduly low wages to workers employed in scheduled employments and to secure certain basic conditions of work and employment such as hours of work, overtime wages, weekly off. The Act was initially made applicable to agriculture and 12 other industries ( listed in the Schedule to the Act ) where sweated labour conditions prevailed.

The scope of the Act has been gradually extended to cover new scheduled employments/industries. The Ministry of Labour has fixed/revised minimum wages under the Minimum Wages Act in respect of 39 scheduled employments under the purview of Central Government. Most of the State Governments have taken advantage of the Act and have fixed wages for employments specified in Part I of the Schedule. They have also extended the application of the Act to some other industries besides those scheduled under the Act.

The scheduled employments covered by the flexible minimum wage has benefited work-people engaged in such diverse employments/industries as printing presses,, rice and dal mills, engineering industries, oil mills, plastic industry, cement products, lime kilns for fuel coke ( all in Madhya Pradesh), refractoriness, fire bricks and ceramics industry and cinema industry (all in Bihar), power loom industry (in Tamil Nadu), cinchona, rubber, tea or coffee plantations (in Karnataka and Kerala), oil mills, tanneries and leather manufactory, clothing dyeing and cloth printing in (Gujarat and Maharashtra), bakeries and confectionaries, restaurants, shop and commercial establishments (in Uttar Pradesh and Maharashtra).

The Minimum wages Act does not provide any guidance to the wage fixing authority in regard to the content of a minimum wage, factors to be taken into account while fixing the minimum wage rates, size of the family unit for which minimum rates have to be fixed, weight age to be given to different factors like cost of living, needs of the workers etc.. It is, therefore, left to the individual committee or the Government to determine their own standards and arrive at conclusions.

Historically, the first to lay down the guidelines for fixation of minimum wages was the 15th session of the Indian Labour Conference held in July, 1957. This was followed by the One-Man Committee headed by Shri K.L. Vidwasagar this report-dated the 19th December, 1966 in suggested that while fixing/ revising minimum wages, the following norm should invariably be taken into consideration:

- (i) Prevailing wage rates in the employment concerned;
- (ii) Prevailing wage rates/statutory minimum wage rates in other employments for similar occupations;
- (iii) Statutory minimum wage rate of the same employment in the adjacent areas;
- (iv) family budget survey of the workers' families employed in such employments in different centres; .
- (v) maintenance of information of CPI Nos. and ACPI Nos;
- (vi) general economic conditions prevailing in the industry including the importance of the industry;
- (vii) information on nutritional standards and balanced diet in various areas and places;
- (viii) number of persons employed in the industry over a period and the reasons for variations, if any;
- (ix) categories of employment and the amount of skill required; and
- (x) cost of production and labour cost

### Wage Boards

The term 'wage board' covers:

- (1) a voluntary negotiating body set up by discussions between organised employers and workers to regulate wages, working hours and related conditions of employment by collective bargaining, and
- (2) a body set up by law or with legal authority to establish minimum wages and other standards of employment which are then legally enforceable in the particular trade or industry to which the board's decision relate.

The concept of wage board was first enunciated by the fair wages committee. It was commended by the first five year plan. The second five year plan also considered the wage board to be "a more acceptable machinery for settling wage disputes", a machinery "which gives to parties themselves a more responsible role in reaching resolutions." the fifteenth session of Indian labour conference reiterated that wage boards should be the appropriate machinery for the fixation of wage rates.

Since their inception in 1957, wage boards were appointed for the following industries/employments:

- (1) cotton textiles,
- (2) sugar
- (3) cement,
- (4) jute,
- (5) tea plantations,
- (6) rubber plantations,
- (7) coffee plantations,
- (8) iron and steel,

- (9) iron ore mines,
- (10) coal mines.
- (11) limestone and dolomite mines,
- (12) working journalists,
- (13) non-journalists,
- (14) cotton textile (second),
- (15) cement (second),
- (16) ports and docks,
- (17) engineering,
- (18) heavy chemicals and fertilizers,
- (19) sugar (second),
- (20) leather and leather goods,
- (21) electricity undertakings,
- (22) road transport, and
- (23) working journalists (second).

A wage board is tripartite character. It consists of an equal number of representatives of employers and workers with an independent chairman. In addition, an economist and a consumer's representative, both independent, are nominated to the board. The total number of members on a wage board including the chairman has varied from seven to nine. Representatives of employers and workers on the board are appointed by the government after consulting the concerned organisations in the industry. The government nominates the chairman and the independent members.

In evolving a wage structure, a wage board according to its terms of reference is required to take into account in addition to the considerations relating to fair wage. (i) the needs of the industry in a developing economy's differentials in such a manner as to provide incentives to workers for advancing their skill. Majority of the wage boards examined the question of need based minimum wage and concluded that it was not feasible to implement the norms approved at the 15<sup>th</sup> session of ILC because of one or more of the following reasons; (a) it would be beyond the capacity and the industry in the to pay (b) it would unduly affect the relativity of wages among industries in the same region. (c) it would result in excessive and abrupt increase in wages and (d) it would be extravagant at the cost of the consumer on whom the burden of increased wages and salaries would fall.

A major criticism of wage board is its delay in submission of its report to the government and in implementing the board's recommendations. The most serious consequence of these long delays is reflected in worker dissatisfaction and agitation by labour unions. In some cases they have interpreted their terms of reference narrowly and recommended wage and dearness allowance increases with considering their possible effects on the economy of the country. Moreover there are also problems associated with the implementation of their recommendations, as they are non-statutory. The government can apply simply moral pressure and persuasion on the employers to ensure compliance. Another frequently encountered problem is the reluctance of some employers to implement even 'unanimous' recommendations of the boards. This had led to considerable

industrial unrest. An illustration of which is the strike in 1969 by the coal-miners. Unanimous recommendations of the wage board for coal mining had been accepted by the government but some employers refused to implement them on the grounds of inability to pay; this refusal precipitated the strike.

The NCL recommended for the continuation of wage boards as they have done some useful work. In this context, it made certain recommendations to make them more effective. Some of its recommendations are:

- (i) the wage boards should normally be required to submit their recommendations within one year of their appointment;
- (ii) the recommendations of a wage board should remain in force for a period of five years;
- (iii) unanimous recommendations of the wage boards should be made statutorily binding;
- (iv) a manual of procedure for wage boards should be prepared.<sup>7</sup>

Tripartite wage boards provided a forum for collective bargaining and constituted an important element in the Indian system of wage determination. This institution has come to be widely accepted in our country as a viable wage-setting mechanism. They have succeeded in promoting industry-wide negotiations; furthermore, in addition to encouraging greater participation by the parties and freedom in the decision making, the boards have apparently functioned with responsibility, restraint and maturity. As the system of tripartite wage boards is essentially a sound one, they may be revived afresh by removing the defects in their working.

### Pay commissions

The first pay commission was appointed by the government of India in 1946 under the chairmanship of justice Vardachariar, a judge of the federal court of India to enquire into the conditions of service of central government employees. The vardachariar commission in its report said that in no case should a man's pay be less than a living wage. The government had urged the commission to bear in mind the inflationary impact of wage revision for such a large body of employees and its effect on the others outside its purview. The commissions dismissed the special pleadings of the government on three grounds:

- (a) that inflation does not automatically follow wage revision;
- (b) that as an authority entrusted with the work of deciding wages according to the workers needs, the commission could not and should not entertain this unproved contention and
- (c) that it was the responsibility of the government to control the inflationary consequences of wage revision by appropriate policies of price control and increased production.

The second pay commission was appointed in August 1957. the commission which submitted its report in 1959, examined the norms for fixing a need based minimum wage set by the 15<sup>th</sup> session of the Indian labour conference. The pay commissions worked out its own daily diet schedule yielding a calorie content of a little over 2,600 contrasted with Dr. Aykroyd's estimate of 2,700 calories. The money value of the minimum wage worked out on the basis of this diet came to

Rs. 80, corresponding to the all India working class consumer price index number 115 (1949 = 100). Workers' organisations rejected this estimate as too conservative and unrealistic and demanded Rs. 110 to 135 depending on the region/area in question.

In view of the continuous demands made by the central government employees, the government of India appointed the third pay commission in 1970 which submitted its report in April 1973. The commission gave an interim relief ranging from Rs. 15 to Rs. 45 per month. The commission expressed its support for a system in which pay adjustments will occur automatically upon an upward movement in the consumer price index. The minimum remuneration for a class IV employee on entry, as recommended by the commission, was Rs. 185 per month. The employees covered by the report were not satisfied. There was widespread/discontent and an agitation was launched to get the pay scales revised upwards. In a bid to assuage the feelings of its employees, the union government raised the minimum from Rs. 185 to Rs. 196 but, this did not satisfy the employees and the discontent continued.

After a lapse of 13 years, the government appointed the fourth central pay commission under the chairmanship of Justice P.N. SHINGLA ON JULY 26, 1983 to examine the structure of emoluments of all central government employees, including those of the union territories, officers belonging to all India service and armed forces personnel. The commission submitted its report on June 30, 1986. it recommended drastic changes in the pay scales of over 5,20,000 government employees at a cost of Rs. 1,925 crore to the exchequer. The demand of the employees of departmental undertakings like the railways, posts and telegraphs, and defense production for wage parity with public sector undertakes was rejected.

Some of its major recommendations are

- (1) it recommended the reduction of the number of pay scales from 153 to 36, a reduction of about 76 percent.
- (2) it suggested a pay scale ranging from a minimum of Rs. 750-940 per-month at the lowest level to Rs. 8,000 per month (fixed) at the secretarial level. The only exception was a basic salary of Rs. 9,000 per month for the cabinet secretary, the chairman of the atomic energy commission and the three service chiefs.
- (3) it proposed to raise the house rent allowance from the existing 15 and 10 percent to a flat rate ranging from Rs. 150 to Rs. 1,000 per month for 'A' 'B' 'T' and B-2 class cities and at lower rates for unclassified cities.
- (4) it proposed to improve the scheme of special compensatory allowance for employees serving in "difficult, remote and bad climate areas"
- (5) it recommended an increase of leave accumulation from 180 days at present to 240 days and its encashment at the time of retirement.
- (6) it advocated for improved work culture among the employees and extension of working hours, particularly for office staff and in the process disfavored the present scheme of overtime allowance.



In September 1986 the government announced its acceptance of the recommendations with marginal improvements a minimum rise of Rs. 75 in the basic pay was extended to over 2,70,000 employees. The government also accepted the pay panel's dearness allowance formula. The restructured pay scales were brought into effect from October, 1986.

Some of the major recommendations of the fifth pay commission are

- (a) raising retirement age to 60 years.
- (b) Like in house rent allowance to 30 per cent of the maximum of the pay scale in A-1 cities and from 5 to 15 percent of the maximum in other cities;
- (c) a minimum salary of Rs. 2,440 and maximum salary of Rs. 26,000 per month;
- (d) abolition of overtime allowance
- (e) a drastic cut in gazetted holidays to three days a year ( from the present 17) along with a six - day working week;
- (f) enhancement of maximum age of recruitment of women to 35 years;
- (g) a 15-day paternity leave and transport allowance for all employees;
- (h) an eligibility ceiling of Rs. 4,500 on payment of bonus and replacement of ad hoc bonus with that of a productivity – linked bonus scheme. There is raging controversy over the pay panel recommendations and hence the central government decided to keep the implementation of the report in abeyance.

### Adjudication

Since independence, adjudication has been one of the main instruments for settlement of wage disputes, Improvement in wage scales and standardization of wages and allowances. Though courts and tribunals were primarily intended to deal with the settlement of industrial disputes, in practice, wage fixation has become an important element in their work and functioning. This is because of a large number of disputes concerning wages and allowances. The Industrial Disputes Act of 1947, which replaced the Trade Disputes Act of 1929, enables the government to intervene in matters involving disputes between workers and employers. It also provides for compulsory adjudication in the case of failure of conciliation proceedings. Numerous wage disputes in many industries have been referred for adjudication to labour courts and tribunals during the past three decades. In this exercise they have been guided by the report of the Fair Wages Committee. The High Courts and the Supreme Court have also adjudicated upon such disputes. The awards given by these authorities not only helped in the formulation of a body of principles governing wage fixation but laid the foundation for the present wage structure in many of the major industries.

In fixing wages, one of the important principles to be borne in mind is the concept of equal pay for work of equal value. It is based on the common justice that no discrimination should be made in this respect on the ground of nationality, race or sex. If this could be applied to all grades of workers, skilled, semi-skilled and unskilled, and to men and women, relative wages

would be fair. However, there are very often practical difficulties in applying this principle, particularly as between different industries. It is a fact that some industries are able to pay higher rates than others, and the employees in these more profitable sector rather naturally feel that they are entitled to a share in their industry's prosperity. Though it is difficult to attain in practice the concept of equal pay for equal work, all concerned – trade unions, employers and governments – should extend their full support to it as it is a sound principle.

In sum, the well-settled legal, position on wage fixation is :

- (i) that the wage structure has to be fixed on an industry-cum-region basis having due regard to the financial capacity of the unit under consideration;
- (ii) that it is ordinarily desirable to have as much uniformity as possible in the wage levels of different concerns of the same industry working in the same region though it may not always be possible to attain this object because of the different financial capacities of different concerns;
- (iii) that the wages prevailing in an establishment must be comparable with those given to workmen of similar grade and scale by similar establishments in other industries in the region;
- (iv) that employees getting the same wages should get the same dearness allowance, irrespective of whether they are working as clerks or members of subordinate staff or factory workmen;
- (v) that the additional financial burden which a revision of wage-structure or dearness allowance would impose upon an employer, and his ability to bear such burden, are very material and relevant factors to be taken into account.

### Wage Fixation in Public Sector

In the beginning, compensation plans for the public enterprises were mainly borrowed from the Government. In some organizations these were based on a comparison of similar industries in private enterprises. In case of public sector steel plants, the pay scales and allowance were a mixture of Government, TISCO, IISCO, Railways, etc. In 1962, the minimum wage and wage structure was suitably modified in line with the recommendations of the Second Pay Commission for Central Government employees. For the first time, a composite Central Wage Board for Iron and Steel Industry was set up in January 1962, which finalized its report in 1965. This was, as it were, the foundation for determination of wages on industry basis both for public, private as well as joint enterprise. The Wage Board produced an extensive document describing the history of iron and steel industry and the wage fixation machinery therein besides dealing with the question of principles of wage fixation and allied matters.

Although similar Wage Boards determined wages in other industries level the working of the Wage Boards and implementation of wages so fixed caused many a problem. This resulted in strife and tension. This also struck at the roots of the collective bargaining, which was considered as an effective tool of handling the industrial relations matters. The working of the Wage Boards also did not allow a broad-based worker

and management participation in the evaluation of the wage normal as well as final decision.

The problems and complexities in functioning of the Wage Board at the national level led to re-thinking on the entire process of setting up of wage boards particularly in the steel industry. In the Second Session of Industrial Committee on Iron and Steel in October, 1969, this matter was deliberated and a machinery for the revision of the wage structure for Iron and Steel Industry was evolved. On the suggestion of the workers' representatives, it was unanimously decided to veer away from the traditional model of wage fixation through a Wage Board or any other ad-hoc arrangement and to choose bilateral system of bargaining as the best suited method for evolving, a wage structure. This was the-birth of a bipartite forum called Joint Wage Negotiating Committee forth Steel Industry.

One of die novel feature of bipartite negotiations in the steel industry is that all-decisions are taken by consensus and not by majority vote. There is no Chairman if this Committee. There is only a Convener who-convenes the meeting. The Committee consists of three members each from central trade union organisations of INTUC, AITUC, HMS, CITU and one representative each from the recognised unions of steel plant\_. From the employers side all the Managing Directors of the Steel Plants are members of this Committee and Director (personnel) of SAIL is the convener Member.

### Conclusion

The wage fixation policy should ensure prevention of exploitation of . labour through the payment of unduly low wages, particularly in those employments where sweated conditions exist and where the workers are vulnerable because of lack of organisation. It is a step in the direction of realising the objectives -of wage policy in developing country like India, namely, the abolition of malpractices and abuses in wage payment, and the fixing of minimum wages for workers whose bargaining position is. Weak because they are unorganized- or insufficiently organised. In a developing economy, with severe-unemployment and under-employment, wages cannot be left to be determined entirely by the market forces, and the government has a positive role to play in ameliorating the conditions of the low-paid workers.

### Notes

## LESSON 15: INTRODUCTION TO NATURE AND OBJECTIVES OF JOB EVALUATION

### Learning Objectives

- To know the definition and concept of job evaluation
- To understand the need for job evaluation
- To know the objectives of job evaluation
- To study the prevalence of job evaluation
- To understand the responsibility of job evaluation and the various bodies responsible for it
- To analyze the relationship between job evaluation and job analysis

### What is job evaluation?

Job evaluation is the process of methodically establishing a structure of jobs within an organization based on a systematic consideration of job content and requirements. The purpose of the job structure or hierarchy is to provide a basis for the pay structure. The job structure, as seen in previous lessons, is only one of the determinants of the wage structure. But it is an important one often used.

### Definition of Job Evaluation

Below are given some important definitions of job evaluation:

The I.L.O. defines job evaluation as “an attempt to determine and compare demands which the normal performance of a particular job makes on normal workers without taking into account the individual abilities or performance of the workers concerned.”

The Bureau of Labour Statistics, U.S.A., says that “job evaluation is the evaluation or rating of jobs to determine their position in the job hierarchy. The evaluation may be achieved through the assignment of points or the use of some other systematic method for essential job requirements, such as skills, experience and responsibility.”

In the words of the Netherlands Committee of Experts on Job Evaluation, “job evaluation is a method which helps to establish a justified rank order of jobs as a whole. Being a foundation for the setting of wages. Job evaluation is the only one of the starting points for establishing the relative differentiation of base wage rates.”

Kimball and Kimball define job evaluation as “an effort to determine the relative value of every job in a plant to determine what the fair basic wage for such a job should be.

According to Wendell French, “job evaluation is a process of determining the worth of the various jobs within the organisation, so that differential wages may be paid to jobs of different worth.” The relative worth of a job means value produced by various factors as responsibilities, skill, effort and working conditions.

We may define job evaluation as a process of analyzing and describing positions, grading them and determining their relative value by comparing the duties of different jobs in terms of their different responsibilities and other requirements.

It is the quantitative measurement of relative job worth for the purpose of establishing consistent wage rate differentials by objective means. It measures the differences between job requirements, the objective being the setting of pay for wage administration purposes.

It does not set the price of a job; it merely fixes its relative worth.

It presents an effort to determine the relative value of every job in a plant, and to determine what the fair wage for such a job should be. It is not evaluating the merit of the worker who does the work. It rates the job and not the qualities of the individual worker on which the task of employee rating.

### Conceptual Discussion

Job evaluation developed out of civil service classification practices. Job analysis applied to time study and selection, and some early employer job and pay classification systems. Whether formal job evaluation began with the United States Civil Service Commission in 1871 or with Frederick W. Taylor in 1881, it is about 100 years old.

The first point system was developed in the 1920s. Employer associations have contributed greatly to the adoption of certain plans. The spread of unionism has influenced the installation of job evaluation in that employers gave more attention to rationalized wage structures as unionism advanced. The War Labor Board during World War II encouraged the expansion of job evaluation as

a method of reducing wage inequities.

Job evaluation has received a good deal of attention in recent years as a result of social concern regarding discrimination.

A study of job evaluation as a potential source of and/or a potential solution to sex discrimination in pay was made by the National Research Council under a contract from the Equal Employment Opportunity Commission.

The study suggested that jobs held predominantly by women and minorities may be undervalued. Such discrimination may result from the use of different plans for different employee groups, from the compensable factors employed, from the weights assigned to factors, and from the stereotypes associated with jobs.

Although the preliminary report failed to take a position on job evaluation, the final report concluded that job evaluation holds some potential for solving problems of discrimination.

### Why to do Job Evaluation?

Organizations usually begin the process of designing a wage structure by determining their job structure. Two often-cited principles of compensation are

(1) equal pay for equal work and

- (2) more pay for more important work. Both imply that organizations pay employees for contributions required by jobs.

Most organizations utilize job assignment as a major determinant of employee contributions. A formal wage structure, defined as a rate or range of rates established for job classifications, seems to be standard organization practice, except in very small organizations. Formal job evaluation or informal comparison of job content is the almost universal base of pay rates.

Job evaluation is concerned with jobs, not people. A job is a grouping of work tasks. It is an arbitrary concept requiring careful definition in the organization. Job evaluation determines the relative position of the job in the organization hierarchy. It is assumed that as long as job content remains unchanged, it may be performed by individuals of varying ability and proficiency.

### Objectives of Job Evaluation

The general purpose of job evaluation may include a number of more specific goals:

1. To provide a basis for a simpler, more rational wage structure;
2. To provide an agreed-upon means of classifying new or changed jobs;
3. To provide a base for individual performance measurements;
4. To reduce pay grievances by reducing their scope and providing an agreed-upon means of resolving disputes;
5. To provide incentives for employees to strive for higher-level jobs;
6. To provide information for wage negotiations;
7. To provide data on job relationships for use in internal and external selection, personnel planning, career management, and other personnel functions.

Also, says an I.L.O. Report, “the aim of the majority of systems of job evaluation is to establish, on agreed logical basis, the relative values of different jobs in a given plant or machinery, i.e., it aims at determining the relative worth of a job.

The principle upon all job evaluation schemes are based is that of describing and assessing the value jobs in the firms in terms of a number of factors, the relative importance of which varies from job to job:

- (i) To secure and maintain complete, accurate and impersonal descriptions of each distinct job or occupation in the entire plant;
- (ii) To provide a standard procedure for determining the relative worth of each job in a plant;
- (iii) To determine the rate of pay for each job which is fair and equitable with relation to other jobs in the plant, community or industry;
- (iv) To ensure that like wages are paid to all qualified employees for like work;

- (v) To promote a fair and accurate consideration of all employees for advancement and transfer;
- (vi) To provide a factual basis for the consideration of wage rates for similar jobs in a community and in an industry; and
- (vii) To provide information for ‘work organization, employees’ selection, placement, training and numerous other similar problems.

In fact, the primary purpose of job evaluation is to set wages and salary on the basis the relative work or jobs in the organisation. It goes this by providing a ground for the following matters:

- (a) Equity and objective of salary administration, i.e., paying the people whose work is alike the same wages, and establishing appropriate wage differentials between jobs calling for different skills and responsibilities;
- (b) Effective wage and salary control;
- (c) Union-management negotiations on wages; and
- (d) Comparison of wage and vary rates with those of other employees. Besides setting wages, job evaluation also helps in:
  - (a) Providing standardization of, and improvement in, working conditions;
  - (b) Clarifying the functions, authority and responsibility of employees;
  - (c) Establishing references for the settlement of grievances arising out of individual rates and for negotiations with a trade union on internal wage structure and differentials;
  - (d) Developing machinery for a systematic reviewing of job rates as job contents change; and
  - (e) Developing personnel statistics.

### Prevalence of Job Evaluation

Job evaluation is used throughout the world. Although recent evidence is not available, it appears that job evaluation is more prevalent in the United States than elsewhere.

However, a 1982 International Labor Office publication states that in centrally controlled economies or in economies where wage or income controls exist, job evaluation is frequently used. Holland has had a national job evaluation plan since 1948 as a basis for its national wages and incomes policy. Sweden and Germany have a number of industry-wide plans.

Great Britain, like the United States, usually employs job evaluation at the plant or company level. Australia and some Asian countries have installed some forms of job evaluation. Russia and some of the Eastern European countries make wide use of job classification.

The evidence on use of job evaluation in the United States shows that smaller companies are somewhat less likely to use job evaluation. Almost all government jurisdictions, however, employ some form of job evaluation.

In the past twenty years job evaluation has come under attack in the United States. This has come about from a change in the American economy and the type of organizations that dominate the “new” economy of today.

Job evaluation works best in large bureaucratic organizations. In the past twenty years these behemoths of the American economy have faced increasing problems remaining competitive. The result is that they have downsized greatly and removed many layers of organization. Vertical movement within organizations has slowed down and employees increasingly move to jobs in other organizations rather than stay with their current employer.

The new companies gaining a foothold in the economy are smaller and organizationally flexible. There has also been a demise of unions; individuals now bargain for their own wages. Lastly, organizations are putting more emphasis on employee skills and performance, as opposed to the job.

All this does not mean that organizations ignore the job as a determinant of wages. What has happened is that wage systems have become more flexible and weight skill and performance more heavily.

The use of market wage data for more and more jobs is increasing and made more practical as data has become readily available on the Internet. Within organizations, job evaluation systems have become simpler, less formal and have reduced their complexity.

A major trend in this direction has been broadbanding. In broadbanding, the number of levels in the job evaluation plan is reduced, and the width of the grade levels increased dramatically. This allows employees to receive wage increases without having to move up to a new grade level that is tied to a higher organizational level.

### **Responsibility for Job Evaluation**

The installation and operation of job evaluation involves certain responsibilities. Several possibilities for implementing the process are apparent.

One or more committees may be selected, a department may be set up or an existing one assigned, or a consulting organization may be brought in. These possibilities are not mutually exclusive.

Support for the program is essential because installation of it involves commitments of time, effort, and money. Such support is usually obtained by securing top management approval and the collaboration of other managers and organization members. Often this approval is obtained through a committee set up for this purpose.

**Hence, let us study below the various bodies involved with the responsibility of Job evaluation**

#### **1.The Committee Approach**

This committee is given an explanation of job evaluation, the purposes it is expected to accomplish, a rough time schedule, and perhaps an estimate of the cost of the program. The committee makes the decision to install job evaluation, decides on the scope of the project, and assigns responsibility for the work.

The actual work of job evaluation is usually done in committee in both large and small organizations, whether the task is

accomplished by organization members alone or with the help of a consultant.

Committees have the advantage of being able to pool the judgment of several individuals. The committee usually selects the compensable factors, determines weighting, chooses the method of comparing jobs, and evaluates jobs.

The chair of the committee is usually a compensation professional, although a consultant, if employed, may assume the chair for part of the work. Other members are typically other managers selected for their analytical ability, fairness, and commitment to the project.

Representation of broad areas of the organization aids in communication and in gaining acceptance. But job evaluation committees should be kept small to facilitate decision making. Five members may be optimum, ten a maximum. A common procedure is to invite supervisors to committee meetings when jobs in their department are under study.

In union-management installations, union members are regular members of the committee. Where the union is not involved employee representation is often rotated. Employee representation in committees seems to aid in securing acceptance and in communication.

Committee job ratings are a result of pooled judgments. This usually means either that ratings made individually are averaged or a consensus is reached as a result of discussion.

Committee members must be trained. Much of this training involves following the steps in the process. But it is advisable to train committee members how to guard against personal bias and the common rating errors.

#### **2.Consultants**

Consultants are sometimes employed to install job evaluation plans. Successful consultants are careful to ensure that organization members are deeply involved in installing the plan and are able to operate the plan on their own.

Consultants are most likely to be employed in small organizations where no member has the necessary expertise. They are also more likely to be employed when a complex rather than a simple plan is to be installed. Consultants often have their own ready-made plans.

Sometimes consultants are brought in to insure objectivity in union-management installations. It is also common to hire consultants to evaluate management jobs, because the objectivity of committee members rating jobs at levels higher than their own may be questioned.

#### **3.Compensation Department Involvement**

It is quite possible for the organization to assign installation and operation of a job evaluation plan to the compensation department. Sometimes the compensation professional heading the unit and a number of job analysts carry out the task.

Those who favor this last approach emphasize the technical nature of the task. They may also be reacting to the difficulty of getting operating managers to devote the time that the program requires.

While they may recognize the education and communication advantages of committees, they believe these advantages can be provided in other ways. It is doubtful that this position can be justified, though.

Input by operating managers and perhaps employees during job evaluation installation is probably essential to acceptance of the results. Once the program is installed, however, there seems to be no reason why a department cannot operate it with proper provision for settling grievances.

#### 4. Union Involvement in Job Evaluation

Union involvement has the same rationale as that offered in our discussion of job evaluation committees. Acceptance and understanding are the expected results of involvement.

In practice, union participation in job evaluation has varied greatly. Some unions profess to formally evaluate an organization's jobs independently and then use the information as an aid in collective bargaining.

Some job evaluation plans have been installed and maintained as a joint venture. A well-known union-management job evaluation plan exists in the steel industry. Less well-known is the joint plan in the West Coast paper industry. There is evidence that joint plans are more successful than unilateral plans. But this is not always the case.

Many unions in organizations with job evaluation plans review the findings after installation by management and either present grievances on individual jobs or insist on bargaining the wage structure. In the latter case, the bargained wage structure may follow the job structure resulting from job evaluation or represent a compromise.

Some unions have ignored job evaluation plans installed unilaterally by management. Some employers prefer this response, believing that job design and evaluation are management prerogatives. Other employers invite union participation in the hopes of obtaining understanding and acceptance of the plan.

If a union rejects an invitation to participate in job evaluation and ignores the plan, the employer installs the plan unilaterally, recognizing the need for a logical hierarchy of jobs. The findings are used in negotiating the wage structure.

#### Unions have criticized job evaluation on several grounds

- (1) that it restricts collective bargaining on wages,
- (2) that wages shouldn't be based solely on job content,
- (3) that supervisors do not or cannot explain the plan to employees,
- (4) that management doesn't administer the plan the way it explained it, and
- (5) that it is subjective.

#### Employee Acceptance of Job Evaluation

Job evaluation is usually judged successful when employees, unions, and organizations report satisfaction with it. Most surveys report organization satisfaction levels at 90 percent or better. Employee acceptance is the primary criterion

organizations use in determining the success of a job evaluation plan.

This is reflected in the increasing use of employees on job evaluation committees and in the communication steps accompanying job evaluation installations.

#### Relationship between Job Evaluation and Job

##### Analysis

Job evaluation is the output provided by job analysis. As seen earlier, Job analysis describes the duties of a job, authority relationships, skills required, conditions of work, and additional relevant information. Job evaluation on the other hand, uses the information in job analysis to evaluate each job valuing its components and ascertaining relative job worth. It involves, in other words, a formal and systematic comparison of jobs in order to determine the worth of one job relative to another, so that a wage or salary hierarchy results. So it is a process by which jobs in an organisation are evaluated.

When jobs are evaluated, the relative worth of a given collection of duties and responsibilities to the organisation is assessed. This process is adopted to help a management to maintain high levels of employee productivity and employee satisfaction.

If job values are not properly studied, it is very likely that jobs would not be properly realized, i.e, high valued jobs may receive less pay than low-valued jobs.

When employees realise that this **is** happening, they become dissatisfied. They may leave the organisation, reduce their efforts or perhaps adopt other modes of behaviour detrimental to the organisation.

Therefore, in modern society, a great deal of attention is paid to the value of a job. What a particular job should be paid is greatly influenced by the value of judgement about the worth of a job. In other words, a person is paid for what he brings to a job his education, training and experience provided that these are related to the requirements of the job which he is assigned.

##### Summary

The discussion in this chapter showed that the development of a wage structure is the result of a number of influences. These factors vary from ones over which management has a great deal of control to ones in which management must simply be responsive.

Given the variety of influences, it is also not likely that organizations will always be able to develop optimum structures and that current structures will need adapting in the future.

While the economics of the labor market is a major consideration, it is not the only determinant to influence the design of wage structures. Most organizations also must consider labor-cost ratios, product market competition, and union demands, when determining their wage structure.

Furthermore, many labor markets are abstractions that do not provide a close fit for an organization's jobs or wage-paying ability.

Wage structures have to do with the internal alignment of jobs in a wage hierarchy. To do this there must be a hierarchy or structure of jobs within the organization. Determining the

internal job structure is the task of job evaluation. This process compares jobs, not people, in terms of a set of criteria, called compensable factors, to establish the job hierarchy.

Job evaluation is a major tool that organizations use to make job comparisons when determining the relative equity of jobs within the organization. In job evaluation there is an interesting conflict.

On one hand, like wage surveys, this process requires technical expertise of a compensation professional. On the other hand, acceptability of job evaluation results relies on the perceptions of management and workers so that their participation would seem to be a necessity in job evaluation.

### Tutorial Activity 1.2

#### HR Managers and Employee Expectations

Competence mapping, **job evaluation** and classification, reward systems management and performance. These two case studies are good indication of the nature of HR .

India as a country is less systems-driven and more relationship-driven. Consequently every employee has high expectations from the HR department. However, due to their administration-heavy roles, HR managers are unable to meet the needs of some or several employees, and land up displeasing many, says TV Rao.

Today in India and in other Asian countries, there are plenty of HR or HRD managers. They inhabit every corner of an organisation. Even a small-scale industry nowadays thinks of HR manager. Organisational life without them seems incomplete. In the IT sector, it is almost a norm to have one HR manager for every 50 IT professionals.

In one of the audits of an IT company, the author found that there were 11 HR managers to handle 300 IT staff.

They were all assigned to 30 IT professionals each. Their job descriptions have indicated that they should socialise every new recruit, mentor them, explain to them the detailed process of their work, performance appraisal, reward system and keep in touch with them so as to enable them to contribute their best. Fresh graduates from the schools of social work were recruited and placed as HR managers. The audit revealed that they are hated most by the IT professionals of the company.

They were considered inaccessible, unsympathetic, putting hurdles all the time, lacking an understanding of IT basics, insensitive to trends in the changing pattern of compensation and excessively concerned with monitoring the performance of new recruits.

#### Shrinking Roles

While the number of HR managers have grown disproportionately in the last few years, their knowledge-base has remained very poor. Their credibility has shrunk, along with their roles and in some cases they have become power brokers. Some of the relatively good HR managers have saved their image by restricting themselves to training and organisation development. Those in charge of performance appraisals have also suffered a great deal of image bashing, as they could not satisfy most line managers who thought they are excellent performers. In the last decade with globalisation and economic

liberalisation, Industrial Relations (IR) jobs have become redundant.

As a result, most organisations have diverted a large number of their IR managers to the HR side as HR managers. Thus, there is a new breed of HR managers in some organisations trying to find out how they can do an HRD-oriented IR. Competence mapping, job evaluation and classification, reward systems management and performance appraisal and training have become the preoccupation of many of them. They were ill prepared for this jump. Outsourcing came to their rescue and they kept themselves busy, trying to find out agencies to whom they can outsource compensation surveys, employee satisfaction surveys, organisational climate surveys, etc.

#### Results of surveys

There are very few scientific studies available on HRD managers of today. The author has been involved in the HRD audit of several companies. The following descriptions taken from some leading industries of India depict the situation.

One of the organisations, which employs nearly 16 HRD staff, was examined. The HRD department is separate from the personnel administration and industrial relations departments of the company, which have 30-odd staff. The 16 HRD staff examined were found to have the following profile:

An average age of 44 years with about a third of them over 50 years of age. Imagine the nature of qualifications they had acquired 25 years ago when no HRD existed. None of them had any professional qualification in HRD. Two of them had qualifications in personnel management and four were trained in training and development. Put together, they had experience as shown in the table.

They have, in all, attended a total of 171 training programmes in the last five years, accounting for about 556 man days' training. A few of them did not attend any programme after joining the company. Of the 556 man-days of training, only 45 man-days dealt with HRD-related themes. Only three of them were found to be members of appropriate professional bodies in HRD.

The line managers of this company, however, felt that the importance given to HRD function by the top management is very high. 66 percent rated this as very high.

In another study of a professionally managed company, a total of 11 staff manned the corporate personnel function. They included four senior managers at general manager/deputy general manager level.

The chief of personnel was estimated to spend less than 29 percent of his total time on HRD activities. Only two of them had professional qualifications in HR. The only area where they had a reasonable degree of proficiency was found to be in performance management.

This is a clear indication of the gross neglect of the HRD function. This case study is a good indication of the nature of HR and some common areas HRD managers are weak in.

## LESSON 16: NATURE AND OBJECTIVES OF JOB EVALUATION

### Case Study

Alpha Co. Ltd. was started about a decade-ago. The location of the plant was based on its present and future requirements. The optimum conditions for this company could be spotted only in an isolated place and hence the plant was situated in a quiet rural area far away from any industrial belt. The nature of process is such that workers are subject to only indirect supervision. Therefore, the final output of the company is dependent on the integrity of individual employees.

The plant has a total work-force of about 2,600. Of this, five per cent managerial, five per cent supervisory, and the rest are workmen and office staff. The bulk of the workers are from the neighboring area of the plant. Since many of the employees had no industrial background, they were given pre-job training before being put on their jobs. The turnover of employees is very low. The majority of the workers have been with the company since its inception.

The company has four major divisions: Production, Services, Laboratory, and Administration. In production, there are four sections concerned with the process or the stage of production. In Services, there are four sections: Mechanical, Maintenance and Workshop, Civil, Electrical and Fluids. Administration consists of Personnel Marketing, Purchase and Stores. The Managing Director is the Chief Executive of the company to whom the heads of the division report directly. Executive decisions are made on the advice of the heads of divisions.

### Job Evaluation Study and Wage Survey

Some employees in Service Department felt that they were not being paid commensurate with the skills required for their jobs, and hence started an agitation. Till then, there was no union worth mentioning in the plant. There was one union, but it did not have any activities nor any sizable membership. Subsequent to the agitation in the Services Department, a new union emerged. It was being led by the workers of the Production Department. It submitted a charter of demands to the management demanding, inter alia, equal wages for 'equal jobs'; according to it, many of the skilled jobs were being paid wages applicable to unskilled jobs. The Managing Director suggested that any wage structure without a scientific basis would not help anybody. The union accepted the suggestion and asked him to formulate an internal wage structure. Both the union and the management agreed to have a wage structure based on work study and job evaluation.

Accordingly, they submitted a Memorandum of Settlement under Section 12(3) of the Industrial Disputes Act, 1947, to the Government Labour Officer, according to which the management was to engage a consultancy agency to carry out manpower studies, work study, job evaluation, and a wage survey. It also envisaged that an interim payment would be

given to certain categories of employees pending the consultancy agency. Then the company engaged a consultancy agency. The consultants, before they started the studies, had a meeting with the union and the management at which the following points were agreed to:

1. The consultants would carry out studies of job evaluation and wage survey for all workers, office staff, and supervisory personnel: These would be preceded by a study to ascertain the optimum manpower required by the company.
2. The union and the management would give full cooperation to the consultants.
3. There would be no retrenchment of staff nor any reduction in the present emoluments, while implementing the consultants' recommendations.
4. The management would implement the recommendations of the consultants in to:

The consultants took up the job evaluation, study and submitted their report within a year. The report was discussed between the union and the management, and both parties accepted the recommendations on a new wage structure.

### Highlights of the Study

1. The study cost the company about Rs. 5 lakh.
2. The number of salary levels went up from the existing 10 to 17.
3. Some of the jobs which were rated higher were evaluated to be lower; some jobs were evaluated to be higher and some jobs retained the same evaluation.
4. While there was a general pay increase for the majority of the jobs, it was not uniform; nor there was increase in all the cases. The study revealed that most of the jobs in the company were not very much underpaid.
5. Job descriptions of most of the jobs were found not to be correct.

The management started to implement the consultant's recommendations. At the implementation stage many problems had to be solved. The job positions, according to the consultants, had to be different from the existing ones in terms of their relative worth. Seniority being the underlying principle, it was not acceptable to anyone that a junior man should be paid more than his senior. In fact, the rules of the company did not allow for this. Retaining the people in the jobs they were doing before the implementation of the recommendations would have meant disturbing the principle of seniority by allowing a junior to get a higher wage than his senior.

Hence it was decided "not to adopt the policy of 'as is where is' placement of men on jobs. It was decided to place employees in a common category of jobs on the basis of their seniority in order that the senior most in that category would get the highest job whether or not he fulfilled the requirements



of the : An agreement was reached between the recognised union and the management to implement the report in full. In the meantime, a section of the employees, particularly those in the Laboratory and some in the Production Department, whose job after evaluation had gone down in ranking, expressed doubts about the validity of the report. This dissatisfaction gradually gained momentum. Some of the leaders of the recognized union who had signed the agreement for the study of job evaluation also joined the dissatisfied group. They deserted the recognised union and jointed the other union which was ignored all along. Thus, the minority union gained strength with the addition of the dissatisfied workers to its ranks. It started propagating among the workers against the new wage str4ucture. Then every emplo9yee started to compare what benefits others got under the new wage structure. Each union wanted to establish its supremacy and brought pressure on the management to achieve its own needs. The unions also felt that the support of the ruling party would help them in achieving their goal. Therefore, they made feverish attempts to get the ruling political party interested in them. The recognised union succeeded in its efforts. But while one faction of the union demanded the immediate implementation of the new wage scales another faction wanted its revision. This resulted in severe interunion rivalry.

In view of the Memorandum of Settlement filed with the Government Conciliation Officer, the new wage structure had got to be implemented. If it was implemented, the restlessness of the dissatisfied section of the employees would incre3ase. A general wage increase for all employees was also not possible because the employees who would derive benefit from the new wage structure would come up with representations that the other employees whose wages were rated low were also being paid on par with them, and therefore, they should be paid more to maintain the differential. If this were agreed to, the other section of the workers would agitate for further increase. Thus, the whole idea of having a rational wage structure had fallen into a vicious circle.

### Questions

1. Identify the main issue in this case.
2. What should have been the policy of management in regard to wage and salary administration?

Does job evaluation help in determination of an equitable and fair wage structure?

### Notes

## LESSON 17:

### PRINCIPLES AND PROCEDURE OF JOB EVALUATION PROGRAM

#### Learning Objectives

- To learn the Principles of Job Evaluation
- To understand the Concept of Job Evaluation procedure
- To learn the Sequential procedure of Job Evaluation

There are certain broad principles, which should be kept in mind before putting the job evaluation programme into practice. These principles are:

- (i) Rate the job and not the man. Each element should be rated on the basis of what the job itself requires. .
- (ii) The elements selected for rating purposes should be easily explainable in terms and as few in number as will cover the necessary requisites for every job without any overlapping.
- (iii) The elements should be clearly defined and properly selected.
- (iv) Any job rating plan must be sold to foremen and employees. The success in selling it will depend on a clear-cut explanation and illustration of the plan.
- (v) Foremen should participate in the rating of jobs in their own departments.
- (vi) Maximum co-operation can be obtained from employees when they themselves have an opportunity to discuss job ratings.
- (vii) In talking to foremen and employees, any discussion of money value should be avoided. Only point values and degrees of each element should be discussed.
- (viii) Too many occupational wages should not be established. It would be unwise to adopt an occupational wage for each total of point values.

#### Lets discuss the Procedure of Job Evaluation

After studying the principles of job Evaluation it is important to know the process and procedures involved in job evaluation, it is useful at this point to understand the steps in the process.

The first step is a study of the jobs in the organization. Through job analysis, information on job content is obtained, together with an appreciation of worker requirements for successful performance of the job. This information is recorded in the precise, consistent language of a job description.

The second step is deciding what the organization “is paying for”-that is, what factor or factors place one job at a higher level in the job hierarchy than another. These compensable factors are the yardsticks used to determine the relative position of jobs.

In a sense, choosing compensable factors is the heart of job evaluation. Not only do these factors place jobs in the organization’s job hierarchy, but they also serve to inform job incumbents which contributions are rewarded.

The third step in job evaluation is to select a method of appraising the organization’s jobs according to the factor(s) chosen. The method should permit consistent placement of jobs containing more of the factors higher in the job hierarchy than jobs involving lesser amounts.

The fourth step is comparing jobs to develop a job structure. This involves choosing and assigning decision makers, reaching and recording decisions, and setting up the job hierarchy.

The final step is pricing the job structure to arrive at a wage structure. Strictly speaking, this step is not part of job evaluation. As seen earlier in this chapter, many wage structure determinants are used by organizations. The job structure is only one of these.

This view of job evaluation implies that its major purpose is to classify jobs and establish a job hierarchy based on job content. Other perspectives are that job evaluation

(1) links external and internal markets, and

(2) is a process used to gain consensus and acceptance of a pay structure.

Perhaps these views could all be accommodated by the recognition that job structures and wage structures are separate concepts and that the relationship between them is a decision that varies among organizations.

#### Significance of Job Evaluation

Job evaluation is a valuable technique in the hands of management by which a more rational and consistent (Internal and external) wage and salary structure can be evolved. Internal consistency is concerned with the maintenance of relative wages within the firm and external consistency refers to a desired relativity of a firm’s structure to that of the industry or region. It helps in bringing or maintaining harmonious relations between labour and management since it tends to eliminate wage and equalities within the organization and the industry. It standardizes the process of determining the wage differentials for various jobs. It means uniform standards will be applied to all jobs in the organization to know their relative worth. It provides a rate for the job and not for the men because of division of labour and specialization any large enterprise may have hundreds or thousands of different jobs to be performed by a substantial no of workers. Many workers work together on the same or technically interdependent jobs. An attempt should be made to precisely define the jobs and fix wages accordingly. This is possible only by job evaluation. It helps in keeping down the cost of recruitment and selection of workers. It also assists in retaining the workers or keeping down the rate of labour turnover because workers wages are determined systematically by the process of job evaluation.

#### Basic Procedure of job evaluation

The basic procedure of job evaluation is to compare the content of jobs in relation to one another, in terms of their skills or

responsibility or some other requirement. The job contents may be decided upon in two ways, i.e.,

Either by making an intuitive “overview” i.e., by deciding that one job is “more important” than another, and not going any deeper in why - in terms of specific job-related factors; or by comparing one job to another by focusing on certain ‘basic factors’, which may be common in each job.

Such factors are called compensable factors - which determine the definition of job content; that determine how the jobs compare to each other; and they also help determine the compensation paid for each job.

The organisation might develop its own compensable factors or use those factors adopted by others. For example, the “Equal Pay for Equal Work Act” (in USA) focuses on four factors: skills, efforts, responsibility and working conditions.

While some other system (say Hay system in the States) focuses on know-how, problem solving and accountability. Often several basic factors are chosen initially and then subdivided into sub-factors. For example, refer to the following table

Table 1.1

Universal Factors	Sub-factors	No. of Degrees
Knowledge	Education	8
	Experience	8
	Skill	8
Problem-Solving	Interpretation	8
	Compliance	8
	Communication	8
Decision-Making	Interpersonal	8
	Managerial	8
	Asset	8

When compensable factors are available, jobs can be evaluated more systematically. Each job is compared with all the others using the same factors, sub-factors, and number of degrees. Sometimes job specifications are based on these factors, stating the “human requirements” of the job in terms of compensable factors like education, skills problem solving, and decision-making.

In India, the National Institute of Personnel Management, has laid down the following steps which should be taken to install a job evaluation programme:

#### 1. Analyse and Prepare Job Description

This requires the preparation of a job description and also an analysis of job requirements for successful performance.

#### 2. Select and Prepare a Job Evaluation Plan

This means that a job must be broken down into its component parts i.e., it should involve the selection of factors, elements needed for the performance of all jobs for which

money is paid, determining their value and preparing written instructions for evaluation.

#### 3. Classify Jobs

This requires grouping for arranging jobs in a correct sequence in terms of value to the firm, and relating them to the money terms in order to ascertain their relative value.

#### 4. Install the Programme

This involves explaining it to employees and putting it into operation.

#### 5. Maintain the Programme

Jobs cannot continue without updating new jobs and job changes in obedience to changing conditions and situations.

### Case Study

#### Point System For Skilled Jobs

A point, said the shop foreman, but I simply can't hire or hold skilled personnel with these rates. Have referred to the rates based on the straight wage line fitted to the point values and wage rates on a dozen key jobs. The new rates had been in effect only a short time. They were established, following job evaluation, on a unilateral basis by the employer. The wage line raised many job rates in the shop, but it reduced those at the top.

The job evaluation program was undertaken to provide a basis for a sound wage structure through out the shop. It was conducted by an interdepartmental committee. Comparisons of earlier rates with wage survey data had indicated that the old structure was not in line with those of an industry. The new wages line was keyed to rates shown in the survey.

Answer the following questions.

- What is the source of difficulty?
- Prepare a memorandum to the director of employee relations suggesting the alternative methods of correcting the deficiency

### Assignments

What is job evaluation? is it different from the job analysis?

#### Discuss

- Discuss the utility of job evaluation. with the help of the examples State the steps in job evaluation.
- “ job evaluation determines the worth of job and not job holder” examine this statement and explain the nature of job evaluation.

## LESSON 18:

### EXERCISE ON JOB EVALUATION

#### Exercise: Job Evaluation

In experimenting with different ways of producing floral arrangements, the Asbury Florist Corporation divided the job of floral designer into five jobs:

- (1) a stock man, who controls the order slip and assembles the flowers.
- (2) the assembler, who prepares the flowers by wiring and wrapping with Para film strips
- (3) the ribbon tier, who prepares bows and marline backing
- (4) the floral designer, who quickly arranges the curse flowers and attaches the ribbon and marline, and
- (5) the boxer, who places the corsage in a bag and box. These five persons would work in sequence along a table.

The organizational structure of the firm is as indicated in the accompanying chart. On the following pages are short job descriptions of the 14 separate jobs. Job descriptions were not made for commission sales personnel. The wage rates of these jobs are follows:

Position	Dollars per hours
Administrative officer	\$7.00
Assembler	3.40
Boxer	3.40
Delivery	3.90
chiefDriver	3.90
Floral designer	7.00
General manager	7.00
Industrial sales officer	Commission
Production supervisor	6.00
Ribbon tier	3.35
Sales control manager	Commission
Sales manager	7.00
Stock man	3.90
Wedding consultant	7.00

A wage survey was undertaken in the local market area for 3 of the 14 jobs. It was discovered that the current competitive rate for floral designers was \$7, for drivers, \$4.50, and for boxers, \$3.50. With the following job descriptions and this wage survey information, the firm is in a position to develop a job evaluation program.

I. Job title General Manager

II. Job Code: \_\_\_\_\_A\_\_\_\_\_

III. Number employed : One

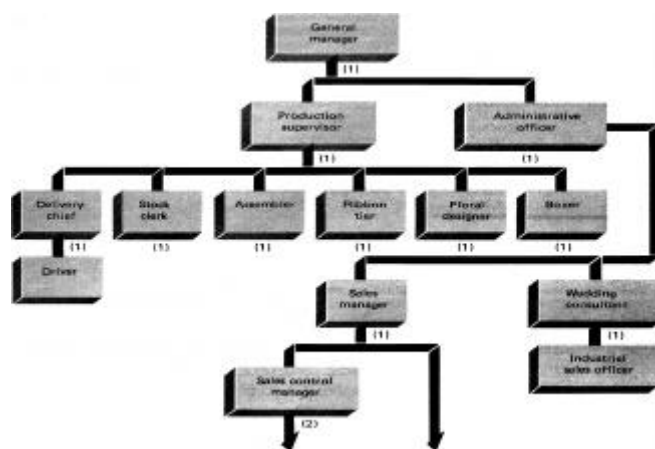
IV. Date : June 30, 1982

V. Location: Central Office, Asbury Florist, Inc.

VI. Job summary: Plans, organizes, controls, and coordinates the activities of the entire firm within limits established by the board of directors.

#### VII. Duties A Daily

1. Plans progress of business, new enterprises, business procedures, policies, and designs many of the necessary forms.
  2. Advises the administrative officer and wedding consultant on the preparation of sales promotional booklets and pamphlets.
  3. Organizes the entire company, assigns duties, and delegates authority. 4 Recruits, selects, and trains the managerial force.
  4. Reviews all recommendations for dismissal of employees.
  5. Approves or disapproves all buying expenditures of sales manager and the expenditures of the production supervisor for flowers in excess of \$100.
  6. Possesses final authority over expenditures under \$1,000.
  7. Handles personally selling accounts in excess of \$200.
  8. Supervises generally and consults daily with administrative officer and production supervisor.
  9. Spot-checks quality of production.
  - 10 Prepares retail price lists with the assistance of the production supervisor and administrative officer.
- B. Periodical: Prepares weekly report of progress of business to stockholders.
- C. Occasional: None.



VIII. Job-knowledge requirements: Order procedure, flower code, wholesale and retail prices, characteristics of floral trade, and characteristics of most of the available floral arrangements.

IX. Supervision given: Generally supervises administrative officer and production supervisor.

X Working conditions:

Vary. Office, production room, and travels.

**I Job title:** Sales. control manager

**II.**Job code: B

**III.**Number employed: Two

**IV.**Date: June 30, 1982

**V.**Location:Administrative and sales department

**VI.**Job summary: Selects, trains, supervises, and compensates a force of 15 to part-time commission salespersons.

**VII.**Duties

A Daily

**80 percent**

- 1 Selects and trains salespersons in own district.
2. Contacts salespersons regarding impending social affairs which they are to cover.
- 3 Transmits information to salespersons about price, product changes, and delivery.
- 4 Holds individual conferences with salespersons to train, orient, and inspire them to greater sales efforts.
- 5 Encourages salespersons to collect delinquent accounts.
- 6 Maintains a work sheet showing schedule and plans for all impending social affairs within district.

**B Periodical**

**15 percent**

- 1 Obtains settlement sheet of district sales and receipts from sales manager weekly, and discusses past week's activities.
- 2 Informs salespersons of delinquent accounts.
- 3 Receives commission weekly from administrative officer, from which the salespersons are paid the commission due them.

**C. Occasional: None.**

**VIII.J**

ob-knowledge requirements: Retail prices, flower code, flower characteristics, and delivery schedule.

**IX.**

Supervision given: Supervises generally 15 to 20 part-time commission sales persons.

Supervision received: Very general from sales manager.

X Working conditions:Vary.

**5 percent**

**I Job title:**

Floral designer

**II Job code:**

**C**

June 30, 1982

**III** Number employed:

**One**

**IV** Date:

**V Location:**

**Production department**

**VI.** Job summary: Designs and fashions bouquets, corsages, sprays, wreaths, and fancy floral designs, determining what flowers to use or using flowers requested by customer.

**VII.Duties**

A Daily

**5 percent 1**

Receives order slip from stock man and reads code to determine flower combination desired.

Receives flowers from assembler and arranges specified flower combination into a design which varies at the discretion of the designer. \* Selects ribbon and attaches maline backing.

Clips wire ends and passes order with order slip to boxer.

Advises and consults with sales manager, wedding consultant, and 70 percent

15 percent 5 percent 1 percent

3 4 5

- Examples of flower combinations are sprays, vases, wedding bouquets, fans, special and standard corsages, baskets, boutonnieres, wreaths, blankets, artificial trees, floats, coronet crowns, candelabras, and centerpieces.

**352 Compensation**

industrial sales officer concerning characteristics of various flower combinations.

B Periodical: None.

C Occasional

1 percent

1 Decorates church interiors for wedding.

2 percent

2 Makes short talks about floral design before various public groups.

1 percent

3 Dyes flowers for special purposes.

**VIII.** Tools and materials used: Table, wire cutters, flowers, maline, ribbon, wire,dye, baskets, vases, arborvitae, picks, moss, pots, water vials, and floral tape.

**IX.** Supervision given: None.

Supervision received: General from production supervisor.

Work received from: Assembler and stock clerk.

Work delivered to: Boxer.

X Working conditions:

Inside, artificial light, concrete floor, damp.

I. Job Title:Production supervisor

II Job code: D

III Number employed:One

IV Date: June 30, 1982

**V Location:**

**Production department**

**VI** Job summary: Plans, organizes, and controls the activities of the production department, purchases flowers, and maintains the stock records.

**VII Duties**

A Daily

**80 percent 1**

- 1 Receives order slips and route sheet from wedding consultant and gives route sheet to delivery chief.
- 2 Separates orders by date, delivery hour, type of flower, color, and combination, and places on control board.
- 3 Supervises and checks production operation and delivery for effectiveness and idleness and adjusts working hours to the work load.
- 4 Consults with general manager on plans for immediate future and reports progress.
- 5 Inspects for proper 'housekeeping' and examines product for quality from time to time.
- 6 Records, selects, and trains production department personnel and records their working time each day.
- 7 Supervises all maintenance work in the company.
- 8 Determines proper stock level for 50 varieties of flowers and calls personally or by telephone to one of several wholesalers to replenish stocks.
- 9 Purchases all production room supplies; is final authority on flower and supply orders not to exceed \$200.
- 10 Checks stock received from vendor against invoices and turns over invoices to administrative officer.

**5 percent**

11 Maintains stock record daily, showing amount received, amounts on hand, amount utilized, and scrap page.

B Periodical: None.

5 percent

C Occasional

**5 percent** 1 Plans layout of production room and arrangement of work places.

**5 percent** 2 Performs various types of maintenance work, such as painting, construction of tables, etc.

**VIII** Job-knowledge requirements: Current market prices of flowers, quality of flowers, flower characteristics of floral combinations, order procedure, production method, and flower code.

**IX** Supervision given: Supervises closely stock clerk, assembler, ribbon tier, and boxer.

Medium-delivery chief.

General-floral designer.

Supervision received: Rather general from general manager.

**X** Working conditions: Inside, concrete floor, artificial light, damp.

**I Job title:** Boxer

**II Job code:** E

**III Number employed:** One

**IV Date:** June 30, 1982

**V Location:**

**Production department**

**VI Job summary:** Receives flower combination from floral designer, water, and boxes, attaching order slip and cards.

**VII Duties****A Daily**

1 10 percent

2 20 percent

3 20 percent

sprays with

**10 percent 20 percent 19 percent**

Makes up boxes from flattened-out cardboard.

Lines interior of box with florist green wrapping papers.

Receives flowers from designer, and sprays with water using cotton squares if necessary.

4 Places flower combination into cellophane bag and/or box.

5 Places artificial green grass, personal card, and corsage pin in box.

6 Attaches address label, company label, and c.o.d. slip, if any, to box and passes to delivery chief with order slip.

**1 percent**

7 Assists in cleanup of production room.

B Periodical: None.

C Occasional: None.

**VIII** Tools and materials used: Table, water spray, boxes, paper, flowers, corsage pins, artificial grass, cellophane bags, cotton, personal cards, address labels, and company labels.

**IX** Supervision given: None.

Supervision received: Rather close from production supervisor.

Work received from: Floral designer.

Work delivered to: Delivery chief.

**X** Working conditions: Inside, concrete floor, damp, artificial light.

**I Job title:** Wedding consultant

**II Job code:** F

**III Number employed:** One

**IV Date:** June 30, 1982

**V Location:** Administrative and sales department

**VI Job summary:** Collects information of approaching weddings, makes contacts, and handles flower arrangements and procedure for entire wedding. Also performs general office work.

**VII Duties****A Daily**

65 percent 1

25 percent

1. Gleans information concerning future weddings from newspapers, salespersons, etc., and files.

2. Telephones brides and informs them of services offered and makes an appointment if possible.

3. Calls at home of bride to discuss wedding details.

4. Prepares a personal data card for each wedding.

- 5 Advises as to wedding gowns, colors, floral decorations, wedding procedure, etiquette, etc.
  - 6 Attends wedding to supervise arrangements.
  - 7 Receives flower orders from customers by telephone and from sales manager.
  - 8 Prepares c.o.d. slips, address labels, personal cards, and attaches to original copy of order, giving c.o.d. list to administrative officer.
  - 9 Delivers original copies to production supervisor and files duplicates.
  - 10 Receives original copies from production supervisor after delivery and checks against duplicates to guard against loss.
  - 11 Files duplicates in permanent file and sends originals to sales manager.
- 10 percent
- 12 Answers telephone.
- 13 Performs general office work, such as typing letters and filing.
- B Periodical: None.
- C Occasional: None.
- VIII.** Job-knowledge requirements: Order procedure, flower code, flower prices, wedding procedures, and flower characteristics of wedding work.
- IX.** Supervision given: General to industrial sales officer.
- Supervision received: Rather general from administrative officer. X Working conditions: Inside, office, agreeable.
- I Job title:** Assembler II Job code: G
- III** Number employed: One
- IV** Date: June 30, 1982
- V Location:** Production department
- VI** Job summary: Cuts, strips, passing to floral designer.
- VII** Duties A Daily
- 1 percent** 1 Receives flowers from stock clerk. wires, and Para films\* individual flowers before
- V4-in. strips lightly coated with paraffin.
- 20 percent
- 5 percent
- 35 percent
- 2 Breaks stems to 1 inch and strips leaves and outer petals.
- 3 Attaches one green leaf to roses only.
- 4 Wires flower by inserting wire through the calix, and bending to form substitute stem.
- 35 percent
- 5 Wraps Para film strips around calix and down around wire.
- 1 percent** 6 Passes flower on floral designer.
- 1 percent** 7 Makes up boxes of cut flowers lined with arborvitae or ferns.
- 1 percent** 8 Assists in cleanup and production room.
- B Periodical: None.
- C Occasional

- 1 percent** 1 Makes up maline backing by bunching an 8- by 6-inch piece of maline
- in the center and wiring.
- VIII** Tools and materials used: Table, wire cutters, scissors, flowers, green leaves, paraffin strips, wire, and maline.
- IX** Supervision given: None.
- Supervision received: Rather close from production supervisor.
- Work received from: Stock clerk.
- Work delivered to: Floral designer.
- X Working conditions: Inside, concrete floor, damp, artificial light.
- I Job title:** Driver II Job code: H
- III** Number employed: Two **IV** Date: June 30, 1982
- V Location:** Production department
- VI** Job summary: for c.o.d.s.
- VII** Duties A Daily
- 5 percent 1
- 10 percent 2
- 70 percent 3
- 5 percent 4
- Delivers flower orders to all parts of the city and collects money
- Receives load of orders and district assignment from delivery chief. Maps out a route from delivery addresses of load.
- Delivers orders and collects money for c.o.d.s.
- Checks in with delivery chief and turns over c.o.d. money or c.o.d. slip, depending upon whether or not the money was collected.
- B Periodical: None.
- C Occasional
- 10 percent** 1 Performs various types of maintenance work, such as painting, constructing tables and shelves, making flower gardens, etc., under the supervision of the production supervisor.
- VIII** Tools and materials used: Automobile or truck, simple maintenance tools, flower order, and money..
- IX** Supervision given: None.
- Supervision received: Medium from delivery chief and production supervisor. Work received from: Delivery chief.
- Work delivered to: Customers.
- X Working conditions: Outside, vary.
- 70 percent 2 Doubles ribbon into
- 7 or 8 loops and wires in the center to form a bow.
- 3 Places bows into boxes by color and stacks on ribbon table in the production room.
- 4 Makes up maline backing by bunching an 8- by 6-inch piece of maline in the center and wiring.
- 1 percent** S Assists in cleanup of production room.
- B Periodical: None.
- e Occasional
- 3 percent** 1 Paints floral baskets.

**VIII** Tools and material used: Scissors, table, ribbon, maline, wire, and boxes.

**IX** .Supervision given: None.

Supervision received: Rather close from production supervisor.

Work received from: Production supervisor.

Work delivered to: Floral designer via production ribbon table.

**X.** Working conditions: Inside, artificial light, concrete floor, damp.

5 percent

20 percent

**I. Job title:** Industrial sales officer

**II. Job code:** L

**III. Number employed:** One

**IV. Date:** June 30, 1982

**V. Location:** Administrative and sales department

**VI. Job summary:** Telephones officials of industrial firms and party organizers, solicits flower orders, and follows up with a form letter.

**VII. Duties**

**A Daily**

**85 percent 1**

2 Obtains names of industrial firms from telephone directory. Telephones officials of firms, introduces self and company, and informs them of special flower offers for industrial accounts.

3 Follows up first call with a form letter summarizing information given over the telephone.

4 Adds new firms as work load permits.

5. Telephones each firm on growing list once each month.

6 Maintains a file of calls made recording name, time, and type of response.

7 Drops firms from call list only upon instructions of wedding consultant.

8 Gleans information concerning parties, club meetings, and other social functions from daily newspapers.

9 Telephones organizers of social functions and solicits orders.

**B Periodical**

**1 percent 1** Receives and analyzes monthly report from sales manager on amount of sales to industrial accounts.

**C. Occasional: None.**

**14 percent**

**VIII** Job-knowledge requirements: and flower characteristics.

Flower prices, discounts to industrial concerns

**IX**Supervision given: None.

Supervision received: Rather general from wedding consultant.

**X** Working conditions: Inside, office, agreeable.

**I Job title:** Delivery chief

**II Job code:** M

**III** Number employed: One

**IV** Date: June 30, 1982

**V Location:** Production department

**VI** Job summary: Separates flower orders by location and time, assigns loads to drivers, supervises delivery, and checks collection of c.o.d.s.

**VII. Duties**

**A** Daily 85 percent 1

2 Receives orders from boxer and files order slip temporarily. Separates orders by district and delivery time and enters order number on route sheet by district of city with driver's name.

3 Assigns drivers to districts and dispatches with loads at the proper times.

4 Checks deliveries made against order slips with driver upon his return and collects money for c.o.d.s.

5 Turns over money order slips to administrative officer.

6 Returns orders not deliverable to production supervisor.

**B** Periodical: None. **C** Occasional

5 percent 1 Instructs drivers as to delivery procedure.

5 percent 2 Delivers orders.

1 percent 3 Assists boxer in making up cardboard boxes.

4 percent 4 Performs general maintenance work under production supervisor.

**III.** Tools and materials used: Order file, route sheet, automobile, flower orders, money, and general-maintenance tools.

**IX.** Supervision given: Rather general supervision of two drivers. Supervision received: Medium from production supervisor. Work delivered to: Drivers, administrative officer, and production supervisor.

**X** Working conditions: Inside, concrete floor, damp, artificial light.

**I Job title:** Administrative officer

**II. Job code:** N

**III** Number employed: One

**IV** Date: June 30, 1982

**V Location:** Administrative and sales department

**VI** Job summary: Handles all advertising, complaints of customers, office management, company payroll, all receipts and disbursements of cash, and special administrative tasks.

**II** Duties

**A** Daily

**"percent 1**

1. Prepares advertising copy for local newspapers.

2 Selects the advertising media.

3 Supervises the office force.

4 Receives c.o.d. list from wedding consultant and checks against cash or c.o.d. slips received from delivery chief.

5. Assists wedding consultant in order writing and checking against deliveries.





## LESSON 19: INTRODUCTION TO BASIC JOB EVALUATION METHODS/SYSTEMS & PACKAGED POINT PLANS

### Learning Objectives

- Introduction to Basic Evaluation Systems
- To know Four Basic, Traditional Systems of Job Evaluation

**There are four basic, Traditional systems/methods of job evaluation:**

- (1) The ranking system;
- (2) The grading or job classification system;
- (3) The point system; and
- (4) The factor comparison system.

The first two systems are popularly known as the non-analytical or non-quantitative or summary systems, because they utilize non-quantitative methods of listing jobs in order of difficulty and are, therefore, simple. The last two systems are called the analytical or quantitative systems, because they use quantitative techniques in listing the jobs. They are more complex and are time consuming.

**The principal differences between these methods reflect**

- (1) Consideration of the 'job as a whole,' versus consideration of 'comparable factors'; and
- (2) Judging and comparing jobs with each other rather than assigning numerical scores on a rating scale.

**The Plans commonly used today represent variations of these basic methods**

#### 1. The Ranking System

**Mechanism:** Under this system, all jobs are arranged or ranked in the order of their importance from the simplest to the hardest, or in the reverse order, each successive job being higher or lower than the previous one in the sequence. It is not necessary to have job descriptions, although they may be useful.

Sometimes, a series of grades or zones are established, and all the jobs in the organization are arranged into these. A more common practice is to arrange all the jobs according to their requirements by rating them and then to establish the group or classification.

The usually adopted technique is to rank jobs according to "the whole job" rather than a number of condensable factors.

According to this method, the ranking for a university may be like thus.

**Table 1.2**

#### Ranking of University Personnel

Ranking Order	Pay Scale Range
Professor	Rs.5000-8000
Associate Professors	Rs. 4000-7000
Assistant Professors	Rs.3500-6000

Registrar	Rs. 4000-7000
Dy. Registrar	Rs.3500-5000
Assistant Registrar	Rs. 3000-4500
Clerk Grade I	Rs. 1000-2500
Clerk Grade II	Rs. 900-1800
Class Four Servants	Rs. 500-800

After ranking, additional jobs between those already ranked may be assigned an appropriate place/wage rate.

Generally speaking, the following five steps are involved in system:

**Step 1:** Preparation of job description, particularly when the ranking of jobs is done by different individuals and there is a disagreement among them.

**Step 2:** Selection of Raters, jobs may be usually ranked by department or in "Clusters" (i.e., factory workers, clerical workers, menials, etc). This eliminates need for directly comparing factory jobs and clerical jobs. Most organizations use a committee of raters.

**Step 3:** Selection of rates and key jobs, usually a series of key jobs or bench-mark jobs (10 to 20 jobs, which include all major departments and functions) are first rated; then the other jobs are roughly compared with these key jobs to establish a rough rating.

**Step 4:** Ranking of all jobs. Each job is then compared in detail with other similar jobs to establish its exact rank in the scale. For this each rater may be given a set of 'index card,' each of which contains a brief description of a job.

These jobs are then ranked from 'lowest to highest' or from 'highest to the lowest' are ranked first and then the next highest and next lowest and so forth until all the cards have been ranked.

**Step 5:** Preparation of job classification from the rating: The total ranking is divided into an appropriate number of groups or classifications, usually 8 to 12. All the jobs within a single group or classification receive the same wage or range of rates.

The ranking system of job evaluation usually measures each job in comparison with other jobs in terms of the relative importance of the following five factors:

- Supervision and leadership of subordinates;
- Co-operation with associates outside the line of authority;
- Probability and consequences of errors (in terms of waste, damage to equipment, delays, complaints, confusion, spoilage of product, discrepancies, etc.);
- Minimum experience requirement; and
- Minimum education required;

### Merits

- (i) The system is simple, easily understood, and easy to explain to employees (or a union). Therefore, it is suitable for small organisations with clearly defined jobs.
- (ii) It is far less expensive to put into effect than other systems, and requires little effort for maintenance.
- (iii) It requires less time, fewer forms and less work, unless it is carried to a detailed used by company.

### Demerits

- (i) As there is no standard for an analysis of the whole job position, different bases of comparison between rates occur. The process is initially based on judgment and, therefore, tends to be influenced by a variety of personal biases.
- (ii) Specific job requirements (such as skill, effort and responsibility) are not normally analyzed separately. Often a rater's judgment is strongly influenced by present wage
- (iii) The system merely produces a job order and does not indicate to what extent more important than the one below it. It only gives us its rank or tells us that it is more or more difficult than another; but it does not indicate how much higher or more lit.

### 2. Job Classification or Grading Method

Under this system, a number of pre-determined grades or classifications are first established by a committee and then the various jobs are assigned within each grade or Grade descriptions are the result of the basic job information which is usually 'ed from a job analysis.

After formulating and studying job descriptions and job specifications, jobs are grouped into classes or grades which represent different pay levels ranging from low to high. Common tasks, responsibilities, knowledge and experience can identified by the process of job analysis. Certain jobs may then be grouped together a common grade or classification.

General grade descriptions are written for each classification, and finally these are used as a standard for assigning all the other jobs particular pay scale.

### Mechanism

The following five steps are generally involved:

- (i) The preparation of job descriptions, which gives us basic job information, usually derived from a job analysis.
- (ii) The preparation of grade descriptions, so that different levels or grades of jobs IY be identified. Each grade level must be distinct from the grade level adjacent to it; the same time, it should represent a typical step in a continuous way and not a big jump or gap.  
After establishing the grade level, each job is assigned to an appropriate grade level on the basis of the complexity of duties, non-supervisory responsibilities and provisory responsibilities.
- (iii) Selection of grades and' key jobs. About 10 to 20 jobs are selected, which elude all the major departments and functions and cover all the grades.

(iv) Grading the key jobs. Key jobs are assigned to an appropriate grade level and their relationship to each other studied.

- (v) Classification of all jobs. Jobs are classified by grade definitions. All the jobs in e same grade receive the same wage or range of rates. For example, menials may be put into one class; clerks in another; junior officers in a higher class; and the top executive in the top class.

Table 1.3 gives us the gradations of five classes designed by a title label and increasing in value.

**Table 1.3**

<b>Grades</b>	<b>Description of Job Classification</b>
Clerk Grade III	Pure routine concentration, speed and accuracy, works under supervision; may or may not be held responsible for supervision.
Clerk Grade II	No supervision by others, specially skilled for the job by having an exhaustive knowledge of the details.
Clerk Grade I	Must have the characteristics of a second class clerk and assume more responsibility.
Senior clerk	Technically varied work, occasionally independent thinking and action due to difficult work which require exceptional clerical ability and extensive knowledge of principles and fundamentals of the business of his department. Not charged with the supervision of others to any extent; works subject to a limited check; dependable, resourceful and able- to take decisions.
Head clerk	Those handling or capable of taking a major decision on the work they do; complicated work requiring much independent thinking; able to consider details outside the control.

### Merits

- (i) This method is simple to operate and understand, for it does not take much time or require technical help.
- (ii) The use of fully described job classes meets the need for employing systematic criteria in ordering jobs to their importance. Since many workers think of jobs in, or related to, clusters or groups, this method makes it easier for them to understand rankings.
- (iii) If an organization consists of 500 people holding to different jobs, the jobs might be broken up into perhaps 5 classes, arranged in order of importance from high to low, and described class by class. This class description broadly reflects level of education, mental skill, profit impact or some combination of these.

- (iv) The grouping of jobs into classifications makes pay determination problems administratively easier to handle. Pay grades are determined for, and assigned to, all the job classification.
- (v) It is used in important government services and operates efficiently; but it is rarely used in an industry.

### Demerits

This system suffers from the following defects:

- (i) Although it represents an advance in accuracy over the ranking method, it still leaves much to be desired because personal evaluations by executives (unskilled in such work) establish the major classes, and determine into which classes each job should be placed.
- (ii) Since no detailed analysis of a job is done, the judgement in respect of a whole range of jobs may produce an incorrect classification.
- (iii) It is relatively difficult to write a grade description. The system becomes difficult to operate as the number of jobs increases.
- (iv) It is difficult to know how much of a job's rank is influenced by the man on the job.
- (v) The system is rather rigid and unsuitable for a large organisation or for very varied work.

### 3. The Points System

This method is the most widely used type of job evaluation plan. It requires identifying a number of compassable factors (i.e., various characteristics of jobs) and then determining degree to which each of these factors is present in the job.

A different of points is usually assigned for each degree of each factors. Once the degree factor is determined, the corresponding number of points of each factor are added and overall point value is obtained.

The point system is based on the assumption possible to assign points to respective factors which are essential for evaluating individual's job. The sum of these points gives us an index of the relative significance of the jobs that are rated.

### Mechanism

This system requires a detailed examination of the jobs. The steps in this method followed are:

**Step 1:** The jobs have to be determined first which are to be evaluated.

They are clustered. The jobs which require:

- (i) similar activities,
- (ii) the same workers characteristics or traits (corresponding machines, tools, materials and instruments) and n the same kind of material (say wood or metal are placed in the same cluster or family. Gonyea and Lunneborg have clustered 22 occupations in five groups, based 11m on factors in five groups.

**Table 1.4**

Clustering of 22 Occupations on the basis of Common Factors in Five Groups(after Gonyea and Lunneborg)

A – Business group	Includes buyer, office manager, personnel manager, interior decorator, Insurance salesman, accountant, and secretary.
B- Masculine group	Includes aviator, automobile mechanics, surveyor, radio operator, policeman and engineer.
C- Aesthetic Group	Artist, writer, interior decorator.
D- Service group	Policeman, social worker, lawyer, physician, personnel counsellor.
E – Scientific Group	Medical lab technician, chemist, physician, engineer, auto mechanic and wire less operator.

**Step 2:** For the purpose, a pre-determined number of factors are arbitrarily selected by raters. The number of factors used varies a great deal from company to company, ranging from as few as 3 to as many as 50, although most companies use less than 15.

Sometimes, only three factors Gob conditions, physical ability and mental requirements) be used. Another company may use 4 factors (skill, effort, responsibility and job conditions). As far as possible, the factors selected are such as are common to all the jobs.

The common factors are: Education and training; experience; physical skills and t; planning for the supervision of others; external contacts, internal contacts; confidential information and working conditions.

Moreover, the factors which overlap in their meaning avoided and factors which are unique and relative to each other described in terms of varying degrees. They should also be so defined and described that everyone associated with the plan gets the same meaning of the words that are used.

**Step 3:** The next step is to break down each factor into degrees or levels, and to assign a point value to each level or degree. For example, experience, which is one of the most commonly used job factors, may be sub-divided into 5 degrees.

The first degree, three months or less may be assigned 5 points; the second degree, 3 to 6 months, given 10 points, the third degree, 6 to 12 months, assigned 15 points; the fourth degree 1 to 3 years, assigned 20 points; and the fifth degree is over 3 years, and is assigned 25 points.

This same procedure is followed for each factor at each level or degree represented by an appropriate number of points. The point to note is that the major factors are assigned total points and that each of these factors is broken up into sub-groups (with written definitions for each), and these sub-groups are assigned points within the total established for the major group.

Le Tourneau has given an example of job work point rating scale.

### CHART 1.5

Some Items from the rating system developed by Le Tourneau with the scale values assigned to different factor (indicated by numbers)

Some Items from the rating system developed by Le Tourneau with the scale values assigned to different factor (indicated by numbers)						
Rated by..... Job ..... Department .....						Date... ..
Factor	Check the Correct Item for Each Factor					
I.	Education	College	High	Elem. Maths	Addl Subjects	Read & Write
	School	5	4	3	2	1
II.	Experience.	Over 12 Months	9 to 12 Months	6 to 9 Months	3 to 6 Months	1 to 3 Months
		12	12	9	6	3
III.	Learning Period	Over 3 yrs.	1 to 3 yrs.	6 months to 1 yr.	3 months to 6 months	1 to 3 months
		10	8	6	4	2
IV.	Mental Effort	Very High	High	Average	Below	Low/Slight
				Average		
		5	4	3	2	1
V.	Mechanical Ability	Very High	High	Average	Below	Slight
				Average		
		5	4	3	2	1
VI.	Physical	A,B,C,D	E,F,G	H,I,J	K,L	M
	Effort	10	8	6	4	2
VII.	Job Conditions	A	B,C	D,E	F,G	H,I
		10	8	6	4	2
VIII.	Hazards	Very High	High	Average	Below	Slight
		5	4	3	2	1
IX.	Responsibility	Over \$	\$ 25 M to \$ 10 M to	\$1 M to		Less
	Equipment	/----50 M	\$ 50 M	\$ 25 M	\$10M	\$ 1M
		5	4	3	2	1
x.	Responsibility	Over 16 Persons	11 to 15	6 to 10	2 to 5	1
			5	4	3	2
xI.	Responsibility	Over \$60M	\$25 M to \$ to	\$10 m to 25M	\$ 1M to \$10 M	Less \$ 1 M
		5	M 4	5	2	
XII.	Complexity	very High	High	Average	Below	Slight
		5	4	3	Average 2	1
XIII.	Effect on	very High	High	Average	Below	Slight
		5	4	3	Average 2	1
XIV.	Attention operations	toVery High	High	Average	Below	Slight
		5	4	3	Average 2	1
XV.	Know operation	otherVery High	High	Average	Below	Slight
		5	4	3	Average 2	1

Generally speaking, the four job factors common to the point method of job rating are skill, effort, responsibility and job conditions. The relative values of these are skill, 50 per cent; effort, 15 per cent; responsibility, 20 per cent; and job conditions, 15 per cent.

**Step 4:** Determination of relative values or weights to assign to each factor. For each job or cluster of jobs some factors are more important than others. For example, for executives, the “mental requirements” factor would carry more weight than

“physical requirements.” The opposite might be true of “factory jobs.”

**Step 5:** The next step is to assign money values to points. For this purpose, points are added to give the total value of a job; its value of a job; its value is then translated into, terms of money with a pre-determined formula.

Point Range	Hourly Basic Rate Range	Job Grade
101-150	Rs. 6 to 10	1
165-200	Rs. 8 to 12	2
201-250	Rs. 10 to 15	3
251-300	Rs. 15 to 20	4
301-350	Rs. 20 to 25	5
351-400	Rs. 25 to 30	6
401-450	Rs. 30 to 35	7
451-500	Rs. 35 to 45	8

Table 1.6 shows the job points translated into job rupees.

### “Packaged” point plans

Developing a point plan for an individual organization is a time-consuming process. Hence, often those evolved by famous groups (as in America) are adopted for use. These contain ready-made factor and degree definitions and point assignments for a wide range of jobs, which can be used with little or no modification.

One of the most widely accepted point systems in NMTA (National Metal Traders Association of the U.S.A.) utilizes the factors.

In the NMTA point system for hourly rated jobs, skill has been given 50 per cent weight age, responsibility 20 per cent and job conditions 15 per cent. Each factor has again been divided into sub-factors, and the points allotted to each factor as distributed among the sub-factors on the basis of their relative importance in job performance.

For example, the ‘skill’ factor has been assigned 250 points. Out of these, its sub-factors education, experience, initiative and ingenuity - have each been assigned 70, 110 and 40 points respectively. Moreover, measurement scales have been constructed which give points and definitions of the degree of particular factor. Thus, 70 points allocated to ‘education,’ have been spread over five degrees in an arithmetic progression of 14 points (Tables 1.7 and 1.8)

Table 1.7

**Job Elements and Degree Value Points Assigned to Each Factor and Key to Grades (for Machine Operators)**

Factors	No. of Points	1st Degree	2nd Degree	3rd Degree	4th Degree	5th Degree
1. Skill:	250					
(i) Education	70	14	28	42	56	70
(ii) Experience	110	22	44	66	88	110
(iii) Initiative and Ingenuity	70	14	28	42	56	70
2. Effort:	75					
(iv) . Physical demand	50	10	20	30	40	50
(v) Mental/ visual demand	25	5	10	15	20	25
3. Responsibility:	100					
(vi) Equipment/process	25	5	10	15	20	25
(vii) Material or product	25	5	10	15	20	25
(viii) Safety of others	25	5	10	15	20	25
(ix) Work of others	25	5	10	15	20	25
4. Job Conditions:						
(x) Working conditions	50	10	20	30	40	50
(xi) Hazards	25	5	10	15	20	50

Table 1.8

**Scale of Value for ‘Education’ Factor in NMTA Point System**

14	28	42	56	70
Read, write	Equivalent	Equivalent	Equivalent	Equivalent
add and	to 2 yrs	4 yrs	4 yrs H.S.	4 yrs
subtract	High School	H.S. +2	+4 Yrs	University
		to 3 yrs	Trade	Training
		Training	Training	

### Assignment

“ Job evaluation determines the worth of job and not of job holder” examine the statement and explain the nature of job evaluation.

## LESSON 20: JOB EVALUATION METHODS

### Learning Objectives

- To know the methods of job evaluation.

We have discussed the point system in the previous letter. To continue with the same here we will learn some sample factors commonly used in this method. We will also discuss about the factor comparison method.

### Sample definition of factors used in points system

#### i. Skill

- (acquired) Facility in muscular co-ordination, as in operating machines; repetitive Movements, careful co-ordination, dexterity, assembling, sorting etc.
- (acquired) Specific job knowledge necessary for the muscular co-ordination acquired by the performance of a job and not to be confused with general education or specialized knowledge. It is very largely training in the interpretation of sensory impressions.

#### Examples

- In operating an adding machine, the knowledge of which key to depress for a sub-total would be a skill.
- In automobile repairs, the ability to determine the significance of a certain knock in the motor would be a skill.
- In a hand firing boiler, the ability to determine from the appearance of the firebed how coal should be shovelled over the surface would be a skill.

Education relates to the schooling requirements, which are essential for a satisfactory Performance of the job.

The experience factor pertains to the extent of job training, which is necessary for I before he gains a satisfactory proficiency.

Initiatives and ingenuity appraise the independent action, exercise of judgment, the of decisions or the amount of planning that a job requires.

#### (ii) Effort

In some jobs, particularly factory and other manual work more physical efforts are while in higher jobs, more of mental requirements is a must.

#### A. Physical Requirements

Physical efforts; sitting, standing, walking, climbing, pulling, lifting; both the amount exercised and degree of continuity should be taken into account. :) Physical status, including age, height, weight, sex, strength and eye-sight.

#### B. Mental Requirements

Either the possession of and/or the active application of the following:

- (inherent) Mental traits, such as intelligence, memory, reasoning, facility for verbal expression, ability to get along with people and imagination.

- (acquired) General education, such as knowledge of grammar and arithmetic; general information as to sports, world events, etc.

- (acquired) Specialized knowledge such as chemistry, engineering, accounting, advertising, etc.

#### iii. Responsibility

The responsibility factor, for different items, measures responsibility for preventing damage to machinery or equipment which may result from error or negligence, and also measures the probability of damage to materials, parts in process or finished goods.

For raw materials, processed materials, tools, equipment and property.

For money or negotiable securities.

For profit or loss, savings or methods improved.

For public contacts.

For records.

For supervision.

- Primarily, it means the complexity of supervision given to subordinates; the number of subordinates is a secondary feature. Planning, direction, coordination, instruction, control and approval characterize this kind of supervision.
- The degree of supervision received. If jobs A & B gave no 'supervision to subordinates, but job A receives a much closer immediate supervision than B, then B would be entitled to a higher rating than A in the supervision factor.

To summaries the four degrees of supervision:

Highest degree	-	Gives much, gets less.
High degree	-	Gives more, gets much.
Low degree	-	Gives none, gets little.
Lowest degree	-	Gives none, get much.

#### iv. Working Conditions

The working conditions factor appraises the surroundings or physical conditions under which a job must be done and the extent to which such conditions make the job disagreeable.

Consideration will have to be given to the presence, relative amount and continuity of exposures to dust, dirt, heat, fumes, cold, noise, vibrations, wetness or other unpleasant conditions.

- Environmental influences, such as atmosphere, ventilation, illumination, noise, congestion, fellow-workers, etc.
- Hazards from the work or its surroundings.
- Hours.

Table 1.9 gives us the points assigned to the factors in National Office Managers'

Association Plan.

In the case of evaluation for managerial positions, the factors and sub-factors given in Table 1.10 have been used in a number of companies in the U.S.A

**Table 1.9**

**Points Assigned to the Factors in National Office Managers' Association Plan**

(1) Elemental - 250 points	
(2) Skill - 500 points	
(a) General of special education	160
(b) Training time on job	40
(c) Memory	40
(d) Analytical ability	95
(e) Personal contact	35
(f) Dexterity	80
(g) Accuracy	50
(3) Responsibility - 200 points	
(a) For company property	75
(b) For procedures	125
(c) Supervision	50
(4) Effort - physical work - 50 points	
a) Place of work	5
b) Cleanliness of work	5
c) Position	10
d) Continuity of work	15
e) Physical or mental strain	15

**Table 1.10**

**Factors and sub-factors used in Companies in the USA**

**i. Know-how**

Requirement of duties

Knowledge

Planning required

Mental application

Understanding required

**ii. Responsibilities**

Initiative

Accountability

For personal relations

For making policies

For policy interpretation

Administration

Original thinking

Creative ability

Managerial techniques

**iii. Relationships**

Supervision exercised

Demand for leadership

Influence on policy-making

Influence on method

**Table 1.11**

**In U.K., the Factors Used by Imperial Chemical Industries Ltd.**

Mental Requirement	Physical Strength
Working Conditions	Good memory
	Muscular strength

**a. Physical**

Ability to reason	stamina
vibration, position, agility	Speed of reaction
Even temperature.	Fumes, Small, sensory accuracy
Perseverance	Dust, Dirt, Acquired skills
Heat, Cold, Change and Knowledge	Mechanical sense
Initiative	Wetness, Clothing
& Equipment, poor Training	Education
Ability to visualize	Disparate attention
Sense of responsibility	Light Exposure
	Experience

**B.Mental:**

Noise, height, below Ground isolation,
Monotony, nervous
Tension, accident Risk
Disease Risk

In France, the factors used for job evaluation scheme for manual workers at Telemecanique Electric Plant, Nanterre, are:

**Table 1.12**

**I. Factors Common to all Jobs:**

1. Training
2. Adaptation
3. Difficulties of the Job
4. Physical Effort
5. Mental Tension
6. Job Risks
7. Discretion
8. Human Contacts within the Company
9. Human Contacts outside the Company

**II. Factors Special to Jobs Predominantly Manual:**

10. Responsibility for tools
11. Responsibility for products
12. Responsibility for the Safety of others

**III. Factors Special to Jobs Predominantly Intellectual:**

13. Responsibility for mistakes
14. Responsibility for judgment



**IV. Supplementary Factors for Management Jobs:**

15. Responsibility for authority
16. Human responsibility

**V. Factors Relating to Environmental Conditions:**

17. Factors of environment

Source: I.L.O. Job Evaluation

For German Democratic Republic and Federal Republic of Germany, the factors used are:

**Table 1.13**

1. Knowledge and experience	1. Training and experience
2. Mental effort	2. Skill, dexterity
3. Physical effort	3. Bodily strain
4. Responsibility for others	4. Mental strain
5. Responsibility for equipment	5. Nervous strain
6. Job conditions:	6. Responsibility
	7. Job Conditions:
(a) temperature	(a) temperature oil, grease, dirt,
(b) water, oil, grease, dust, etc	(b) dust dampness, etc.
(c) gas, acid, poison, etc	(c) accident hazards
(d) noise, glare, etc.	(d) gas, noise, cold, darkness, etc
(e) risk of accident	

**8. Unsupervised work.**

(Source: I.L.O. Ibid., pp. 137-139).

**Merits:** The system enjoys the following, merits:

- (1) It gives us a numerical basis for wage differentials; by analysis a job by factors it is usually possible to obtain a high measure of agreements on job value.
- (2) Once the scales are developed, they can be used for a long time.
- (3) Jobs can be easily placed in distinct -categories.
- (4) Definitions are written in terms applicable to the type of jobs being evaluated, and these can be understood by all.
- (5) Factors are rated by points which make it possible for one to be consistent in assigning money values to the total job points.
- (6) The workers' acceptance of the system is favorable because it is more systematic and objective than other job evaluation methods.
- (7) Prejudice and human judgment are minimized, i.e., the system cannot be easily manipulated.
- (8) It has the ability of handling a large number of jobs and enjoys stability as long as the factors remain relevant.

**The availability of a number of ready-made plans probably accounts for the wide points plans in job evaluation.**

**Demerits:** The drawbacks of the system are:

- (1) The development and installing of the system calls of heavy expenditure.

(2) The task of defining job factors and factor degrees is a time-consuming and difficult task.

(3) If many rates are used, considerable clerical work is entailed in recording and summarizing the rating scales.

(4) It is difficult to determine the factor levels within factors and assign values to them. It is difficult to explain to supervisors and employees. Workers find it difficult to fully comprehend the meaning of concepts and terms, such as factors, degrees and points.

In spite of these drawbacks, this system is used by most organizations because its greater accuracy possibly justifies the large expenditure of time and money.

**4. The Factor Comparison Method**

Under this system, jobs are evaluated by means of standard yardstick of value. It entails deciding which jobs have more of certain condensable factors than others.

Here analyst or the Evaluation Committee selects some 'key' or 'benchmark' jobs for which there are clearly understood job descriptions and counterparts in other organisations, and for which the pay rates are such as are agreed upon and are acceptable to both management and, labour.

Under this method, each job is ranked several times – once each condensable factor selected. For example, jobs may be ranked first in terms of factor 'skill.' Then, they are ranked according to their mental requirements. Next they ranked according to their 'responsibility,' and so forth. Then these ratings are combined for each job in an over-all numerical rating for the job.

**Mechanism:** The major steps in this system consist of the following:

**Step 1:** Clear-cut job descriptions are written and job specifications then developed.

Preferably in terms of condensable factors. The people writing job specifications are generally Provided with a set of definitions which have been used in each of the condensable factor selected.

**Usually five factors are used:**

- (1) Mental requirements,
- (2) Physical requirements;
- (3) Skill requirements;
- (4) Responsibility and
- (5) Working conditions.

These factors are universally considered to be components of all the jobs.

**Step 2:** Selecting of Key-Jobs: Such jobs are those jobs which represent the range of jobs under study; and for which pay is determined to be 'standard' or 'reference points' and for which there is no controversy between the management and the employees. These 'key' jobs serve as standards against which all other jobs are measured.

They are selected in such a way that they cover the range from the 'low' to the 'high' paid jobs. Besides, such jobs must be those on the pay of which analysts and executives do not disagree. Again, they should be definable in accurate and clear terms. Usually 10 to 30 jobs are picked up as 'key' jobs.

**Step 3: Ranking of 'Key' Jobs:** Several different members of the job Evaluation Committee rank the key jobs on each of the five factors (mental requirements, physical requirements, skill, responsibility, and working conditions). Ranking is made individually and then a meeting held to develop a consensus (among raters) on each job.

Mental requirements involve inherent mental trait (such as memory, intelligence, reasoning, ability to get acquired education, and acquired specialization of education or knowledge).

Physical Requirements consist of physical effort (climbing, pulling, walking and lifting); and physical conditions (age, height, weight, sex, eye-sight and strength); skill requirements are concerned with acquired facility in muscular co-ordination, assembling, sorting, and dexterity of fingers; and acquired job knowledge for an effective performance of the job.

Responsibility involves responsibility for raw and processed materials, tools, equipment and property; money securities; profit and loss; supervision; and maintenance of records.

Working Conditions include atmospheric conditions (illumination, ventilation, noise, congestion); hazards of work and its surroundings; and hours of work.

**Step 4: Valuing the Factors:** The basic pay for each 'key' job is allocated to each factor. Pay for such jobs should range from about the lowest to, at or near the highest, and there must be complete agreement on job selected. Usually, 15 to 20 jobs are chosen against which to evaluate all the other jobs.

**Step 5: Comparing all. Jobs with Key Jobs:** All the other jobs are then compared with the key jobs, factor by factor, to determine their relative importance and position in the scale of jobs, to determine also their money value.

This identical process is repeated for all the other factors. The pay rate assigned to a job is obtained by adding the determined amounts as indicated by the money values shown in the five scales that individually set a job money value in relative comparison to fixed key jobs.

**Step 6: Establishing the Monetary Unit Value for all Jobs:** Monetary values are assigned to each factor of every key job. This should reflect a range from the lowest to the highest.

**Table 1.14**  
**Factors used in a Typical System**

Cents per hour	Mental Requirement	Skill requirements	Physical requirement	Responsibility	Working conditions
200	Toolmaker*	Labourer			
180	Toolmaker		Electrician		
160			Toolmaker*	Inspector*	
140	Electrician*	Machinist		Toolmaker*	Toolmaker*
120	Machinist!	Electrician!	Machinist*		Inspection
100	Assembler!	Assembler!	Inspector	Machinist	Electrician
60	Inspector	Inspector	Assembler!	Electrician	Machinist!
50	Labourer!			Assembler!	Assembler!
25		Labourer!		Labourer!	Labourer!

The following example will clearly show how the system works: Suppose job E and job A are similar in skill (Rs. 3.00); job B in responsibility (Rs.85); job C in effort (Rs. 1.40); and job D in

working condition (Rs. 1.20); then its correct rate of pay will be Rs. 6.45, i.e., the sum total of all.

**Table 1.15**  
**Key Jobs, Job Factors and Correct Rates of Jobs**

Job factor	Job A correct Rate:Rs 20	Job B correct Rate:Rs 16	Job C correct Rate:Rs 14	Job D correct Rate:Rs 12	Job E correct Rate:Rs 24
1. Skill	10	8	7.50	5	11
2. Effort	5	3	4	4	6
3. Responsibility	3	1	1	1	4
4. Working Conditions	2	4	1.50	2	3

This system is usually used to evaluate white collar, professional and managerial positions.

### Merits

This system enjoys the following benefits:

- It is a systematic, quantifiable method for which detailed step by step instructions are available.
- Jobs are compared to other jobs to determine a relative value.
- It is a fairly easy system to explain to employees.
- There are no limits to the value which may be assigned to each factor.
- The plan does not require a translation from points to money. It involves a comparative process wherein jobs are priced against other jobs rather than against some established numerical scale.
- The reliability and validity of the system are -greater than the same statistical measures obtained from group standardized job analysis plans.
- The limited number of factors (usually 5) tends to reduce the possibility of overlapping and over-weighting of factors.

### Demerits

The system suffers from the following shortcomings:

- It is costly to install, and somewhat difficult to operate for anyone who is not acquainted with the general nature of job evaluation techniques.
- Wage levels change from time to time, and their minor inconsistencies may be adjusted to bring all the jobs into alignment. Jobs in which discrepancies are too wide are discarded as key jobs.
- Money rates, when used as a basis of rating, tend to influence the actual rate more than the abstract point.
- The system is complex and cannot be easily explained to, and understood by, every day non-supervisory organizational employee.
- The use of five factors is a growth of the technique developed by its originations. Yet using the same five factors for all organizations and for all jobs in an organization may not always be appropriate.

### Assignment

1. Explain point method of evaluation. Taking a sample position try to develop a point method for evaluating the job.
2. Write notes on the following:  
Factor comparison method.  
Job ranking
3. What is job grading? Discuss its procedure.

**Notes**

## LESSON 21: SUCCESS OF JOB EVALUATION

### Learning Objectives

- To know the Advantages of Job Evaluation
- To learn the Limitations of Job Evaluation
- To understand the Implementation of the Evaluated Job Structure
- To know the Suggestions for improving of the Job Evaluation Programs

### Essentials of success of Job Evaluation Programs

When it is finally decided to install a formal system of job evaluation irrespective which system is decided upon, the utmost care must be exercised to ensure that Human as well as technical aspects are taken into account.

In order that a job evaluation system works efficiently, it is necessary that all those to are concerned with job evaluation should be fully conversant with the techniques d implications of the different available systems. Otherwise, the chances of success are doubtful.

#### The following measures may be adopted

- (i) Supervisors should have full knowledge of the system. They should understand it, and be able to explain to their workers the purpose of the plan and how it works.  
They must accept the desirability of the plan, for if they are not convinced that it is useful, they will certainly not be able to convince the employees.
- (ii) Supervisors as a group should receive a thorough training in advance of the actual introduction of the plan to enable them to explain the policies, principles and procedures to anyone who wants to understand them.
- (iii) The management must give the widest publicity to every phase of the programme, utilizing employee publications, notice boards, departmental meetings and letters to employees' homes.
- (iv) Separate pay structures should be maintained for major groups of employees. For example, it would be difficult to work out a plan equally applicable to factory workers, office workers, salesmen, and departmental heads.  
The wages that are offered must be at or about the prevailing rate in order that there may be a successful competition for capable people.
- (v) Whatever plan or system is selected for each group will arouse some fears or apprehensions. To overcome these, the details of the administration of the plan should be as simple as possible, and the management should endeavor to involve a broad range of employees from a number of departments.

According to the findings of the International Relations Sections of the Princeton University, the following conditions are necessary for the successful operation of a job valuation programme:

- (a) It must be carefully established by ensuring that:
  - (i) The management's aims are clear to all concerned and that not only the manual workers but also all levels of supervision and management employees fully understand its implications; and
  - (ii) All the relevant internal and external factors have been taken into account in arriving at the final form of the scheme.
- (b) It must have the full approval and continued support and backing of the top management.
- (c) It must have obtained the acceptance of trade unions.
- (d) Adequate administrative control must be set up to ensure:
  - (i) a centralized coordination of the scheme;
  - (ii) the evaluation of new and changed jobs;
  - (iii) a proper control of individual rate ranges; and
  - (iv) the conduct of wage surveys to provide the necessary information about the intra-plant ranges.
- (e) The importance of factors, other than job content, in wage rate determination (employment market conditions, sex, wage differentials, geographical wage differentials, and the relative bargaining power of the management and the trade union) must be recognized and taken into consideration while launching a job evaluation programme.
- (f) Before launching a job evaluation programme, certain issues should be decided beforehand. There are:
  - (i) which category of employees are to be covered (i.e., whether hourly paid job or salaried job employees) and up to what range?
  - (ii) who will evaluate a job outside consultants or trade analysts or the personnel of the personnel department?
  - (iii) How will the employees be consulted in regard to the method of putting the programme through? and
  - (iv) does a proper atmosphere exist for launching of the programme?

### Advantages of Job Evaluation

Knowles and Thomson state that job evaluation is useful in eliminating many of the evils to which nearly all systems of wage and salary payments are subject. These are:

- (i) Payment of high wages and salaries of persons who hold jobs and positions not requiring great skill, effort and responsibilities;

- (ii) Paying beginners less than they are entitled to receive in terms of what is required of them;
- (iii) Giving a raise to persons whose performance does not justify the raise;
- (iv) Deciding rates of pay on the basis of seniority rather than ability;
- (v) Payment of widely varied wages and salary for the same or closely related jobs and positions; and
- (vi) Payment of unequal wages and salaries on the basis of race, sex, religion or political differences.

It may, however, be noted that a job evaluation system does not accomplish all the purpose; rather it facilitates them. Basically, it provides a systematic catalogue of the jobs in an organisation, which is indispensable for management purposes.

#### **I.L.O., Publication claims following advantages for job**

##### **Evaluation:**

- (i) Job evaluation is a logical and, to some extent, an objective method of ranking jobs relative to one another. It may help in removing inequalities in existing wage structures and in maintaining sound and consistent wage differentials in a plant or industry.
- (ii) In the case of new jobs, the method often facilitates fitting them into the existing wage structure.
- (iii) The method helps in removing grievances arising out of relative wages; and it improves labour-management relations and workers' morale. In providing a yardstick, by which workers' complaints or claims can be judged, the method simplifies discussion of wages to be explained and justified.
- (iv) The method replaces the many accidental factors, occurring in less systematic procedures, of wage bargaining by more impersonal and objective standards, thus establishing a clear basis for negotiations.
- (v) The method may lead to greater uniformity in wage rates, thus simplifying wage administration.
- (vi) The information collected in the process of job description and analysis may also be used for the improvement of selection, transfer and promotion procedures on the basis of comparative job requirements.
- (vii) Such information also reveals that workers are engaged in jobs requiring less skill and other qualities than they possess, thereby pointing to the possibility of making more efficient use of the plant's labour.

#### **Limitations of Job Evaluation**

These are:

- (i) Though many ways of applying the job evaluation techniques are available, rapid changes in technology and in the supply and demand of particular skills have given rise to problems of adjustment. These need to be probed.
- (ii) Substantial differences exist between job factors and the factors emphasised in the market. These differences are wider in cases in which the average pay offered by a company is

lower than that prevalent in other companies in the same industry or in the same geographical area.

- (iii) A job evaluation frequently favours groups different from those, which are favoured by the market. This is evident from the observations of Kerr and Fisher. They observe, "the jobs which tend to rate high as compared with the market are those of janitor, nurse and typist, while craft rates are relatively low. Weaker groups are better served by an evaluation plan than by the market; the former places the emphasis not on force but on equity.
- (iv) Job factors fluctuate because of changes in production technology, information system, and division of labour and such other factors. Therefore, the evaluation of a job today is made on the basis of job factors, and does not reflect the time job value in future. In other words, continuing attention and frequent evaluation of a job are essential.
- (v) Higher rates of pay for some jobs at the earlier stages than other jobs or the evaluation of a higher job higher in the organizational hierarchy at a lower rate than another job relatively lower in the organizational hierarchy often give rise to human relations problems and lead to grievances among those holding these jobs.
- (vi) When job evaluation is applied for the first time in any organization, it creates doubts and often fear in the minds of those whose jobs are being evaluated. It may also disrupt the existing social and psychological relationships.
- (vii) A large number of jobs are called red circle jobs. Some of these may be getting more and others less than the rate determined by job evaluation.
- (viii) Job evaluation takes a long time to install, requires specialized technical personnel, and may be costly.
- (ix) When job evaluation results in substantial changes in the existing wage structure, the possibility of implementing these changes in a relatively short period may be restricted by the financial limits within which the firm has to operate.

#### **Implementation of the Evaluated Job Structure**

The evaluated job structure has to be translated into a structure of wage rates. This depends upon:

- (i) The range of wages to be paid, i.e., what should be the maximum and minimum wages for the grade.
- (ii) Should there be any overlapping between pay ranges for adjacent pay grades? If so, by how much?
- (iii) How many grades should be used?
- (iv) On what basis will an individual employee be advanced in wages through the established pay range for the grade?

These issues are inter-related, and a change in any of these calls for a change in at least one or the other issue.

As far as the first issue is concerned, it may be noted that the difference between the maximum and the minimum is referred to as the 'wage range' or 'wage differential'.

While evaluating a wage structure, it should be seen that the range is not too high and that the job evaluated wage curve does not have too many deviations from the existing industry

wage line. This should be done to prevent the turnover of workers and avoid dissatisfaction amongst them.

A wage range can be made with or without an overlap. Theoretically, there should be no overlap because, in that case, an employee near the top of a lower grade gets higher wages than the employee in the higher grade. Too great an overlap may cause dissatisfaction amongst employees and minimize the rewards for superior performance.

However, though a too great overlap should be avoided, there should be some overlapping between the grades so that employees in the lower grades may, following an excellent performance, get higher wages than an employee working in a higher grade but showing a poor performance.

As regards the number of grades to be adopted in many wage structures, the accuracy may be secured up to six grades; 12 or more grades result in a higher accuracy. Generally, the number of grades considered are between 6 to 11. If more grades are adopted, the overlapping between them would be greater

### Suggestions for improving working of Job Evaluation

#### Programs

We suggest the following measures and steps for improving the working of evaluation programmes:

- (1) A job evaluation scheme should be chosen cautiously. It should be devised and administered with due regard to the conditions of the employment market, which cannot be ignored if the scheme is to be successful. It should, therefore, reflect those forces which are important in the market, e.g., relative supply of and demand for labour, bargaining power of the parties and job conditions.
- (2) The details of a scheme should be drawn up in such a way that they do not conflict with other provisions of a Collective Agreement such as, for example, seniority clauses and grievance procedure.
- (3) The scheme should be introduced on a plant-to-plant basis than applied to a whole industry. This is because it is difficult to standardize jobs throughout an industry unless the plants in it are so familiar that they can be treated as being virtually a single firm.
- (4) The scheme should be sold to all concerned and suggestions sought. If the workers in a plant are unionized, it is highly desirable that any scheme adopted should be agreed to and, if possible; developed jointly by the company and the trade unions.
- (5) It is of major importance that the number of job titles and classifications be kept to a minimum. If they are not, a scheme becomes too inflexible because of the narrow coverage of the job descriptions. Promotions within a grade become more serious. Moreover, workers tend to feel more insecure and cling to their present jobs because they may not have the qualifications for another job.
- (6) Any anticipated changes in methods should be carried out before a scheme is installed and all modifications in it should be resisted until it becomes fully established.
- (7) In preparing job descriptions it is a sound practice to emphasize in them the things which make one job different

from another rather than to find a comprehensive statement of all the duties of the jobs.

- (8) A scheme which provides for single rates and for definite ratios between the rates for classes of workers (A, B, C etc.) within a job grade is easier to administer than one which establishes rate ranges and has no fixed ratios.
- (9) A scheme is better administered by the Industrial Relations staff of a company than by the Industrial Engineers who may have developed it. The essence of successful administration of a scheme is flexibility, and this is better understood by those engaged in industrial relations work than by Industrial Engineers.
- (10) The better the state of industrial relations the easier it is to introduce a job evaluation scheme.

### Tutorial

#### Factors used in rating jobs

The factors usually considered in any rating procedure are education, training, experience, mental effort, physical effort, visual attention, initiative, responsibility, working conditions, and physical hazards. These factors are sub-divided into degrees - usually six; and points are allocated to these.

#### 1. Education

This factor appraises the educational background of an individual to determine whether he do the job satisfactorily.

**First Degree:** Ability to read, write and follow simple written or oral instructions.

**Second Degree:** Basic school education or its equivalent to do small arithmetical calculations involving addition, subtraction, division and multiplication of decimals and fractions.

**Third Degree:** High school education to determine knowledge of elementary accounting or general shop practice and manufacturing methods.

**Fourth Degree:** Intermediate education to determine the ability to understand and perform work calling for a knowledge of general engineering principles, commercial theory, principles of advanced drafting, knowledge of general accounting fundamentals and of complicated shop procedures and processes, etc.

**Fifth Degree:** Graduation to determine the ability to understand and perform work of a specialized or technical nature, knowledge of finance, business administration, chemistry, physics, journalism or any other technical or specialized field.

**Sixth Degree:** Post-graduate research experience in any technical or specialized field.

#### 2. Training

This factor appraises the period of training needed by an average individual to perform his efficiently.

First Degree: Upto 6 months;

Second Degree: 6 to 12 months;

Third Degree: 12 to 15 months;

Fourth Degree: 15 to 18 months;

Fifth Degree: 18 to 21 months;

Sixth Degree: Over 21 months.

### 3. Experience

This factor appraises the length of period needed by an average employee with a previously specified educational standard to be able to perform the job satisfactorily.

First Degree: Upto 3 months;

Second Degree: 3 to 6 months;

Third Degree: 6 months to 2 years;

Fourth Degree: 2 to 4 years;

Fifth Degree: 4 to 6 years;

Sixth Degree: Over 6 years.

### 4. Mental Efforts

This factor appraises the mental effort required of an individual to perform his job satisfactorily.

First Degree: Minimum mental effort required to do a simple rating job.

Second Degree: Some mental effort required.

Third Degree: Considerable mental effort needed.

Fourth Degree: Considerable organizing ability required.

Fifth Degree: Sustained and diversified mental effort required.

Sixth Degree: Sustained and diversified mental effort required, as also clarity "Of concepts and ideas.

### 5. Physical Efforts

This factor appraises the physical effort needed from an employee for a satisfactory performance of a job.

First Degree: Very light physical effort required.

Second Degree: Light physical effort required, as in an office job.

Third Degree: Continuous physical activity required.

Fourth Degree: Moderately heavy physical activity required.

Fifth Degree: Great physical effort to lift or push heavy objects.

Sixth Degree: Extremely arduous physical effort required.

### 6. Visual Attention

This factor appraises the extent and continuity of the visual attention needed on a job.

First Degree: Minimum visual attention required.

Second Degree: Ordinary visual attention required.

Third Degree: Fairly close attention required.

Fourth Degree: Close visual attention required to check the quality of products.

Sixth Degree: Extremely close work with intense and constant visual attention.

### 7. Initiative

This factor appraises the capacity for independent decision or action required of an individual.

**First Degree:** Elementary type of job. The employee receives detailed instructions and is expected to perform the job exactly, as indicated, without deviations.

**Second Degree:** Repetitive type. of job. Requires a close following of instructions and procedures.

**Third Degree:** Requires more frequent simple decisions on the part of the employee, but only when definite clear-cut precedents are available.

**Fourth Degree:** In addition to frequent simple decisions, the job calls for occasional decisions or actions following only general procedures in the absence of clear-cut procedures.

**Fifth Degree:** Difficult and complex type of job. Requires independent and original action to achieve the desired results.

**Sixth Degree:** Extremely difficult and complex type of job requiring independent and original action to achieve the desired results.

### 8. Responsibility

This factor appraises the responsibility, which goes with the job for preventing damage to tools, equipment or materials used in the performance of a job.

**First Degree:** Probable damage to tools up to Rs. 100 for an average mishap.

**Second Degree:** Probable damage to tools between Rs. 100 and Rs. 200.

**Third Degree:** Probable damage to tools between Rs. 200 to Rs. 500.

**Fourth Degree:** Probable damage to tools up to Rs. 5,000 per mishap.

**Fifth Degree:** Probable damage to tools, equipment and materials not to exceed Rs. 10,000 per mishap.

**Sixth Degree:** Probable damage exceeding Rs. 10,000 per mishap.

### 9. Working Conditions

This factor appraises the physical environment under which a job is performed. Physical environment includes heat, cold, dampness, darkness, glare, dust, fumes, noise, etc.

**First Degree:** Excellent working conditions.

**Second Degree:** Occasional exposure to dust or fumes.

**Third Degree:** Constant exposure to one or more unpleasant conditions.

**Fourth Degree:** More disagreeable conditions.

**Fifth Degree:** Continuous exposure to disagreeable conditions.

**Sixth Degree:** Continuous exposure to various intensely disagreeable conditions.

### 10. Physical Hazards

This factor appraises the accident or health hazards, which exist even though safety devices have been installed.

**First Degree:** No hazard exists.

**Second Degree:** Minor injuries may be sustained if an accident takes place.

**Third Degree:** If an accident takes place, an employee would receive severe cuts or burns. Fourth

**Sixth Degree:** If an accident takes place, the employee is more likely to be killed or permanently injured by injuries.

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## LESSON 22: OBJECTIVES, ROLE, IMPORTANCE OF REWARDS AND INCENTIVES

### Learning Objectives

- To know the Meaning of Rewards and Incentives
- To know the Features of the Incentive Plans
- To understand the Determinants of Incentives

### Meaning of Rewards and Incentives

An 'incentive' or 'reward' can be anything that attracts a employees' attention and stimulates him to work. In the words of Burack and Smith, "An incentive scheme is a plan or programme to motivate individual or group performance. An incentive programme is most frequently built on monetary rewards {incentive pay or monetary bonus}, but may also include a variety of non-monetary rewards or prizes."

On the other hand, French says, the term "incentive system has a limited meaning that excludes many kinds of inducements offered to people to perform work, or to work up to or beyond acceptable standards.

It does not include:

- (i) wage and salary payments and merit pay;
- (ii) over-time payments, pay for holiday work or differential according to shifts, i.e., all payments which could be considered incentives to perform work at undesirable times; and
- (iii) premium pay for performing danger tasks. It is related with wage payment plans which tie wages directly or indirectly to standards of productivity or to the profitability of the organization or to both criteria."

The use of incentives assumes that people's actions are related to their skills and ability to achieve important longer-run goals. Even though many organizations, by choice, or tradition or contract, allocate rewards on non-performance criteria, rewards should be regarded as a "payoff" for performance.

### An Incentive Plan has the following Important Features:

1. An incentive plan may consist of both 'monetary' and 'non-monetary' elements. Mixed elements can provide the diversity needed to match the needs of individual employees.
2. The timing, accuracy and frequency of incentives are the very basis of a successful incentive plans.
3. The plan requires that it should be properly communicated to the employees to encourage individual performance, provide feedback and encourage redirection.

### Determinants of Incentives

These features are contingencies, which affect the suitability and design of incentives to varying degrees. The effective use of incentives depends on three variables - the individual, work situation, and incentive plan.

### i and iii. The Individual and the Incentives:

Different people value things differently. Enlightened managers realize that all people do not attach the same value to monetary incentives, bonuses, prizes or trips. Employees view these things differently because of age, marital status, economic need and future objectives.

However, even though employee reaction to incentives varies greatly, incentives must have some redeeming merits. For example, there might be a number of monetary and non-monetary incentive programmes to motivate employees. Money, gift certificates, praises, or merit pay are of the continuous parade of promotions.

### ii. The Work Situation

This is made up of four important elements:

- (a) Technology, machine or work system, if speed of equipment operation can be varied, it can establish range of the incentive.
- (b) Satisfying job assignments, a workers' job may incorporate a number of activities that he finds satisfying. Incentives may take the form of earned time-off, greater flexibility in hours worked, extended vacation time and other privileges that an individual values.
- (c) Feedback, a worker needs to be able to see the connection between his work and rewards. These responses provide important reinforcement.
- (d) Equity, worker considers fairness or reasonableness as part of the exchange for his work.

Incentives, in general, are important motivators. Their effectiveness depends upon three factors: drives, preference value, and, satisfying value of the goal objects. Misra says: "Beyond subsistence level, becoming needs (self-actualization needs) possess greater preference value and are more satisfying than deficiency needs (which are necessary for survival).

Below the subsistence level, however, the reverse holds true."

He makes the following generalizations:

- (i) Incentives, whether they are monetary or non-monetary, tend to increase the level of motivation in a person.
- (ii) Financial incentives relate more effectively with basic motivation or deficiency needs.
- (iii) Non-financial incentives are linked more closely with higher motivation, or becoming needs.
- (iv) The higher the position of a person in an organization's hierarchy, the greater is his vulnerability to non-financial incentives.

"While budgetary restrictions and temporary improvements in performance place a limit on the potency of money as a motivator, non-financial incentives involve only human

ingenuity as investment and also insure a relatively stable acceleration in output.

Monetary incentive imply external motivation, non-monetary incentives involve internal motivation. Both are important. It is a judicious mix-up of the two that tends to cement incentives with motivation."

## Tutorial Activity

### Objectives, Expectations, Rewards

By E. A. Winning

"Motivation comes from within: the only thing that a manager or management can do is to provide an atmosphere in which the individual can be motivated."

Since 1968 I have used a modified Management by Objectives (MBO) process, as opposed to a program, to generate the communications necessary in achieving results desired and stated by various structured and healthy companies.

MBO has primarily been used as a tool for individuals to make the process successful, and these employees want to know what good it's going to do for them by following what could become an unwieldy procedure. As I asked in a 1974 article about MBO, "what's in it for the individual?"

Many organizations that have implemented management by objectives have assumed that achievement of objectives is motivating for the employee, but this assumption has been the downfall of many MBO programs.

An awkward number of individuals still ask, "What's in this for me?" For that reason, I believe that management by objectives is not a motivator unless it is linked to a reward system. This will appear contrary to many managers to whom I've told over the years that you cannot motivate an employee.

Motivation comes from within: the only thing that a manager or management can do is to provide an atmosphere in which the individual can be motivated, hence, the rewards which I'll address in this chapter.

The rationale of organizations adopting MBO is this: Achievement is a motivator; meeting objectives is achievement; therefore, meeting objectives is a motivator — something satisfying to a person. The problem lies with defining achievement and motivation. In their dictionary of psychological and psychoanalytical terms (no longer in print), English and English defined achievement as "success in bringing and effort to a desired end."

In this case, just who is stating what the desired end is? Usually, it is the organization, the company, the manager; even when the individual has a say in the definition of the goal, it is external to that person. And achievement has quite a different base from motivation, which English and English describe as "the general name for the fact that an organism's acts are partly determined in direction and strength by its own nature...and/or internal state."

What is motivating to an individual is, then, determined by the individual. What is achievement to an individual is shaped by external forces - the supervisor, the company, for example. And how does the individual know he has achieved? He may have a sense of achievement, but it is the external reward for attaining

the desired end that overtly tells him that others recognize his achievement - an essential condition to his internal motivation.

In other words, objectives setting without tangible rewards is MBO in a vacuum. Rewards are tangible things by which the employee can measure whether or not, and how much, he has achieved, "grown," and been recognized. Motivation depends on how well an individual's needs are met.

If achievement is one of those needs, the employee may be motivated by his own sense of achievement, but if his sense of achievement depends on confirmation by the rewards he receives for meeting objectives, then he will need the rewards, both as a confirmation and as a device to measure how well he has achieved.

To put it a little more simply, if an individual has the need to achieve something and he accomplishes that something, he will be motivated. However, if he is told to do something, set dates for reaching objectives, and he does what he was "supposed to do" in a timely fashion, then unless he is rewarded, there is no inherent motivation in reaching the goal.

In other words, even with mutually agreed upon goals, the employee must receive a raise, a private office, a company car, a bonus (ugh...but that's later), or a pat on the back, the latter probably the only "true" motivator.

What is needed is a greater incentive for the individual to set and meet objectives, to be fully involved in MBO as a process. MBO is usually thought of as a program, and a program has a beginning and an end. The fact that most MBO programs do have an end - die a natural death - may point to the underlying flaw in hypotheses companies have about management by objectives and what the employee will attain from them.

The incentive should meet the individual's needs, the driving forces that propel (motivate) an employee toward a goal that is most often self-centered, rather than company-oriented.

Because motivation is internal, it is difficult to ascertain, but achievement is external to the individual, and achievement can be measured.

Although I don't believe that a primary goal of MBO was to measure achievement, it can certainly be used to do so. By itself, it may satisfy only the company's needs. It aids in planning and control.

It helps in assessing productivity, costs, overhead, and so on. If it doesn't satisfy the individual's needs, however, in the long run MBO won't work for the organization either. MBO with a reward system is a viable approach to meeting corporate and individual needs, to meeting terms of the employer-employee "psychological contract."

In an MBO/Rewards System, What Rewards?

There are, of course, a number of incentive or reward plans, the success of which is dependent on the type of organization involved. One of these incentive systems, piecework or commission, predates MBO in its present form by a century. Another, the bonus, goes back at least as far as Bob Cratchit's Christmas turkey.

Last, we have a percentage system; it may be a percentage of salary increase based on merit (i.e., productivity), or a percentage based on sales, or profits.

The idea behind piecework was to get the employee to produce more by paying him in terms of the number of items he produced. It is still a common practice, especially in textile, electronics, and other assembly line industries. The commission, one step above piecework, is usually paid in sales areas, the sales person reaping a percentage of the sales he has generated. One step further is, of course, salary-plus-commission. These three (two-and-one-half?) systems have one common underpinning: the individual is rewarded, or paid, according to his own productivity.

Is the piecework or commission system a good one? To the extent that both have at times excluded other motivational factors, no. To the extent that both place the responsibility for productivity on the individual, yes. The individual sets his own pace and in doing so has set certain objectives within corporate standards to be met.

Both systems are MBO approaches without being labeled as such. Further, piecework and commissions standards are relatively contractual in favor of the employer, thereby making it easier to either reward the employee or dismissing him fairly.

The bonus is probably the oldest form of incentive system and has been popular at upper-management levels for the past 20 years. The bonus is usually based on the individual's present salary, his status in the organization, his productivity, and/or the company's profit picture.

It is an incentive, but it loses much of its motivational impact because it is too far separated in time from performance, or it may be given across-the-board without regard for individual productivity. Moreover, its impact is limited; it does not reach far enough down into the company to affect the middle- or lower-level employee.

The lower-level employee who gets no bonus feels that he is doing the "real" work, while upper-management reaps a percentage of the profits the employee has been instrumental in attaining. If such is the case, why should the lower-level employee write objectives and try to meet them? He may do it because he has been told to, but he will really want to write and meet objectives only if there is something in it for him, a tangible reward when the goal has been reached.

If the bonus is given once a year, then how does one sustain the momentum to reach the desired goal? Perhaps the bonus will have to be a large one, or perhaps it should be given out several times a year - for instance, at the end of every objectives-review period. If a bonus system is used, it should be related to objectives and based upon productivity. For that matter, all incentives should be based on productivity, or value to the company.

If bonuses are handed out across-the-board, they will satisfy only a few, and may actually de-motivate those who feel that they have been more productive than others who are receiving the same reward.

Some of the defects of a bonus system may be avoided in a percentage system, which, all in all, is probably the most palatable and most productive when combined with MBO. The percentage of salary would be entirely an individual matter. The employee's performance, and only his performance, would be the basis for such a reward. His performance would be measured by how well he met the objectives he was committed to and had "contracted" for with his supervisor.

Since objectives can be set for anyone at any level in the company, all employees could benefit from such a program. Moreover, since a manager is supposed to be in control of his organization and his subordinates' reaching or not reaching their objectives will reflect on his abilities, it is a fair system to use in both the evaluation of the manager's performance and his reward.

A percentage increase of salary can be seen as a type of bonus, but it is more specific and does not have some of the drawbacks of other bonus systems. It is related only to the individual's performance and on what he has agreed to attain, and the distance-in-time objection can be eliminated if it is tied to fairly short-term objectives, if, for example, objectives are set on a quarterly basis, and percentage increases are given (or not given) at those intervals.

### **The Problems of an MBO/Rewards System**

There is no question that there are negative aspects in all incentive systems, and they are complicated by problems inherent in MBO (which, I hope I made clear is not a panacea for all rewards and motivational problems).

The first question that comes up is that of the negative incentive, the reduction in salary or the loss of a bonus because the employee hasn't met objectives. In theory, if an employee is to be rewarded for meeting objectives, then there should be a reduction or withdrawal of the reward for not meeting them.

Years ago, I felt that the system should bend to some extent so that effort toward meeting objectives should be rewarded, at least minimally. In keeping with the loftier principle of never confusing effort with results, I must retrench.

If the employee's performance is based solely on meeting or not meeting objectives, then effort would mean nothing. However, employees are evaluated on a number of criteria, and therefore effort is only one of the factors involved.

There are still some who would go so far as to give an individual a decrease in salary depending on the degree to which objectives were missed, and in an "entrepreneurial" context, this might be acceptable: If the individual has total control over his environment, the staffing, the budget, and the way the organization operated, like the self-employed business person, he should expect to reap the profits, but he should also expect to take any loss too.

Setting objectives is a tricky business, however. Control of conditions is difficult enough at upper levels and sometimes nonexistent at lower ones. Aside from the external determinants of productivity - the market, raw materials, and the like - much of an individual's achievement may be contingent on that of others inside his company.

If a reduction in salary were to be imposed, in part because of factors he could not control, the employer's reaction to MBO/Rewards would become evident in a number of ways: He would set easily attainable goals; he would argue that no objective can be counted on as being attainable in present-day circumstances; he would set objectives having due dates months past the times when they can be achieved; he might reduce the number of objectives; or he might just plain balk.

**Overcoming the Drawbacks in an MBO/Rewards System:** Assuming that an MBO/Rewards system is decided on (and certainly not as the sole evaluation/rewards system), how can these problems be solved? First, as is customary in MBO, objectives are set by the supervisor and employee together to reflect the unit or corporate objectives.

Ultimately, it's the boss' responsibility to see that objectives are reasonable and feasible, with dates that are neither too far off or too close, and that the number of objectives is realistic.

Second, the number of objectives, their timing, and their rationale should be open to later negotiation and adjustment. Since it is difficult to fix objectives because of the control factor, the objectives should be flexible; the MBO process should allow for the changing of objectives that are "too easy," but he should not agree to too-difficult objectives, either.

To sum up, the points made here are these: MBO without an incentive program is a system without sound foundation. The individual is self-centered and needs a reward in order to meet management's expectations of him. There are three types of incentive systems that may work along with MBO and make MBO a stronger tool. The positive aspects of MBO/Rewards outweigh the negative. The negative aspects can be handled.

A crucial step in the MBO process is the discussion between supervisor and subordinate in setting objectives, a discussion that should include both the definition of responsibilities and a definition of expectations. Expectations are more than objectives. They are statements of desired behavior of both supervisor and subordinate.

While the supervisor has expectations of the employee in terms of productivity and performance, the employee has expectations of the supervisor in terms of direction, support, training, and so on. If he is to achieve objectives that are aligned with corporate or department goals, then he must be given the opportunity to explain what he needs from his supervisor in order to meet those goals.

And the expectation of the company that he will meet those goals will be considerably more realistic if the employee himself has the expectation of a tangible reward if he does meet them. "What's there in it for me?" is a very human question.

## Notes

## LESSON 23: IMPORTANCE OF REWARDS AND INCENTIVES

### Learning Objective

- To understand the relation between money and motivation
- To know the financial rewards criteria

### Money and Motivation

The general theory of motivation described above has produced the following explanations of the relationship between money and motivation: the 'economic man' approach, Herzberg's two factor model, instrumental theory, equity theory and expectancy theory.

#### The 'Economic Man' Approach

According to this view, which is based on reinforcement theory, people are primarily motivated by economic rewards. It assumes that they will be motivated to work if rewards and penalties are tied directly to the results they achieve. Pay awards are contingent upon effective performance.

Motivation using this approach has been and still is widely adopted and can be successful in some circumstances. But it is based exclusively on a system of external controls and fails to recognize a number of other human needs. It also fails to appreciate the fact that the formal control system can be seriously affected by the informal relationship existing between employees.

#### Herzberg's two factor model

Herzberg's two factor model of motivation was developed following an analysis of anecdotes of unusually satisfying or unusually dissatisfying job events provided by 200 engineers and accountants. He claimed that money is a so-called 'hygiene factor' which serves as a potential dissatisfier if not present in appropriate amounts, but not as a potential satisfier or positive motivator. A further reason given by Herzberg for regarding salary as a 'hygiene factor', that is, a factor which prevents disease rather than promotes health, was because its impact on favorable feeling was largely short term, while its impact on unfavorable feelings was long term extending over periods of several months.

But, as Opsahl and Dunnette point out, Herzberg's argument that money acts as a potential dissatisfier is mystifying.

In all of the definitions of unusually good job feelings, salary was mentioned as a major reason for the feelings 19 per cent of the time. Of the unusually good feelings that lasted several months, salary was reported as a causal factor 22 per cent of the time; of the short-term feelings, it was a factor 5 per cent of the time. In contrast, salary was named as a major cause of unusually bad job feelings only 13 per cent of the time. Of the unusually bad job feelings lasting several months, it was mentioned only 18 per cent of the time (in contrast with the 22 per cent of long-term good feelings mentioned above).

They concluded that these data seem inconsistent with the interpretations and lend no substantial support to hypotheses of a so-called differential role for money in leading to job satisfaction or job dissatisfaction.

Herzberg's two factor model does not therefore provide a reliable basis for developing pay policies.

#### Instrumental Theory

This theory states that money provides the means to achieve ends. It is an instrument for gaining desired outcomes and its force will depend on two factors: first, the strength of the need and, second, the degree to which people are confident that their behaviour will earn the money they want to satisfy the need.

The instrumental role of money has been stressed by Gellerman,<sup>6</sup> who suggested that money in itself has no intrinsic meaning and acquires significant motivating power only when it comes to symbolize intangible goals. Money acts as a symbol in different ways for different persons, and for the same person at different times - a man's reaction to money 'summarizes his biography to date, his early economic environment, his competence training, the various non-financial motives he has acquired, and his current financial status'.

Money is therefore a powerful force because it is linked directly or indirectly to the satisfaction of all the basic needs. But the effectiveness of money as a motivator depends on a number of circumstances, including the values and needs of individuals and their preferences for different types of financial or non-financial rewards.

#### Equity Theory

Equity theory, as developed by Adams, argues that satisfaction with pay is related to perceptions about the ratio between what one receives from the job (outcomes in the form of pay) to what one puts into it (inputs in the form of effort and skill) compared with the ratios obtained by others.

Equity theory is related to discrepancy theory which, as stated by Lawler, indicates that satisfaction with pay depends on the difference between the pay people receive and what they feel they ought to receive. Equity theory, however, emphasizes that these feelings are based on comparisons.

The significance of equity was also emphasized by Jaques.<sup>9</sup> He stated that: 1) there exists 'an unrecognized system of norms of fair payment for any given level of work, unconscious knowledge of these norms being shared among the population engaged in employment'; and that 2) an individual is 'unconsciously aware of his own potential capacity for work, as well as the equitable pay level for that work'. Jacques called this the 'felt-fair' principle, which states that, to be equitable, pay must be felt to match the level of work and the capacity of the individual to do it.

## Application of Expectancy Theory

Expectancy theory as described earlier in this chapter, states that motivation will be strong if individuals can reasonably expect that their efforts and contributions will produce worthwhile rewards.

This theory was developed by Porter and Lawler into an expectancy model which suggests that there are two factors determining the effort people put into their jobs:

1. The values of the rewards to individuals in so far as they satisfy their needs for security, social esteem, autonomy, and self-actualization.
2. The probability that rewards depend on effort, as perceived by the individual - in other words, his or her expectations about the relationships between effort and reward.

Thus, the greater the value of a set of awards and the higher the probability that receiving each of these rewards depends upon effort, the greater the effort that will be put forth in a given situation.

But mere effort is not enough. It has to be effective effort if it is to produce the desired performance. The two variables additional to effort which affect task achievement are:

1. **Ability:** individual characteristics such as intelligence, manual skills and know-how;
2. **Role Perceptions:** what the individual wants to do or thinks he or she is required to do. These are good from the view 'Point of the organization if they correspond with what it thinks the individual ought to be doing. They are poor if the views of the individual and the organization do not coincide.'

## Conclusions on The Role of Money as a Motivator

Money is important to people because it is instrumental in satisfying a number of their most pressing needs. It is significant not only because of what they can buy with it but also as a highly tangible method of recognizing their worth, thus improving their self-esteem and gaining the esteem of others.

Pay is the key to attracting people to join an organization, although job interest, career opportunities and the reputation of the organization will also be factors. Satisfaction with pay amongst existing employees is mainly related to feelings about equity and fairness. External and internal comparisons will form the basis of these feelings, which will influence their desire to stay with the organization.

Pay can motivate. As a tangible means of recognizing achievement, pay can reinforce desirable behavior. Pay can also deliver messages on what the organization believes to be important. But to be effective, a pay-for performance system has to meet very stringent conditions as defined by expectancy theory. To achieve lasting motivation, attention has also to be paid to the non-financial motivators.

## Causes of satisfaction or dissatisfaction with pay

Reactions to reward policies and practices will depend largely on the values and needs of individuals and on their employment conditions. It is therefore dangerous to generalize about the causes of satisfaction or dissatisfaction.

However, it seems reasonable to believe that, as mentioned above, feelings about external and internal-equity (the 'felt-fair' principle) will strongly influence most people. Research by Porter and Lawler and others has also shown that higher paid employees are likely to be more satisfied with their rewards but the satisfaction resulting from a large pay increase may be short-lived. People tend to want more. 'In this respect, at least, the views of Herzberg have been supported by research.

Other factors which may affect satisfaction or dissatisfaction with pay include the degree to which:

- individuals feel their rate of pay or increase has been determined fairly;
- rewards are commensurate with the perceptions of individuals about their ability, contribution and value to the organization (Out this perception is likely to be founded on information or beliefs about what other people, inside and outside the organization, are paid);
- individuals are satisfied with other aspects of their employment - for example, their status, promotion prospects, opportunity to use and develop skills and relationships with their managers.

## Financial Rewards Criteria

The criteria for assessing the effectiveness of financial reward practices as means of motivation are that:

- they are, as far as possible, internally equitable as well as externally competitive (although there will always be a tension between these two criteria'- paying market rates may upset internal relativities);
- pay-for-performance systems are, created in the light of an understanding that direct motivation 'Only takes place if the rewards are worthwhile, if they are specifically related to fair, objective and appropriate performance measures: if employees understand what they have to achieve, and if their expectations on the likelihood of receiving the reward are high;
- employees understand how the financial reward system operates, how they benefit from it, and how the organization will help them to develop the skills and competences they need to receive the maximum benefit.

## Non-financial Rewards

Non-financial rewards can be focused on the needs most people have, although to different degrees, for achievement, recognition, responsibility, influence and personal growth.

## Achievement

Research carried out by McClelland of the needs of managerial staff resulted in the identification of three major needs, those for achievement, power and affiliation. The need for achievement is defined as the need for competitive success measured against a personal standard of excellence.

Achievement motivation can be increased by organizations through processes such as job design, performance management, and skill or competency-related pay schemes.

## Recognition

Recognition is one of the most powerful motivators. People need to know not only how well they have achieved their objectives or carried out their work but also that their achievements are appreciated.

Praise, however, should be given judiciously - it must be related to real achievements. And it is not the only form of recognition. Financial rewards, especially achievement bonuses awarded immediately after the event, are clearly symbols of recognition to which are attached tangible benefits, and this is an important way in which mutually reinforcing processes of financial and non-financial rewards can operate. There are other forms of recognition such as long service awards, status symbols of one kind or another, sabbaticals and work-related trips abroad, all of which can be part of the total reward process.

Recognition is also provided by managers who listen to and act upon the suggestions of their team members and, importantly, acknowledge their contribution. Other actions which provide recognition include promotion, allocation to a high-profile project, enlargement of the job to provide scope for more interesting and rewarding work, and various forms of status or esteem symbols.

The recognition processes in an organization can be integrated with financial rewards, through performance management and pay-for performance schemes. The importance of recognition can be defined 'as a key part of the value set of the organization and this would be reinforced by education, 'training and performance appraisals.

### **Responsibility**

People can be motivated by being given more responsibility for their own work. This is essentially what empowerment is about and is in line with the concept of intrinsic motivation based on the content of the job. It is also related to the fundamental concept that individuals are motivated when they are provided with the means to achieve their goals.

The characteristics required in jobs if they are to be intrinsically motivating are that first, individuals must receive meaningful feedback about their performance, preferably by evaluating their own performance. and defining the feedback they require, second, the job -must be perceived by individuals as requiring them to use abilities they value in order to perform the job effectively and third, individuals must feel that they have a high degree of self-control over setting their own goals and over defining the paths to these goals.

Providing motivation through increased responsibility is a matter of job design and the use of performance management processes. The philosophy behind motivating through responsibility was expressed as follows in McGregor's theory Y: 'The average human being learns, under proper conditions, not only to accept but also to seek responsibility.'

### **Influence**

People can be motivated by the drive to exert influence or to exercise power. McClelland's research established that alongside the need for achievement, the need for power was a prime motivating force for managers, although the need for 'affiliation', i.e. warm, friendly relationships with others, was

always present. The organization, through its policies for involvement, can provide motivation by putting people into situations where their views can be expressed, listened to and acted upon. This is another aspect of empowerment.

### **Personal growth**

In Maslow's hierarchy of needs, self-fulfillment or self-actualization is the highest need of all and is therefore the ultimate motivator. He defines self-fulfillment as 'the need to develop potentialities and skills, to become what one believes one is capable of becoming'.

Ambitious and determined people will seek and find these opportunities for themselves, although the organization needs to clarify the scope for growth and development it can provide (if it does not, they will go away and grow elsewhere).

Increasingly, however, individuals at all levels of organizations, whether or not they are eaten up by ambition, recognize the importance of continually upgrading their skills and of progressively developing their careers. This is the philosophy of continuous development. Many people now regard access to training as a key element in the overall reward package. The availability of learning opportunities, the selection of individuals for high prestige training courses and programmes and the emphasis placed by the organization on the acquisition of new skills as well as the enhancement of existing ones, can all act as powerful motivators.

### **Questions for Discussion**

1. Do you think that non-financial motivators can work more effectively when integrated with financial rewards in a total reward process?
2. Do you agree that the needs of individuals vary almost infinitely depending upon their psychological makeup, background, experience, occupation and position in the organization. Therefore it is dangerous to generalize about which mix of motivators is likely to be most effective in individual cases. Hence one cannot rely on nostrums such as performance-related pay, skill-based pay, job enrichment or performance management to work equally well for every person or in every organization. These processes need to be 'customized' to meet the needs of both the organization and the people who work there. But this customization will take place more effectively only if judicious use is made of achievement bonuses, pay increases related to the acquisition of specific skills and a performance management and reward process which concentrates on identifying individual needs and gaining the joint commitment of employees and their managers to satisfying them.

## LESSON 24: CLASSIFICATION OF REWARDS AND INCENTIVES

### Learning Objectives

Introduction to classification or types of Rewards

- To understand classification of Rewards or Incentives
- To understand Incentive Payments
- To learn classification of Incentive Schemes
- To know wage Incentives
- To learn the objectives of wage Incentive Schemes

### Introduction to Classification or Types of Rewards

As we all know that reward management is concerned with the development of appropriate organizational cultures, underpinning core values and increasing the motivation and commitment of employees. So now let us study below the classification or types of Incentives/Rewards.

### Classification of Rewards or Incentives

- (i) Direct compensation, and
- (ii) Indirect compensation.

Direct compensation includes the basic salary or wage that the individual is entitled to for his job, overtime-work and holiday premium, bonuses based on performance, profit sharing and opportunities to purchase stock options, etc.

Indirect compensation includes protection programmes (insurance plans, pensions), pay for time not worked, services and perquisites. But these are maintenance factors rather than reward components.

Since they are made available to all employees, irrespective of performance, they will tend to retain people in the organization but not stimulate them to greater effort and higher performance.

Sometimes, the rewards are also termed as 'Intrinsic' rewards and 'Extrinsic' rewards. The former are those that an individual receives for himself. They are largely a result of the job that the worker does.

The techniques of job enrichment, shorter work weeks, flexible work hours, project structures, and job rotation can offer intrinsic rewards through providing interesting and challenging jobs, and allowing the worker greater freedom.

On the other hand, the latter rewards refer to direct compensation, indirect compensation, and non-financial rewards.

Fig. 17.1 gives structure of rewards.

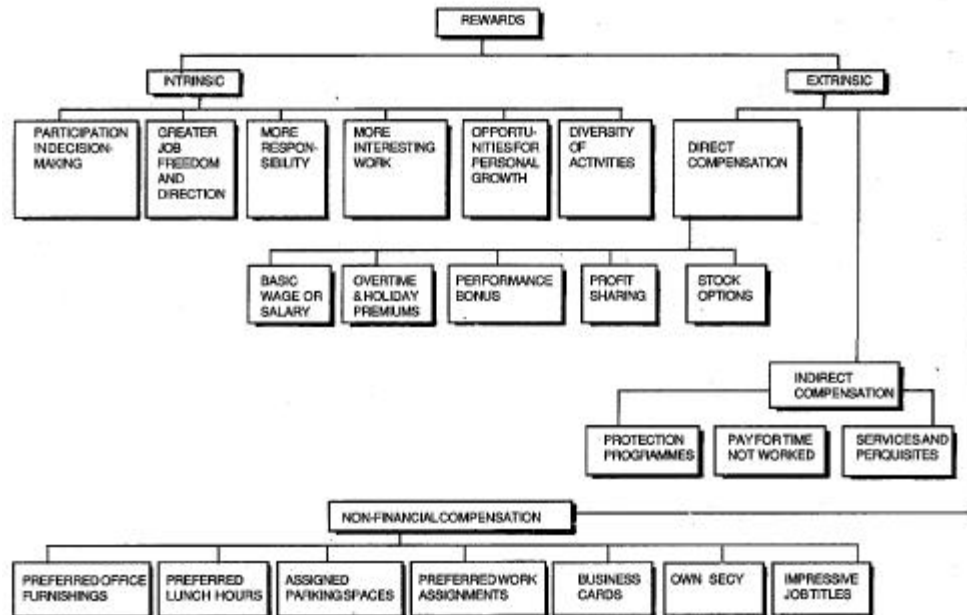


Fig. 17.1 Structure of Rewards

Controversy prevails over the issue of 'money' only motivates the individual. The supporters of the view say that money is potentially an effective motivation. For example:

"Money may potentially be an effective motivator, regardless of the level one has attained and the organization or the amount of money he is earning."

"Money does appear to have a good deal of symbolic value, and it does mean different people having differing biographies or backgrounds of training and experience."

"For some people, money can be instrumental in satisfying esteemed and recognition need as well basic physical needs. Motivating people with financial rewards is not a picker's game.

A company must be willing and able to give certain employees very large raises and/or bonuses if pay is to motivate performance. If a company cannot afford to do this, or is not willing to do so, it should probably forget about using pay to motivate performance."

"Pay in one form or another is certainly one of the main-springs of motivation in our society. The most evangelical



human relationist insists it is important while protesting that other things are too (and are perhaps in his view) nobler.

It would be unnecessary to belabor the point if it were not for a tendency for money drives to slip out of focus in a miasma of other values and other practices. As it is, it must be repeated: Pay is the most important single motivator used in our organized society”.

Contrary to these observations, Allen Port observes: “Money incentives alone do not bring the desired motivation. Employees in an industry are not ‘economic men’ so much as they are ‘ego men.’ What they want, above all else, is credit for work done, interesting tasks, appreciation, approval and congenial relations with their employers and fellow-workers. These satisfactions they want even more than high wages or job security.”

“Workers will normally respond to monetary incentives only to a certain point. Beyond that point money becomes ineffective as an inciter of action. This is for two reasons:

- (i) Money is not foreseen as having the ability to satisfy an urgent need.
- (ii) The worker may respond to money as a motivator if he believes the benefits will be greater than the expenses incurred by him. If the benefits perceived are less than the personal cost he will not respond to money as an incentive any further.

In effect, a break-even point is reached in which additional money earnings become marginal or even undesirable because of the efforts and conditions demanded to earn the added income.”

“Using money as a motivator may decrease intrinsic motivation. To use money and other extrinsic reward as effective motivators, they must be made contingent upon performance. “

It may be summed up that a more reasonable interpretation would be that intrinsic motivation is increased by money if two conditions are met:

- (i) The monetary reward closely follows performance so as to be reinforcing, and
- (ii) The monetary reward is perceived by the employee to be a function of his work behavior. Further, it may be fair to conclude that pay holds motivational properties. However, the issue is considerably more complex than merely stating “money motivates.”

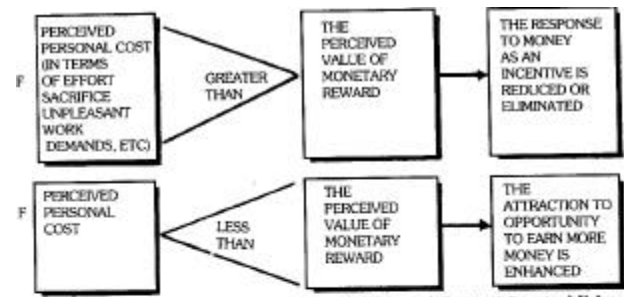


Fig. 17.2 Relationship between Perceived Personal Cost and Perceived Value of Obtained Monetary Rewards

perceived by the employee to be a function of his work behaviour. Further, it may be fair to conclude that pay holds motivational properties. However, the issue is considerably more complex than merely stating that “money motivates.”

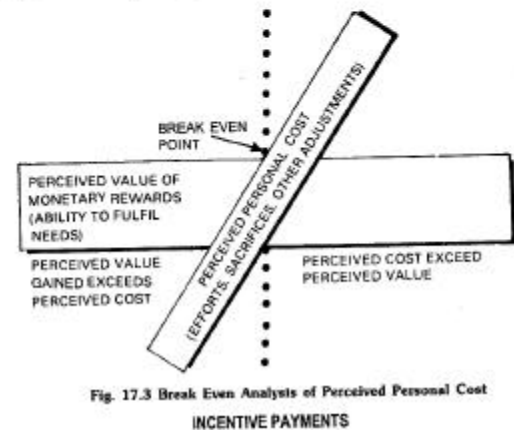


Fig. 17.3 Break Even Analysis of Perceived Personal Cost  
INCENTIVE PAYMENTS

### Fig. 17.3 Break Even Analysis of Perceived Personal Cost Incentive Payments

Incentives are monetary benefits paid to workmen in recognition of their outstanding performance. The “International labour organization (ILO) refers to incentives as “payment by results.” But it is appropriate to call them “incentive systems of payments” emphasizing the point of motivation, that is, the imparting of incentives to workers for higher production and productivity.

The primary advantage of incentives is the inducement and motivation for higher efficiency and greater output. But with fixed remuneration, it is difficult to motivate employees. Increased earnings would enable the employees to improve their standard of living and help the organization to improve their production capacity. They also help in reduced supervision, better utilization of equipment, reduced scrap, reduced lost time, reduced absenteeism and turnover and increased output.

### Classification of Incentive Schemes

It has been classified into four categories by ILO. They are mentioned below as:

- (1) Schemes in which earnings vary in proportion to output,
- (2) Schemes where earnings vary proportionately less than output,

- (3) Schemes where earnings vary proportionately more than output, and
- (4) Schemes where earnings differ at different levels of output.

### Wage Incentives

The term wage incentives has been used both in the restricted sense of participation and in the widest sense of financial motivation. It has been defined differently by different authors. We give below a few of these definitions.

“It is a term which refers to objectives in the external situation whose function is to increase or maintain, some already initiated activity, either in duration or in intensity.

“According to Hummel and Nickerson: “It refers to all the plans that provide extra pay for extra performance in addition to regular wages for a job. “Florence observes: “It refers to increased willingness as distinguished from capacity. Incentives do not create but only aim to increase the national momentum towards productivity.”

In the words of Scott, “it is any formal and announced programme under which the income of an individual, a small group, a plant work force or all the employees of a firm are partially or wholly related to some measure of productivity Output.”

According to the National Commission on Labour, “wage incentives are extra financial motivation. They are designed to stimulate human effort by rewarding the person, over and above the time rated remuneration, for improvements in the present or targeted results.”

“A wage incentive scheme is essentially a managerial device of increasing a worker’s productivity. Simultaneously, it is a method of sharing gains in productivity with workers by rewarding them financially for their increased rate of Output.”<sup>16</sup>

According to Suri, this definition is based on the principle that “an offer of additional money will motivate workers to work harder and more skillfully for a greater part of their working item, which will result in a stepped-up rate of Output.”<sup>16</sup>

We may define a wage incentive as a system of payment under which the amount payable to a person is linked with his output. Such a payment may also be called payment by results. The term incentive has gradually acquired a wide connotation and includes all the possible factors, besides economic gains, which can possibly motivate human beings towards better and greater performance.

### Objectives of Wage Incentive Schemes

Wage incentive schemes aim at the fulfillment of one or more of the following

#### Objectives

- (i) To improve the profit of a firm through a reduction in the unit costs of labour and materials or both;
- (ii) To avoid or minimize additional capital investment for the expansion of production capacity;
- (iii) To increase a worker’s earnings without dragging the firm into a higher wage rate structure regardless of productivity; and

- (iv) To use wage incentives as a useful tool for securing a better utilization of manpower, better production scheduling and performance control, and a more effective personnel policy.

### Tutorial Activity 1.1

#### Motivation and Financial and Non-financial Rewards

##### The objective of the tutorial activity

To understand that the development of reward management policies, structures and practice will be underpinned by assumptions about how people can best be motivated to deliver high levels of performance. These assumptions may not be articulated but the reward philosophies and policies of an organization can be no better than the motivational theories and beliefs upon which they are based.

In this activity we therefore examine motivation theory under the following headings:

- the process of motivation;
- types of motivation;
- the six basic concepts of motivation relating to needs, goals, reinforcement, expectations, attribution theory and self-efficacy;
- the implications of motivation theory for those concerned with the design and management of financial and non-financial reward policies and practices.

#### The Process of Motivation

Motivation theory is concerned with what determines goal-directed behavior. It is about how behavior is initiated by needs and by expectations on the achievement of goals which will satisfy those needs; how the achievement of goals and/or feedback on their achievement reinforces successful behavior; how belief in one’s ability to carry out a specific task will actuate behavior which is expected to achieve the successful performance of that task.

The process of motivation can be initiated by someone recognizing an unsatisfied need. A goal is then established which, it is thought, will satisfy the need, and a course of action is determined which is expected to lead towards the attainment of the goal.

Alternatively, someone can be presented with a goal and if it is expected that achieving this goal will meet an unsatisfied need, action is taken to reach the goal and thus satisfy the need.

People can be motivated by rewards and incentives which will enable them to satisfy their needs or will provide them with goals to attain (as long as those goals are worthwhile and attainable). But the needs of individuals and the goals associated with them vary so widely that it is difficult if not impossible to predict precisely how a particular reward or incentive will affect individual behavior.

The social context will also affect the level of motivation. This context will consist of the organization culture generally, but it also includes management style (the way in which individuals are managed) and the influence of the group or team in which the individual works.

## Types of Motivation

Motivation at work can take place in two ways:

### 1. Intrinsic motivation

This is derived from the content of the job. It can be described as the process of motivation by the work itself in so far as it satisfies people's needs or at least leads them to expect that their goals will be achieved. Intrinsic motivation is self-generated in that people seek the type of work that satisfies them, but management can enhance this process through its empowerment, development and job design policies and practices. The factors affecting intrinsic motivation include responsibility (feeling the work is important and having control over one's own resources), freedom to act, scope to use and develop skills and abilities, interesting and challenging work and opportunities for advancement. The concept of empowerment is strongly influenced by this aspect of motivation.

### 2. Extrinsic motivation

This is what is done to and for people to motivate them. It arises when management provides such rewards as increased pay, praise, or promotion. When the motivating impact of pay-for-performance schemes is discussed, this is the type of motivation to which people are referring.

The extrinsic motivators can have an immediate and powerful effect, but this will not necessarily last for long. The intrinsic motivators, which are concerned with the quality of working life, are likely to have a deeper and longer-term effect because they are inherent in individuals and not imposed from outside, although they may be encouraged by the organization. The effectiveness of pay as an extrinsic motivator is a matter for continuing debate, as discussed below.

### Basic concepts for motivation

The framework for non-financial motivators is provided by those concepts of motivation which are concerned with needs, goals, reinforcement, expectations (expectancy theory), attribution theory and self-efficacy.

### Needs

Needs theory states that behavior is motivated by unsatisfied needs. The key needs associated with work are those for achievement, recognition, responsibility, influence and personal growth.

### Goals

Goal theory was developed by Latham and Locke! on the basis of a 14-year research programme into goal-setting as a motivational technique. They claimed that the level of production in the companies they studied was increased by an average of 19 per cent as a result of goal-setting processes with the following characteristics:

- the goals should be specific;
- they should be challenging but reachable;
- the goals are seen as a fair and reasonable;
- individuals participate fully in goal-setting;
- feedback ensures that people get a feeling of pride and satisfaction from the experience of achieving a challenging but fair goal;

- feedback is used to gain commitment to even higher goals.

### Reinforcement

Reinforcement theory suggests that successes in achieving goals and rewards act as positive incentives and reinforce the successful behavior, which is repeated the next time a similar need arises.

### Expectancy theory

Expectancy theory as originally developed by Vroom states that for there to be a heightened motivation to perform, individuals have to:

- feel able to change their behavior;
- feel confident that a change in their behavior will produce a reward;
- value the reward sufficiently to justify the change in behavior.

Expectancy theory applies just as much to non-financial as to financial rewards. For example, if people want personal growth, they will only be motivated by the opportunities available to them if they know what they are, if they know what they need to do to benefit from them (and can do it) and if the opportunities are worth striving for.

Expectancy theory explains why extrinsic motivation - for example, an incentive or bonus scheme - works only if the link between effort and reward is clear and the value of the reward is worth the effort. It also explains why intrinsic motivation arising from the work itself can sometimes be more powerful than extrinsic motivation. Intrinsic motivation outcomes are more under the control of individuals, who can place greater reliance on their past experiences to indicate the extent to which positive advantageous results are likely to be obtained by their behavior.

### Attribution theory

Attribution theory is concerned with how people interpret and explain their success or failure. If they can attribute their achievement or lack of achievement to something over which they have control they are more likely either to repeat their successful behavior (this is a form of reinforcement) or, alternatively, take steps to behave in ways they believe are more likely to succeed. Managers can do a lot to influence attributions through feedback, communication, appraisal and guidance, thus creating a social context which is more likely to foster high motivation.

### Self-Efficacy

Self-efficacy is the belief in one's ability to perform a specific task. Those with high self-efficacy will have the capacity to see a link between their own effort and performance and their rewards. They are therefore more likely to take action, to persist in the action and, in the face of failure, to try alternative courses of action rather than give up trying. Self-efficacy is socially learned and developed from personal experience and performance feedback, which creates a sense of competence and reinforces people's belief in themselves.

### Implications of Motivation Theory

Motivation theory conveys two important messages. First, there are no simplistic solutions to increasing motivation. No single lever such as performance-related pay exists which is guaranteed

to act as an effective motivator. This is because motivation is a complex process. It depends on:

- individual needs and aspirations which are almost infinitely variable;
- both intrinsic and extrinsic motivating factors, and it is impossible to generalize on what the best mix of these is likely to be;
- expectations about rewards, such expectations will vary greatly amongst individuals according to their previous experiences and perceptions of reward processes;
- **Equity and fairness** - the 'felt-fair' principle applies to levels of pay in comparison with others in accordance with what people believe to be the relative size or importance of jobs and their perceptions of relative levels of performance or contribution. Pay-for-performance schemes, for example, will only be accepted as fair and may therefore only act as effective motivators if they are based on acceptable performance measures which are applied consistently;
- **Attributions** - the subjective and often distorted explanations people make of their successes or failures;
- **Self-efficacy** - the differences in the degree to which people believe in themselves;
- the social context where the influences of the organization culture, managers and co-workers can produce a wide variety of motivational forces which are difficult to predict and therefore to manage.

The second key message provided by motivation theory is the significance of expectations, goal-setting, feedback and reinforcement as motivating factors. The implications of these two messages are considered below.

### Creating the Right Climate

It is necessary in general to create a climate which will enable high motivation to flourish. This is a matter of managing the organization culture. The aims would be, first, to reinforce values concerning performance and competence; second, to emphasize norms (accepted ways of behavior) relating to the ways in which people are managed and rewarded; and third, to demonstrate the organization's belief in empowerment - providing people with the scope and 'space' to exercise responsibility and use their abilities to the full. Without the right climate, quick fixes designed to improve motivation such 'as performance-related pay are unlikely to make much of an impact on overall organizational performance, although they may work with some individuals.

### Flexibility

It should be remembered, in the words of McDougall, that: attempts to apply a standardized, across-the-board system of remuneration, on the assumption of homogeneity of values and motives amongst those it is intended to reward, are unlikely to meet the needs of many of them. There appears to be a strong case for flexibility, both in terms of the mechanisms and administration of remuneration systems and in the form in which individuals receive their remuneration.

### Recognizing Complexity

Motivation policies should recognize the complexity of the motivation process and not attempt to adopt simplistic solutions to motivational problems. The organization should provide for a mix of various types of intrinsic and extrinsic motivation and make use of both financial and non-financial incentives. But it should be borne in mind that the social context and the ways in which these incentives are managed for individuals will be key factors influencing their effectiveness.

### Goal-setting, Feedback and Reinforcement

Provision should be made for goal-setting, feedback and reinforcement to be major features of the management and reward processes. Performance management processes as described in Chapters 18 and 19 can fulfil this purpose well.

### Managing Expectations

It is necessary to manage expectations. No reward offered through an incentive, bonus or performance-related pay scheme will be effective as a motivator unless individuals believe it is worthwhile and they can reasonably expect to obtain it through their own efforts.

We discuss these implications as they affect financial and non-financial reward policies and practices below.

### Financial rewards

Financial rewards need to be considered from three points of view:

1. the effectiveness of money as a motivator;
2. the reasons why people are satisfied or dissatisfied with their rewards;
3. the criteria which should be used when developing a financial reward system.

## LESSON 25: GUIDELINES FOR EFFECTIVE INCENTIVE PLANS

### Learning Objectives

- To know the Prevalent Systems of wage Incentives in India
- To understand the Precautions against ill effects of Incentive Systems
- To learn the Prerequisites of a Good Wage Incentive Scheme
- To know the reasons of the failure of Incentive Plans
- Requisites or guidelines for effective Incentive Plans

Before discussing the prevalent systems & guidelines for effective incentive plans

Let us first discuss that can workers be motivated with wage incentives?

### Yes/No/Depends

What do blue collar and white-collar employees hunt in motivating jobs?

- 1) Blue collar: pay, job security, interesting work
- 2) White collar: interesting work, pay, job security

### What else they all look for?

Direct financial plans-wage incentives, pay proportional to output  
Indirect financial plans - fringe benefits, vacation, promotions; stimulates morale, but could be taken for granted

### The Prevalent Systems in India

The most widely prevalent incentive scheme in Indian industries is the piece-rate system. In industries like iron, steel and chemicals, however only a small percentage of workers are paid on piece-rate basis.

Another incentive system that is prevalent in Indian industries is the payment of production bonus usually at a differential rate for the output produced in excess of the normal output for a unit of time. The norms are generally fixed on the basis of job analysis and/or time studies.

The incentive scheme operates on a group or individual basis, depending on the measurability of the work of individual workers and the inter dependence of their output performance. Engineering and chemicals have mostly the group system, while textiles have mainly the individual system of incentives. The group incentive system is more widely prevalent in the Indian industry than the system of individual incentive or a combination of both.

Wage incentive plans, other than the piece-rate system, bristle with some problems in their operation.

First, incentive earnings, as a percentage of the total wages of workers covered under the incentive plans, are very low. In 1961, it was 10.9 per cent. There may be several reasons for this situation: either the norms of standard work are fixed high and it is not possible for a worker to exceed them by a sizable percentage; or the fall-back on time rate wage is sufficiently high and workers do not have much inducement to put in greater

effort beyond the standard norms; or the rate structure of incentive wage is not adequately progressive.

In any case, this situation reflects the relative ineffectiveness of incentive plans. Moreover, the percentage of workers paid by results is around 31 in India as compared to 42 per cent in the U.K., 45 per cent in the USA and 77 per cent in USSR for iron and steel industry. For cotton textiles, the percentage of workers paid on piece-rate in India is 70 against Britain's 63, America's 36, and Russia's 87.

Second, a number of units may have unnecessarily complex incentive plans, probably transplanted from European firms, which are not easily comprehensible to illiterate or semi-literate workers on the one hand, and which do not have a direct relationship between effort and wages on the other.

In addition to numerous slabs in the rate structure, there are often changing bases of calculation and distinctions between different types of employees - permanent, temporary staff, workmen, etc.

Third, in cases where group incentive plans are in vogue, a system becomes difficult to operate effectively, for the direct link between effort and earnings is lost.

Fourth, while there is no need for the rate structure of incentive wages to be

progressive from the beginning, it needs to be so when workers show high levels of productivity.

Some of the incentive plans actually turn out to be regressive in practice in these final stages. These maladies of the incentive plans betray a lack of wage to make them an effective tool of increasing productivity.

### Precautions against ill Effects of Incentive Systems

Experience has shown that incentive schemes are not an unqualified blessing in themselves. They are fraught with some dangers that have to be guarded against during the course of their evolution and implementation.

First, there is a tendency amongst workers to sacrifice quality for quantity. This calls for a strict system of checking and inspection.

Second, incentive schemes bring about a certain fixity in the operations and undermine flexibility, which is an essential requirement in view of the rapid progress in technology. Such changes in technology, methods, machines and materials involve a revision of norms and rates. The incentive schemes should, therefore, be adequately provided with such revision in case of significant changes.

Thirdly, there is a danger that safety regulations would be disregarded by workers and this may result in higher accident rates. This may be solved by greater vigilance on the part of workers concerned.

Fourthly, there is a danger that workers would tend to overwork and undermine their health. This may be checked by fixing a ceiling on incentive earnings.

Finally, incentive schemes sometimes lead to jealousies and misunderstanding among the workers because of the difference in their earnings.

However, differences in earning will differ for workers according to the differences in their abilities and efforts. Moreover, trade unions discourage ill feelings or jealousies amongst its members.

### **Prerequisites of a Good Wage Incentive Scheme**

The installation of an incentive scheme presupposes the existence of certain prerequisites, which are, more often than not, ignored.

Quite often, incentive payments are just taken to be necessary part of the total wage packet, and hastily conceived schemes are introduced primarily because of pressures from workers and trade unions. Such schemes naturally result in a number of personnel problems which may, in fact, be

#### **1. Impediments to improve productivity**

It is, therefore, advisable to ensure that a proper climate exists for the introduction of such schemes.

Some important considerations, which should ordinarily be taken into account while choosing a particular type of wage incentive scheme, are:

- (i) The management should strive to create a proper climate by adopting sound policies of recruitment, promotion, trading etc., right from the inception of an enterprise.

Unless there is mutual understanding and concern for improving productivity, even a well-conceived incentive scheme may not yield the optimum results. Therefore, the management must concentrate on creating a proper industrial relations climate before introducing incentive schemes.

- (ii) The objectives of the scheme must be clear, and these should be well understood at the levels of management and of workers. Certain specific factors may be selected as the basis for a scheme. Too many factors selected at a time may make it complicated.

The scheme should suit both the particular enterprise and its workers. At every stage, right from the conception of the scheme to conducting studies, etc., all the workers and supervisors should be consulted so that they understand the objectives and benefits of the scheme and may contribute to its success.

- (iii) Incentive schemes should be installed only when production has reached 60 per cent of the rated capacity. Care should be taken to provide a suitable gestation mechanism in the scheme on a time-bound basis so that incentive payments at a lower level of the performance are allowed only for limited time periods.

The quantum of incentive paid at the low levels of production and efficiency should be such as to ensure that earnings continuously increase when the targets are raised.

- (iv) The scheme chosen should be one which would result in overall economy for the establishment. Incentives should not only increase production but also result in higher productivity and lower cost per unit; and the gains of increased productivity should be shared both by the employer and the employed.

- (v) The scheme should not be very costly in operation, i.e., it should not involve the maintenance of very elaborate records, complicated calculations, and too much material handling.

- (vi) The scheme should be based on a work study, and the work contents of various jobs should be stabilised.

- (vii) In principle, each individual or group should be paid according to effort and productivity, for disparity in earnings may create discontent. Unless the scheme i.e. well-defined, it may turn out that indirect groups may receive higher incentive earnings than the main production group.

- (viii) The scheme should have elasticity to take care of technological and other changes taking place from time to time and rectify errors that may have crept in at the time of its initial introduction.

- (ix) The scheme should not undermine co-operation amongst the workers. It should rather stimulate co-operation with a view to achieving the common objective of increasing the well-being of the business and, therefore, of the workers in general.

- (x) Performance standards and norms 'for incentive payments should be set up at the average performance level of the employees, i.e., they should not be too high nor too low.

Such performance standards should be set as are within the control of employees.

The adoption of objective assessment procedures and the use of functional responsibility are to be advocated in addition to such indices of productivity as wage cost per unit sale, salary savings on inventory, etc.

- (xi) To make the scheme effective, a climate should be created in which the employees feel that the management is fair and just in its dealings with them on wage incentive matters. For this purpose, mutual discussions and appropriate management action would be called for.

- (xii) Incentive payment should be made as soon as possible after a job is completed.

Any hastily conceived or haphazardly introduced incentive scheme does more harm than good. Therefore, it should be introduced after a proper consideration of the various preparatory measures.

#### **2. Incentive Plans For White Collar Workers/ Salesmen**

The salesmen are usually given incentives in the form of sales commissions. 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 the incentives are needed to motivate salesmen.

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

**Table 17.6**  
**Firms Using Incentive Plans for Salesmen**  
% of Companies

Incentive Plan	% of Companies			
	Consent Products	Industrial Products	Other Commerce and Industry	All Industries
1. Straight salary	20.1	25.6	56.5	27.6
2. . Straight commission	2.1	1.3	2.2	1.5
3. Draw straight commission	7.5	1.3	-	20.1
4. Salary + commission	19.2	21.1	13.0	17.7
5. Salary + Individual bonus	21.3	10.8	8.7	17.7
6. Salary + group bonus	8.5	4.4	6.5	5.4
7. Salary + commission + individual bonus	7.5	5.3	2.2	5.4
8. Salary + commission + group bonus	1.1	0.6	-	0.6
9. More than one method of payment	12.7	22.4	10.9	19.3
Total	100.0	100.0	100.0	100.0

**a. 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 disadvantage 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 reduced salesmen's performance.

**b. Straight Commission Basis:** Under this method 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:

- (i) Salesman focusses on making a sale on high volume items. Cultivating dedicated customers and working to "push" hard-to-sell items are often neglected,
- (ii) Salesmen tend to be less company-oriented and more money-oriented, and the company has less control over them;
- (iii) Salesmen's income generally fluctuates widely.

**(c) Combination Method of Salary and Commission Basis:**

Under this, salesman not only get a fixed salary but also a commission in proportion to the sales effected. The advantages of this method are:

- (i) Since salesmen are assured of minimum earnings, they are relieved of financial worries.
- (ii) The company has more control over its salesmen, as there is sizable salary component in most combination plans. So that it can direct salesman's activities by detailing what services and salary component is being paid for.

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. Such plans also tend to become very complicated, and misunderstanding often results in frustration. In spite of these disadvantages, these plans are widely used with several basic variations, like:

**d. Salary Plus Commission:** Commission Plus Drawing

Account where not only commission is paid but the salesman is also allowed to draw on future earnings to get him through low sales period; commission plus bonus, where salesmen are paid primarily on the basis of commission but they are also given a bonus for activities like "slow moving" items; and salary plus bonus, wherein salesmen are paid a basic salary; and also given a bonus for carrying out specified activities.

### 3. Incentives For Management Employees

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 two, 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 size of bonus is much higher for top level executives, and lower for the lower level executives.

#### Failure of Incentive Plans

Many of the incentive plans, aimed at increasing the motivation of employees, often fail to have their desired impact. This is due to several reasons, most of which become apparent when it is considered that for motivation to take place, the worker must believe that his effort will lead to rewards and that he must want that reward. In most cases incentives plans fail because one or both of these facts are not met.

The principal reasons of failure are

1. **Unfair Standards** are a great hindrance in the way of motivating employees. In order to motivate them, the standards must be viewed as fair and attainable.
2. **Fear of Rate Cut:** There is fear in the minds of the employees that standards will be raised high or rates will be cut if they earn too much.
3. **Group Restrictions:** Peer pressure is a double-edged sword when it comes to incentive plans. If the group views the plan as fair, it can keep "Loafers" in line and maintain high production.

If the group feels that plan is not in its interest it will through education, ostracism, or punishment - see that production levels of group members is kept at a minimum.

4. Employees do not understand the Plan: This happens when either the details of the plans are not communicated to employees or if communicated, the employees do not clearly understand them. If employees cannot understand how performance will lead to rewards, the plans would not prove fruitful in motivating them.
5. Lack of Require Tools, Training, Equipment etc: The lack of required machines and tools, equipment and absence of a sound organisation structure often break the effort - reward link; and without that link, incentive plan fails.
6. Other Causes: The inequitable wage structure with the organisation and the inter-group conflict also lead to non-cooperation of the employees.

#### **When to use 'time' or 'output' basis as an incentive plan?**

The employees may be paid on a 'time' basis under following circumstances:

1. When units of output are difficult to measure;
2. When employees have little control over the quantity of the output, such as on much-paced assembly lines;
3. When there is no clear direct relationship between the worker's effort and his output, such as when jobs are highly interrelated;
4. When delays in the work are frequent and beyond employee's control;
5. When quality is a primary consideration as with engineering and other professional personnel; and
6. When precise advance knowledge of unit labour costs is not required by competitive conditions.

On the other hand, payment on 'output' basis would be preferable if:

1. Units of output can be measured.
2. There is a clear relationship between employee effort and quantity of output.
3. The job is standardised, the work-flow is regular, and delays are few or consistent.
4. Quality is less important than quantity or, if quality is important, it is easily measured.
5. Competitive conditions require that unit labour costs be definitely known and fixed in advance of production.

#### **Requisites or guidelines for effective incentive Plans**

Monetary incentive plans do motivate employees. Robert Opsahl and Marvin Dunnette have concluded: "There is considerable evidence that installation of such plans usually results in greater output per man hour, lower unit cost, and higher wages in comparison with outcomes associated with the straight payment systems."

But these plans will not be effective unless a careful planning is done and the plans properly implemented.

Several authors have suggested a list of requisites that monetary incentive plans should meet if the incentive method is to be attractive to the employee; and at the same time administratively sound. Some of the more important requisites/ specific guidelines for developing effective incentive plans are:

#### **1. Insure that Efforts and Rewards are Directly Related**

The incentive plan should reward employees in direct proportion to their performance and increased productivity. Employees must also perceive that they can actually do the tasks required.

This standard set has to be attainable; necessary tools, equipment, training etc. should be timely provided and the employee should have adequate controls over the work process.

#### **2. The Reward Must be Valuable to the Employees**

Increased monetary earnings must have the potential to satisfy the existing needs of the worker if the worker is to be attracted to them. In other words, the monetary incentives offered must be relative to current or visible future needs.

#### **3. The Reward Must be Clearly Identifiable**

Individual's or groups' contributions and efforts must be clearly identifiable, if rewards are to be given for specific performance. .

#### **4. Methods and Procedures Must be Carefully Studied**

Since effective incentive plans are generally based on a meticulous work methods study, the services of an Industrial Engineer or other Methods' expert should be obtained who may "through careful observation and measurement, define fair performance standards on which the plan is to be based.

#### **5. The Plan Must be Understandable and Easily Calculable by the Employees**

The incentive plan should be easily understood by the workers so that they can easily calculate personal cost benefit for various levels of effort put by them.

#### **6. Effective Standard Must be Set**

The standards of which the plan is to be based should be effective, i.e., they should satisfy these conditions:

- (i) Standards are viewed as fair by the subordinates;
- (ii) They should be set high, but reasonable (i.e., there should be about a 50-50 chance at reaching it);
- (iii) They should be specific; and
- (iv) They should be complete. "Do not just focus on quantity and disregard quality, unless that is the intention."

#### **7. Standards Must be Guaranteed**

The standard should be viewed as a contract with the employees. Once the plan is operational, great caution should be used before decreasing the size of the incentive in any way.

#### **8. An Hourly Base Rate Must be Guaranteed**

At least the plant employees should be guaranteed the base rate. Moreover, there should be one base rate for a job regardless of whether or not it is on 'incentives.'

#### **9. Clear Policies and Rules Must be Developed**

Specific policies and rules concerning how employees will be paid, and the rules for attaining the standard (and incentives) should be clear to both manager and employees.





## LESSON 26: NON-MONETARY INCENTIVES

### Learning Objectives

- To understand what are Non-Monetary Incentives?
- To know examples of Non-Monetary Incentives
- To understand the Aims of Reward Management

### What are non-monetary Incentives?

While monetary incentives often appear as important motivators, many factors unrelated to money can also serve as 'attention-getters' and 'encouragers of action.' "The classification of such non-financial incentives tends to a smorgasbord of desirable 'things' that are potentially at disposal of the organisation.

The creation of such rewards is only limited by managers' ingenuity and ability to assess 'payoffs' that individuals within the organisation find desirable and which are within the managers jurisdiction."

As the old proverb goes: "One man's food is another man's poison" certainly applies to rewards. What one employee views as "something I have always wanted", another finds superfluous. Therefore, care must be taken in providing the "right" reward for each person.

### Some examples of non-monetary incentives

The need-motives for affiliation, power and recognition in particular can be appealed to by such incentives.

For example,

1. A person with strong need for affiliation may respond readily to job assignments that provide with opportunities to relate to socially attractive and satisfying individuals or groups.
2. The opportunity to communicate with and relate to others is a factor many workers emphasize and seek.
3. Persons who are very status conscious, can be motivated with the availability of a panelled office, a carpeted floor and wall paintings, a large desk and aristocratic furniture or a private bathroom, impressive job title, their own visiting cards, their own secretary and telephone, or a well located parking place with their name clearly painted underneath the "Reserved" sign - all of which are status symbols.
4. An employee with high-level desires for power may respond easily to opportunity whereby he can gain leadership and administrative responsibilities. He may be stimulated by participative or free rein leadership in the decision-making process.

The use of job enlargement provide added incentive to some employees because they feel capable of controlling wider sets of activities than they previously performed.

5. Persons interested in enhancing their reputations and receiving recognition in the

eyes of others may respond to verbal 'praise' or two publicized 'awards.'

6. Persons proud of their long service may be attracted by awards recognising their seniority.
7. Workers in safety minded organisation are often attracted by competition on awards for best safety performance records.
8. Individuals proud of their past accomplishments may feel recognised and rewarded if their superiors extend opportunities for participation on more complex and more important job assignments.

In short, management may look to many non-monetary incentives for effective motivation of those who are most need-conscious. In many cases, these non-monetary incentives might stimulate even more attention than the monetary ones.

### Aims of Reward Management

Reward management aims to:

- (1) To support the achievement of the organization's strategic and shorter term objectives by helping to ensure that it has the skilled, competent, motivated and committed workforce it needs;
- (2) To help to communicate the organization's values and performance expectations;
- (3) Support culture management and change by matching pay culture to organization culture and ensuring that reward management underpins the existing or desired organization culture and helps the organization respond to change.  
But pay itself, as Flannery state: 'cannot drive change or lead the change process. It cannot define what the change should be. It cannot establish values. It cannot replace effective leadership, drive and support desired behaviour by indicating what sort of behaviour will be rewarded and how this will be done through performance or variable pay and performance management processes;
- (4) Encourage value-added performance by focusing performance pay and gain sharing schemes on areas where the maximum added value can be achieved;
- (5) Promote continuous development through competence-related and skill-based pay schemes, broad banding and effective performance management;
- (6) Compete in the employment market by paying competitive rates which attract and retain good-quality employees;
- (7) Motivate all members of the organization from the shop-floor to the board room through the judicious use of a combination of financial and non-financial rewards;
- (8) Promote teamwork through the use of team pay, the encouragement of multiskilling and by rewarding collaborative behaviours;

- (9) Promote flexibility by replacing unduly hierarchical and rigid pay structures with more flexible and, typically, broad banded structures, treating job evaluation as a process which can be adjusted to meet specific needs rather than a package which has to be applied rigidly, avoiding the use of over-mechanistic pay-for-performance schemes, making greater use of variable or 'at risk' pay and allowing employees more choice over the benefits they receive;
- (10) Provide value for money by evaluating the costs as well as, the benefits of reward management practices and ensuring that they are operated cost effectively.
- (11) Achieve fairness and equity by rewarding people consistently according to their competence and contribution.
- (12) Pay can play a significant part as an investment which will support the long-term success of the organization.

As Flannery points out: "Organizations are beginning to understand that pay should no longer be considered? Only in terms of specific jobs and current financial results. Compensation must inextricably be tied to people, their performance and the organizational vision and values that their performance supports.

It is an important tool for communicating and reinforcing new values and behaviours, supporting accountability for results and rewarding the achievement of, new performance goals."

### Tutorial Activity

#### Evaluating Reward Process

#### The objective of the Tutorial Activity:

To understand that the evaluation of reward processes is best carried out by a diagnostic review which, as set out below, could cover the following areas:

- Basic philosophy and strategic principles;
- Overall reward policies;
- Individual reward policy and practice areas;
- Cost considerations;
- Overall reward management;
- Overall perceptions;

#### Communications

The diagnostic review should be carried out by examining written strategy and policy statements, details of structures, procedures, processes and schemes, any reports and records on reward matters and discussions with managers, HR staff, employees and union representatives. It is also highly desirable to conduct an attitude survey (as illustrated in Appendix A); this can be supplemented by focus group discussions with managers and employees to understand views in greater depth. Reward management: diagnostic checklist

#### Basic philosophy and strategic principles

These questions deal with the high level, strategic issues facing organizations.

1. Are the fundamental principles on which the system and its development is based linked to:
  - (a) the organization's current needs and goals;

- (b) HR management strategy (see also 3 below);
- (c) policy on pay levels needed to recruit and retain high-quality and committed staff (see also below);
- (d) policy on assessing the pay market practice needed to achieve recruitment and retention:

- locally (for locally recruited staff);
- regionally (for regionally recruited staff);
- nationally (for nationally recruited staff);
- internationally (where the market is for specific 'world-class' individuals);
  - (a) equal pay for work of equal value;
  - (b) avoidance of discrimination other than differences warranted by job/role size, responsibility, complexity and valid responses to market pressures?

#### 2. Have these Principles been Developed:

- (a) in consultation with key stakeholders (management, staff, unions);
- (b) on the basis of current and future business strategies;
- (c) by reference to any projected changes in the culture of the organization?

#### 3. Is there a clear and articulated link between reward strategies and HR strategy on

- (a) organization design: the structures and processes needed to deliver organization strategy and the levels and distribution of work needed to do this;
- (b) recruitment: a reasonably attractive total package;
- (c) training: rewarding skills acquisition and use;
- (d) development: rewarding the behaviours or competences associated with good performance and continued learning;
- (e) performance improvement: delivering an effective and efficient personal contribution;
- (f) effective team/group working;
- (g) promotion: rewarding the acceptance and successful delivery of greater responsibilities;
- (h) reinforcing loyalty, integrity and commitment?

#### 4. Is there a strategy for ongoing reward management which

- (a) is based on the organization's
  - mission;
  - culture;
  - operating values;
  - current and future needs;
- (b) staff at all levels understand, at least in outline, and believe to be fair and rational;
- (c) provides for a flexible response when different parts of the organization have different needs or face different pressures?

#### 5. Does the strategy provide a sound basis for the development of reward Policies, systems and procedures, i.e:

- (a) provision for proper responses to changing circumstances;
  - (b) management of the system to protect its integrity and validity;
  - (c) monitoring and management of the cost of managing the system with a focus on:
    - cost effectiveness;
    - avoiding duplication of effort;
    - using new technology, notably IT support to enable greater efficiency?
6. Is the strategy congruent with the culture of the organization?
- (a) Are there any conflicts between practice and organization values, e.g.:
    - rewarding service and experience rather than continuous performance improvement;
    - providing long-term benefits when shorter term contracts are becoming more common;
    - becoming increasingly complex or cumbersome when the organization is trying to simplify the way it manages itself in other ways;
    - focusing too much on equity beyond what is feasible within the judgmental frameworks on which effective reward management depends?

### Overall Reward Policies

These questions focus on the articulation of overall reward policies.

7. What is the policy on levels of rewards, e.g.:
- 1) the chosen place in a well defined, surveyed and comparable pay market for-different grades, levels and specialisms;
  - 2) the need to attract and retain high quality staff;
  - 3) the need for stability and sustained staff commitment?
8. What is the policy on-market rates and responses to market pressure?
- (a) Is the organization subject to skill shortages and areas of market pressure?
  - (b) How are these tracked, eg through:
    - analysis of leavers or exit interviews;
    - analysis of recruitment issues;
    - analysis of where people come from and where they go;
    - pay surveys;
    - other market intelligence?
  - (c) Are pay responses the only way to retain people 'at risk'?

- (d) Have other strategies, such as improved performance management and development or improved working conditions, been tried?
  - (e) At what stage are specific market responses or market premiums paid?
  - (f) Is it clear to staff that market premium can go down as well as up?
  - (g) Is this specifically communicated with market adjustments?
  - (h) If not, how will the cost implications be managed when the market declines?
9. Are, or should, reward levels be linked to the organization's performance?
- (a) Are there identifiable performance measures for the organization?
  - (b) Can these be tracked without undue effort?
  - (c) Are they subject to external or political influences in the short, medium or long term that take sensitive handling?
  - (d) Would better performance actually generate more money for rewards?
  - (e) Is there scope for rewarding specific individual or team achievements?
  - (f) Would this be culturally appropriate?
  - (g) Who will assess and manage performance?
  - (h) Are they close enough to employees - especially those out in the field - to be able to judge performance effectively?
  - (i) Is there trust in the current performance management processes?
  - (j) Are people given the training and development needed to help improve performance?

### 10. What is the policy on equity?

- (a) How important is equity in the organization's culture?
- (b) Is there a focus on complete equal treatment for similar jobs/jobs of the same size?
- (c) Or, is there a preference for equal treatment in relation to contribution and performance?
- (d) How is equity measured and tracked?
- (e) Does this ensure reasonably fair and equal treatment:
  - by location;
  - by region;
  - across the whole organization?

### Individual reward policy and practice areas

These questions concentrate on specific areas of reward policy and practice.

### Job Evaluation

11. Is a formal system of job evaluation used to determine internal relativities? If not, how are they determined?
- (a) Is this analytical?
  - (b) Is it related to skill sets/competences?

- (c) Is it defined in terms of relevant factors?
12. Are the factors used for job evaluation:
- (a) relevant to the organization;
  - (b) relevant to the jobs they cover;
  - (c) unbiased in terms of sex, race or disability;
  - (d) relevant individually and not subject to 'double counting' (looking at the same areas from a different angle)?

13. Is the scoring system:
- (a) weighted effectively to reflect organizational values;
  - (b) able to provide sensible grade breaks between distinct levels of work?
  - (c) Do grade breaks fall into natural gaps in job scores?

### Pay Structure

14. What is the overall policy on the pay structure?
- (a) What is the rationale for the current pay/grade structure?
  - (b) Did it/does it reflect practice in comparable organizations in terms of:
    - actual levels of work performed;
    - the needs of any specialist/professional groups which are different in character from the mainstream of staff, if these exist;
    - union bargaining units, if relevant;
    - the need to progress staff spending several years in grade to reflect experience, performance and service in grade?
  - (c) Is the structure- flexible enough to cater for:
    - the current pattern of career development and promotion;
    - changes in pay/job market conditions?
  - (d) Or are there:
    - too many people with no further progression or promotion opportunities, stuck on the grade maximum (even if well paid);
    - few opportunities to respond to changes in market circumstances?

15. What type of specific pay and grade structure or structures exist in the organization?

- (a) Graded salary scales?
- (b) Pay spines?
- (c) Spot rates?
- (d) Pay curves?

16. Is the pay structure relevant to the needs of the organization as a whole or the part of the organization in which they operate, i.e. do they:

- (a) fit the circumstances and culture of the organization, in that it is flexible in organizations subject to rapid

change or well defined and rigorously applied where order and predictability are of paramount importance;

- (b) provide a logical framework or system for enabling consistent and defensible decisions to be made on the levels of pay and differentials of all the employees to be covered by the structure;
  - (c) make provision for the reasonable and sometimes inevitable fact that external market rate considerations may have to prevail over the requirements of strict internal equity, especially in the areas of skill shortage?
17. Is the grade structure designed and administered properly?
- (a) Are the grades clearly defined? Do they fit the way work is currently organized (eg the number of levels in the organization)?
  - (b) Are the pay ranges wide enough to allow scope for pay progression in accordance with service (where relevant), competence and performance?
  - (c) Is there an adequate differential (say 15 to 20 per cent) between grades?
  - (d) Is there an overlap between grades to provide some flexibility and recognize the fact that an experienced individual at the top of one grade may be of more value to the organization than a newcomer in the grade above?
  - (e) Are consistent methods used to allocate jobs into grades, including decisions on recruitment, promotion and upgrading because of greater responsibility?
  - (f) Is there any evidence of inequities in the pay structure because of wrongly graded jobs?
  - (g) Are pay scales regularly reviewed against external data? If not, what are the factors which are used to determine annual adjustments in pay scales? Are these factors consistent across grades?
  - (h) Is there a balanced and cost-effective approach to the provision of employee benefits with status distinctions dictated only by 'good' market practice?
  - (i) Is there a consistent and fair basis for allocating benefits?
  - (j) Is there any evidence of salary levels falling ahead of or behind the market rates?
  - (k) If so, what are the causes and are they short term or long term in nature?
18. Is the system regularly maintained and updated:
- (a) to take account of new jobs;
  - (b) to take account of the structural change in the organization?
19. Is 'grade drift' a problem (are people always trying to get jobs upgraded to improve pay levels without sufficient reason)?
- (a) How is this controlled?
  - (b) Are the controls adequate or are inconsistencies emerging?

## Pay Progression

These questions consider all types of pay progression schemes within a graded structure, up a pay spine 'or along a pay curve.

20. Is there a consistent method of progressing pay, eg according to:
- (a) length of service;
  - (b) experience (how is this assessed?);
  - (c) performance or contribution;
  - (d) work level;
21. Is the rate of progression based on fair and consistent methods of assessment?
- (a) Are there effective links between performance-based progression and the performance management and any competency framework that exists and related development planning?
  - (b) Does the approval process for any service-based progression ensure that under-performers do not get undeserved increments?
22. If a performance-related pay system is in use:
- (a) Is the relationship between contribution, effort and reward clearly defined and understood?
  - (b) Is there a credible, well-established and managed process of performance management to support pay decisions, as well as deliver the organization's performance goals?
  - (c) Is the amount of performance-related pay sufficient to recognize the contribution not only of high-flyers but also of the reliable 'core' performers on whom most organizations depend?
  - (d) Do employees have a reasonable degree of control over the results which determine their reward levels?
  - (e) Do bonus earnings (if any) fluctuate too much or too little?
  - (f) Is the system easy to understand and administer?
  - (g) If it is causing problems, how are these being addressed?

## Pay reviews

23. How are pay reviews conducted?
- (a) What arrangements are made for cost of living awards?
  - (b) To what extent are pay levels reviewed on the basis of market rate movements?
  - (c) Are there satisfactory arrangements to track market rates, both generally and for specific occupations?
  - (d) How much money, in terms of payroll percentage, has been and is likely to be made available for pay reviews?
  - (e) What arrangements are made to provide guidance on individual reviews related to performance or competence (if applicable)?
  - (f) How are budgets for pay reviews set and controlled?
  - (g) Are the budgeting arrangements satisfactory?

- (h) What freedom do managers have to make their own pay decisions or recommendations at the annual pay review?

- (i) How is consistency and equity achieved?

## Total remuneration and Employee benefits

24. What is the policy on the structure "and balance of the reward package?
- (a) What is the mix between?
    - Base salary;
    - Other cash rewards, eg bonuses (if paid);
    - Allowances of various kinds to compensate for specific circumstances;
    - Benefits, eg pensions and related relevant provisions, loans, mortgage assistance, moving allowances;
    - Sick pay and long-term disability provisions;
    - Medical provisions;
    - leave;
    - meals;
    - employee advisory services,
    - other non-cash items?
  - (b) Are any choices over the mix available?
    - Why?
    - Is this cost effective?
    - Do staff like having a choice over their package to meet personal requirements?
  - (c) Is the balance between different elements felt by management and staff to be:
    - about right;
    - in need of change?

## Pensions

25. Does the pension scheme properly reflect current:
- (a) employment patterns and demography;
  - (b) levels of employee mobility;
  - (c) comparable practice in similar organizations?
26. Can pensions be 'topped up' where individuals have insufficient service or previous provisions?
- (a) Do the mechanisms reflect good market practice?
  - (b) Do they make sound financial sense for both employer and staff?
27. Are there provisions for partners/dependants?
- (a) How do these compare against the market?
  - (b) Are the rules concerning their entitlements regularly reviewed?
  - (c) How is this communicated alongside the overall pension scheme?
28. Is the pension scheme cost-base sound or will demographic change or changing employee profiles put pressure on affordability?
- (a) How are changes in this area being tracked?

- (b) Who will decide on change and how?

### Cost Considerations

These questions focus on the way costs are understood and managed.

29. What is the level of employment costs and how are costs managed?

- (a) What proportion of operating costs are employment costs?
- (b) How does this compare to other comparable organizations in terms of magnitude?
- (c) Are equivalent costs increasing? Why? Is this acceptable and defensible in current circumstances?
- (d) How are pay budgets for the organization and its constituent parts compiled and agreed?
- (e) Are effective costing/modelling procedures in place?
- (f) Is there IT support for this so that 'what ifs' can be tested?
- (g) How are the costs of benefits/allowances monitored?
- (h) How are approvals given for progression/promotion?
- (i) Which elements of the system have to change with any pay adjustment?
- (j) How complex is this change process?
- (k) Could it be simplified without causing undue inequity?
- (l) How often are changes in the system required and what does the process of change cost in (if known):
  - man hours;
  - computer time;
  - communications to staff?

### Ongoing reward Management

30. How well is reward management carried out?

- (a) Are responsibilities for elements of the system properly distributed and managed within the pay management department?
- (b) Do the people who operate the pay system fully understand its purpose and operating principles and methodologies?
- (c) Are full records/definitions of practice kept?
- (d) Are decision-making processes about updating or changing the system straightforward and designed to produce robust and acceptable results?
- (e) Are the right checks and balances in place at top executive levels and through the organization?
- (f) Are computers effectively used to increase responsiveness, accuracy and effective modelling of policy changes?
- (g) Are sound cost-management processes in place for pay budgeting, monitoring spend and controlling outcomes centrally and in local offices, where needed?
- (h) Could any of the processes be simplified or made more efficient?

- (i) What lessons are available from improvements already achieved in comparable organizations?
- (j) How well or regularly is information gathered on this?
- (k) Is there a sensible level of information sharing between comparable organizations?

### Overall Perceptions and Communications

These questions focus on perceptions and understanding.

31. Management perceptions

- (a) Does top/operational management believe that the pay system is:

#### Effective

- Supporting the way people are recruited, managed and developed;
- Giving the right messages to staff and potential recruits?
- (b) If not, what changes would they want to see and why?

32. Staff/union perceptions

- (a) Do staff-and or unions like and wish to keep the current reward system?
- (b) Do they find it motivational in most aspects?
- (c) Has the organization tracked/measured these perceptions recently through:
  - attitude surveys;
  - interviews;
  - focus groups;
  - informal testing of views?
- (d) If they do not like the current system:
  - What do they want to change?
  - Why?
  - Is this realistic, given current affordability/financial circumstances?
  - How is the organization planning to respond?

### Communications

33. How well are reward policies communicated to employees?

- (a) How well are managers briefed on current reward practice?
- (b) Are staff aware of the total value of their pay and benefits package?
- (c) What improvements in communication would they like to see?

## LESSON 27: CAFETERIA STYLE OF COMPENSATION

### Learning Objectives

- To know the concept of Cafeteria Style Compensation
- Features of a Cafeteria Style Compensation

### Cafeteria Approach

In Cafeteria benefit plan the employees could spend their benefits, allowances on a choice of benefits options. The idea is to allow the employee to put together his/her own benefit package subject to two constraints-

1. The employer must carefully limit total cost for each total benefit package.
2. Each benefit plan must include certain non-optional items. These include for example social security, Worker's compensation and unemployment insurance.

Subject to these two constraints employees can pick and choose from the available options. Thus a young parent might opt for a company's life and dental insurance plans. While an older employee opts for an improves pension plan. The list of possible options might include many of the benefits- Vacations, insurance benefits, pension plans, educational services and so on.

It is a type of compensation which refers to compensation programmes that allow employees to choose what type and how much of each reward is desired during the coming year. This programme is based upon the assumption that every employee's needs are different and he has flexible arrangements that meet individual needs, and for that he is permitted to select that combination of rewards that is most attractive to him.

An organization might run what has been called a cafeteria system, whereby a range of benefits are on offer, and employees can choose from among them up to their allowed budget. This offers the element of choice and may increase the value of the benefit to the individual, since it answers his real needs or wants.

As an example, a flexible plan was instituted at IDS Financial services, a Minneapolis based American Express subsidiary. The 2500 IDS employees covered by the plan automatically got core benefits including Minimum Life insurance, a no. of vacation days based upon years of service, short term disability that pays 100% of salary and gradually drops to 70% overtime, long term disability that begins after a 150 days and a attendance bonus that is earned when no health related time off is taken during the year. However the company also contributed 5% of salary that the employee can use toward anyone or a company deferred savings plan. (For the first 3% the employee puts in, the company will add another 2.5%). A second option is to take all or parts of the 5% as cash. Option 3 is to put apportion of the entire credit towards extra benefits including medical coverage, life insurance, long-term disability and vacation. (Employees can by up to 5 days)

### Advantages of Cafeteria approach are as follows

1. Employees choose packages that best satisfy their unique needs.
2. Flexible benefits, help firms need 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 organization sets the dollar maximum. Employee chooses within the constraint.

### Disadvantages of Cafeteria style

1. Employees made 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.

According to an article in Personal management in December 1994, 'The number of firms offering their employees flexible benefits has risen by more than 50% in the last year, with perks ranging from childcare vouchers to personal pensions.'

A scheme at Admiral Insurance, for example, allows employees to spend a sum worth up to 13% of the basic salary on benefits from a menu including an extra day's annual leave (valued at £9.32 per month), members of a sports club (£20 per month) or vouchers: 'unspent' allowance can be taken in cash. All staff receive 'care' benefits, including 20 days' holiday discounts on motor insurance, death-in-service and sickness benefits, interest-free seasons ticket loans and loans for work-related training.

### Features of a Cafeteria Style Compensation

Under this programme, the employee is told that his total compensation is made of say Rs.2000/- and that he can choose a mix of salary life insurance, deferred compensation, and other benefits that suit his particular needs. Each of these options carries a price and the employee can select up to Rs.2000/- of salary - those items that he feels best suit his personal needs.

The philosophy of this approach is that workers will be more highly motivated if they can select those rewards that have the greatest payoff for them. If the organisation's benefit programmes are such because they have been designed for the "average employee" in the organisation, by giving the employee the option to develop his own flexible compensation package, each package should be ideally tailored to the needs of the employee. In other words, cafeteria compensation can make maintenance items motivators.



While adopting the programme, the management should remember that the most of younger employees are more concerned with “take-home pay” than with “retirement benefits.” On the other hand, older employees are “more concerned about retirement and pension programmes.”

One of the major problems with compensation programme is that employees tend to think in the short rather than the long term. Hence, the management may be forced to pressure workers to make a decision that directly affects their “take-home” pay.

Robert Good has observed: “If an employee selects the ‘wrong’ benefits package, the motivational purpose for the company is defeated. Moreover, even just a few bad choices can put the company at severe risk.

It is a crushing de-motivator throughout the company when the news spread that X was laid up for weeks without pay or that Y is destitute because Z choose cash over survivors’ benefits. Even though the employees made these choices themselves, the company simply cannot allow such situation to come about.

If a company undertakes the heavy and costly administration burden of installing a cafeteria compensation programme, it will be forced to step in and rectify ‘inequities’ even though the circumstances were created by the employees’ own free choice.”

For an effective and successful working this programme requires more information to be provided to employees by management so that they will have adequate data with which to make their decision. This might increase administrative cost. Further, each employee’s benefits have to be carefully priced out and updated periodically.

This programme has not gained much success even where it has been introduced.

### **An Article on Cafeteria Plans Grow in Popularity**

Warner Norcross and Judd, LLP

By Sue O Convoy

Since their introduction in the early 1980’s, cafeteria plans (also called “flexible benefits plans” or “Section 125 plans”) have become a popular method for employers to provide health and other benefits in a way that results in employee choice as well as tax savings for both the company and its workers.

#### **Types of Cafeteria Plans**

The two most popular types of cafeteria plans are pre-tax premium conversion plans and flexible spending arrangements (FSA’s). Many employers combine both in their plan design. A third type, the “full-flex plan,” offers true cafeteria-style choices that may include multiple health plan options, different levels of life and disability insurance coverage, vacation days or cash. Because the full flex plan is administratively complex and generally used only by larger companies, it is not discussed here.

#### **Premium Conversion**

Premium conversion, the simplest type of cafeteria plan, permits employees to pay their share of premiums for health coverage, life insurance and other qualified benefits such as disability insurance on a pre-tax basis. The plan “converts” what

would otherwise be after-tax employee contributions to pre-tax contributions by means of an employee’s election, prior to the beginning of the year, to reduce pay and to have the company contribute the amount of the reduction to pay for the coverage selected by the employee.

#### **Flexible Spending Arrangements**

Flexible spending arrangements (FSA’s) are also popular. FSA’s enable employees to set aside money on a pre-tax basis to pay medical and dependent care expenses. Prior to the beginning of the plan year, employees decide whether and how much to contribute to an available FSA based on the expenses they anticipate during the upcoming year.

These are two types of FSA’s - health and dependent care.

*Health FSA.* Employees may set aside money in a health FSA to pay health plan deductibles and co-payments as well as other uninsured medical care expenses, such as dental or vision expenses, on a pre-tax basis.

Under IRS rules, the full amount elected for the plan year must be available to reimburse the employee’s medical expenses at all times during the year (less any amount already reimbursed).

This is the “uniform reimbursement” rule.

In addition, the elected amount cannot be changed during the plan year unless the employee experiences a “change in status” (such as the birth or death of a dependent, marriage, divorce, etc.) and the plan permits the change. Finally, unused funds remaining in an employee’s account at the end of the plan year may not be refunded to the employee or carried over to the next year. This is the “use it or lose it” rule.

*Dependent Care FSA.* Employees may be reimbursed under this FSA for dependent care expenses that enable the employee (and spouse) to work. Dependent care FSA’s are not subject to the uniform reimbursement requirement. However, they are subject to the “use it or lose it” and “change in status” rules.

#### **Legal Requirements**

Section 125 of the Internal Revenue Code contains the legal requirements for a cafeteria plan. There must be a written plan document meeting specified requirements and all participants must be employees. For employees to obtain maximum tax advantages, the plan must not discriminate in favor of highly compensated persons as to eligibility to participate, employer contributions or benefits. In addition, each cafeteria plan must file an annual informational report (Form 5500) with the IRS.

#### **Pros and Cons of a Cafeteria Plan**

*Pay Less Tax.* Employers do not pay FICA or FUTA taxes on salary reductions amounts. Employees do not pay federal income tax, FICA tax, and, in Michigan and most other states, state and local income taxes on their salary reduction amounts. *Address Employee Needs.* Employees can choose benefits that meet their individual needs and adjust those choices annually as needs change.

*Cost Control.* Cafeteria plans help employers control costs by ensuring that money is not spent on benefits that employees neither want nor need.

*Competitive Benefit Program.* By offering more flexible cafeteria-type benefits, employers gain an edge in attracting and retaining valuable employees.

**Improve Employee-Employer Relationship.** Giving employees control over their benefits promotes goodwill and creates a partnership in the benefit program between employer and employee.

**Respond to Work-Force Diversity.** Cafeteria plans address the wide variation in benefit needs of diverse employees.

**Better Understanding of Benefits.** A better understanding of the benefits package results when employees are actively involved in the selection process.

While cafeteria plans are advantageous to both employers and employees, some drawbacks exist.

The uniform reimbursement rule can put the employer at risk if an employee in a health FSA quits before contributing the full amount for which she has been reimbursed, and, under the “use it or lose it” rule, an employee must forfeit unused FSA contributions. However, with proper planning and good communication, the effect of any disadvantages can be greatly minimized.

## Conclusion

The advantages of establishing a cafeteria plan are many for both employer and employee and significantly outweigh any perceived disadvantages. Employees can receive the benefits they want while at the same time lowering their and their employer's tax liability and helping to control benefit costs.

## Tutorial Activity

An Article On The benefits of Employees

### By Michelle Collins

Cash is not enough today to recruit and retain top talent for your business. Providing an attractive benefits plan is just as important.

While the costs can be exorbitant and the choices overwhelming, you can and should find ways to build a benefits program that works for your company. Here's help.

Find out what your employees want.

It's critical to recognize just how important a competitive benefits package can be in recruiting the best staff possible. Gone are the days when salary in and of itself was lure enough.

“Competitive organizations, whether they are big or small, with benefits programs will be able to attract employees away [from you] - especially if you don't provide the most fundamental programs such as health care, disability insurance and things like that. It's almost mandatory,” says Lloyd Foight, a benefits consultant with the Ross Companies in New York.

The next step in providing a winning benefits program is to find out what your group is looking for. It's possible that subsidized or free parking could be more important to them than life insurance.

“Go to your employees and find out what they want,” says Fred Lange, president of HR Architect in Los Angeles. “Give them a list of a dozen or so things that they can choose, and leave them room to fill in things. You'll find those unique quirky things that are related to your population.”

The two essentials for every plan:

While you might be faced with a variety of requests, experts say that there are two essentials for every plan: medical coverage and a retirement plan. Other coverage such as dental, disability and life insurance often are considered extras.

“Most people want to know that they're covered when they go into the hospital. So that's one of the things on the top of our list,” says Larry Landes, president of Garden State Brickface, Windows & Siding in Roselle, N.J.

Meanwhile, retirement plans offer an opportunity to hang onto valued employees. You should offer to match or contribute some additional portion to what your employees put in, with the stipulation that the money will mature over a certain period of time. “The longer that people stay, the more likely they are to stay,” Foight says. “The chance of them leaving a year from now is less than it is today.”

## Who pays for all of this?

One way or another, someone has to foot the bill for your employee benefits. However, it doesn't have to be you who picks up the entire check. You could even pass on the entire cost to your employees.

Here are three other options:

### 1.High deductible Plan

Offer to help with medical costs once they go beyond a certain dollar amount, such as \$2,000. Foight says this approach will cut down on the administration expenses and reduce the overall costs of the plan.

### 2. Cafeteria-style Benefits

Here, employees pay for the benefits that they want on a pretax basis. The only costs that you will have to deal with are administrative.

### 3. Split the Cost

Another effective strategy is sharing the cost of essentials - such as medical care and retirement - between the company and its employees. Extra coverage such as disability and life insurance are available at the employee's expense.

Communication matters, too Once you've arrived at a plan that suits both you and your employees, let your people know about it. “People need to know that you're spending money on these things. They need to realize that and know that it is a benefit for them even if they choose not to participate in it,” says Bruce Wynn, a compensation and benefits lawyer in Atlanta.

Lange recommends taking this level of awareness a step further and providing an itemized list with yearly tax statements. This way, the employees will know just what they're getting and what you've spent on them.

Michelle Collins is a staff writer at CanadaOne.com, Canada's premier business channel on the Internet, with articles, tools and other resources.

## Assignment

1. What are the values and problems of establishing a Cafeteria fringe benefit programme?

2. What are the rationalized returns to an organization of a cafeteria? A recreational programme? Educational Tuition assistance? Housing Assistance? Child care?

## Notes

[illegible]

## LESSON 28: COMPENSATION POLICY

### Learning Objective

- Introduction To Compensation Policy
- To understand the Base Compensation–Job
- To know significant significant Factors Affecting Compensation Policy

### Introduction to Compensation Policy

It is a general practice all over that employees make comparisons between themselves and their co-workers. They perceive what they get from a job situation (outputs) in relation to what they must put into it (inputs). They also compare their output-input ratio with the output-input ratio of their fellow-workers.

If a person's ration and that of others are perceived to be equal a state of equity is said to exist. If they are unequal, inequity exists i.e., the individual considers himself as 'under rewarded' or 'over-rewarded' when an employee envisions an equity, he may choose anyone or more of five alternatives:

- (i) distort either his own or other inputs or outputs;
- (ii) behave in the same way as to induce others to his own inputs or outputs;
- (iii) behave in some way as to change his own inputs or outputs;
- (iv) choose a different comparison referent; and
- (v) leave the job.

Equity approach recognises that individuals are concerned not only with the absolute amount of money they are paid for their efforts but also with the relationship of this amount to what others are paid.

They make judgement as to the relationship between their inputs and outputs with those of the others. Based on one's inputs such as effort, education and competence - one compares outputs - such as salary levels, raises and other factors.

When people perceive an imbalance in their input output ratio relative to others tension is created. It may result in lower productivity, more absenteeism, etc. This tension provides the basis for motivation, as one strives for what he perceives as equity and fairness.

To get relief, the employee may decrease his inputs while holding his output constant, or increase his outputs while holding inputs constant - possibly resulting in fighting the system, increased absenteeism, or other undesirable behaviours.

### Base Compensation-Job

One of the most difficult functions of personnel management is that of determining rates of monetary compensation. Not only is it one of the most complex duties, but it is also one of the most significant to both the organization and the employee.

It is important to the organization, because wages and salaries often constitute the greatest single cost of doing business; in

1929 employee compensation amounted to 58 percent of the nation's income, as compared with 75 percent in recent years. It is important to the employee because the paycheck often is the sole means of economic survival: it is also one of the most influential factors determining status in society.

As far as the organization is concerned, employee compensation programs are designed to do three things:

- (1) to attract capable employees to the organization,
- (2) to motivate them toward superior performance,
- (3) to retain their service over an extended period of time. As a consequence, our discussion is divided into three chapters with the first subject being that of determination of base pay. Though no science of pay exists, systems of job evaluation are widely used to make this first important decision.

When coupled with surveys of rates paid by competing firms; the organization can establish a pay policy that will meet its desired goal of attracting sufficient personnel to accomplish work tasks.

In many cases, organizations prefer that their employees perform at a rate higher than average. In the following chapter, we shall examine methods of varying individual through merit evaluation and incentive pay plans, as well as systems of promoting group productivity through profit sharing and production bonuses.

Finally, the third chapter in this part will deal with the fastest-growing segment of total compensation, the provision of all types of supplementary pay or fringe benefits. Such programs are more effective in maintaining a work force that they are in motivating higher levels of performance.

### Significant Factors Affecting Compensation Policy

Though a considerable amount of guesswork and negotiation are involved in salary determination, certain factors have been extracted as having an important bearing upon the final dollar decision. Among these factors are the following:

- (1) Supply and demand for employee skills,
- (2) Labor organizations,
- (3) The firm's ability to pay,
- (4) Productivity of the firm and the economy,
- (5) Cost of living, and
- (6) Government.

Each of these will be discussed briefly in order to demonstrate the exceedingly complex nature of compensation. Perhaps a realization of these complexities will lead to a greater appreciation and acceptance of job evaluation despite its arbitrariness and scientific failings.

Supply and demand through the commodity approach to labor, as discussed earlier, is not completely correct, it is nevertheless true that a wage is a price for the services of a human being. The firm desires these services, and it must pay a price that will bring forth the supply, which is controlled by the individual worker or by a group of workers acting in concert.

The primary practical result of the operation of this law of supply and demand is the creation of the “going-wage rate.” It will be demonstrated later how the wage and salary survey of this going rate is incorporated into a job evaluation approach to wage determination. We shall discuss the charges of certain groups that the market going rate reflects fundamental biases towards female employees.

This simple statement of the effect that the demand and supply of labor have on wages belies its complexity. It is not practicable to draw demand-and-supply curves for each job in an organization, even though, theoretically, a separate curve exists for each job.

But in general, if anything works to decrease the supply of labor, such as restriction by a particular labor union, there will be a tendency to increase the compensation. If anything works to increase the employer’s demand for labor, such as wartime prosperity, there will be a tendency to increase the compensation.

The reverse of each situation is likely to result in a decrease in employee compensation, provided other factors, such as those discussed below, do not intervene.

**Figure 12-1**  
**Labor Union and Earnings**

	Median Weekly Earnings	Percent Represented by a Union	Percent Who are Women
All full-time workers	\$289	29	39
Highest-paying industries			
Petroleum and coal products	433	36	20
Mining	423	36	15
Railroad transportation	422	82	7
Aircraft and parts manufacture	414	50	23
Ordnance	410	37	22
Motor vehicle and equipment manufacture	407	63	15
Lowest-paying industries			
Private households	114	1	90
Apparel manufacture	170	27	79
Eating and drinking places	174	8	55
Leather and leather products	185	24	61
Personal services	188	18	59
Agriculture	189	4	16

**Labor Unions** In the structure of economic relationships, the labor union attempts to work primarily on the supply side.

In a strike for higher wages, the employer’s demand for labor to meet a market need is pitted against a supply withheld by the union. Union leaders are often very adroit in selecting the appropriate time to strike as judged by the markets for the employer’s products.

To strengthen their control over the supply of labor, unions seek such goals as union or closed shops, regulated or restricted substitution of capital for labor through technology, and

controlled entry into apprenticeship programs. All compensation must come from products sold in a market that is usually competitive in nature.

Inequitable compensation to any or all will create trouble in maintaining the health of the organization. The increase in the strength of labor unions is due, in part; to the fact the employees’ interests had not been receiving attention equal to that given to other components of the enterprise.

The impact of this strength is shown in Figure 12-1. In the six highest-paying industries, approximately half of the full-time workers are organized. In the six lowest-paying industries, only 14 per cent are recognized. It should also be noted that the percentage of female employees is lowest among the highest-paying industries.

Ability to pay Labor unions have often demanded an increase in compensation on the basis that the firm is prosperous and able to pay. However, the fundamental determinants of the wage rate for the individual firm issue from supply and demand.

If the firm is marginal and cannot afford to pay competitive rates, its employees will generally leave it for better-paying jobs. Admittedly, this adjustment is neither immediate nor perfect because of problems of labor immobility and lack of perfect knowledge of alternatives.

If the firm is highly successful, there is little need to pay far more than the competitive rate to obtain personnel. Such a firm, however, may choose to adopt a policy of paying above the competitive rate in order to attract a superior calibre of personnel. If firms in general are prosperous and able to pay, the tendency is to bid up the price of labor as a whole.

**Productivity** Beginning with the famed General Motors Contract with the United Automobile Workers (UAW) in 1948, much attention has been paid to the effect of general productivity increases in the economy upon the specific compensation of huge aggregations of employees.

In the battle against inflation, representatives of the federal government have attempted to use computed productivity gains as guidelines in the settlement of wage disputes between managements and unions. Between 1947 and 1966, the computed average annual productivity increases in manufacturing was set at 2.9 per cent, leading to the establishment of a ‘no inflationary’ guideline for wage increases of 3.2 percent.

With growing inflation, resulting briefly in short-term wage and price controls, the validity of this guideline suddenly vanished. With inflation reaching double

digit levels, the government approach of “jawboning” to influence negotiated settlements has been placed under serious handicaps.

An even more serious problem is that the average annual productivity increase in the United States during a recent 11-year period has sunk to 1.9 percent as compared with 9 percent in Japan, 5.5 percent.

In West Germany, 5.1 percent in France, and 2.8 percent in Great Britain.<sup>2</sup> During this same period, however, hourly pay has increased over 100 percent. A part of this problem of pay

speedup and productivity slowdown is characteristic of a maturing economy; service businesses now account for 70 percent of an jobs. Productivity advances in services are more difficult to effect than in manufacturing.

Though some have hailed the widespread use of productivity index as a major breakthrough in compensation, these are several serious drawbacks to its use. Among these are the following:

- (1) there is no precise and accurate measure of productivity acceptable to all;
- (2) the reported percent increases are generally a long-term average and are not achieved each year;
- (3) not all industries participate equally in productivity gains and
- (4) use of any index does not materially reduce controversy in bargaining since the index is used as the base from which to bargain.

### Cost of Living

Another formula hailed by many as the answer is the cost-of-living adjustment of wages. Among the problems engendered by this approach are the following:

- (1) no cost-of-living formula will indicate what the base compensation should be- it merely indicates how that rate should vary;
- (2) this approach tends to vary monetary income but freeze real income, a result with which labor is not content; and
- (3) as in the case of productivity indexes, there are certain measurement problems in ascertaining cost-of-living increases. The Consumer Price Index of the Bureau of Labor Statistics, however, is widely accepted and followed by many employers and labor organizations.

Cost-of-living adjustment of compensation constitutes no fundamental solution to equitable compensation to employees. It is useful as a stopgap device in times of inflation when labor is pressed to keep up with the rise in prices.

It is an essential ingredient of long-term labor contracts unless provision is made to reopen the wage clause periodically. The United Auto Workers agreement, for example, provides for quarterly cost-of-living adjustments amounting to a 1-cent increase for every 0.3 percent advance in the Consumer Price Index.

### Government

Our varying levels of government often have very specific things to say about wages and salaries despite the theoretical and nebulous nature of equitable compensation. There are at least three major federal laws that deal directly with the subject of compensation.

Employees assigned to executive, administrative, or professional positions are usually excluded from coverage by the act. Labor organizations constantly press for increases in the minimum wage, decreases in the standard workweek, and increases in the penalty for overtime hours, all in the interest of increasing total compensation for labor.

### Equity and Compensation

If our first goal of attracting capable employees to the organization is to be achieved, personnel must perceive that the compensation offered is fair and equitable. Equity is concerned with felt justice according to natural law or right.

Homans's exchange theory predicts greater feelings of equity between people whose exchanges are in equilibrium. When an employee receives compensation from the employer, perceptions of equity are affected by two factors:

1. the ratio of compensation to one's inputs of fort, education, training, endurance of adverse working conditions, and so on.
2. the comparison of this ratio with the perceived ratios of significant other people with whom direct contact is made. Equity usually exists when a person perceives that the ratio of outcomes to inputs is in equilibrium both internally with respect to self and in relation to others.

In Figure 12-2, nine different situations are proposed. Equity theory would hypothesize that the correlation of pay and contribution that exists in cells 3, 5, and 7 would result in feelings of equity. In all other cells, feelings of dissonance are likely to exist. Research conducted with respect to under-reward situations (6, 8, and 9) clearly indicates that employee satisfaction is lower than in either the equity or over-reward situations.

Employee contributions exceed their outcomes of money. Resulting dissatisfaction often leads to efforts to reestablish equilibrium, such as "borrowing" from the supply room to increase rewards, trying to adversely affect the effort and pay of others, convincing self that pay is not out of line, quitting or frequently absenting oneself from the organization, promoting labor organization, and so on.

Concerning the over-reward situations (cells 1, 2, and 4), original research conducted by Adams suggested that feelings of discomfort and guilt resulting from inequitably higher pay would lead to actions to reduce dissonance. He led an experimental group of employees to believe that the pay allocated was significantly in excess of their qualifications.

**Figure 12.2. Equity in Compensation**

Gross Over reward (1)	moderated over award (2)	Equity (3)
Moderated Over reward (4)	Equity (5)	moderate under reward (6)
Equity (7)	Moderate under reward (8)	gross Under reward (9)

(output background etc)  
( line of equity)



## LESSON 30: FRINGE BENEFITS

### A Case Study On Teri Rewards Corporate Efforts

The annual awards recognise the efforts of corporates in environmental management and sustainable initiatives

In order to encourage environmental management and protection in the corporate sector, TERI instituted the Corporate Environmental Awards last year. Encouraged by the response and interest shown by corporates, TERI has decided to confer the awards annually.

The objective of the awards is to recognise the leadership efforts of corporates in environmental management and sustainable initiatives, recognise innovative practices that promote sustainable development and further encourage and provide momentum to environmental initiatives.

The awards are divided into three categories: Category 1: companies with a turnover of less than or equal to Rs 100 crore per annum; Category II: companies with a turnover of between Rs 100 crore and Rs 500 crore per annum; and Category III: companies with a turnover above or equal to Rs 500 crore per annum. The application fee for category I is Rs 500 per application; category II, Rs 2,000, and category III, Rs 5,000.

Says R K Pachauri, director general, TERI, "The TERI Corporate Environmental Awards help corporates and Indian society in general in two major ways. Firstly, the awards recognise good practices and excellence in protecting the environment on the part of deserving corporate organisations. Secondly, the awards help to focus on the responsibility of business in protecting the environment and conserving our natural resources.

Even those organisations that do not participate in the process will get to know about these awards and feel motivated to do their bit in the same cause. Overall, these awards will help to prepare businesses for the coming era when the corporate sector will have to face very stringent environmental standards to be imposed by the public at large and governments in particular. The bottomline of a company that prepares effectively for such a future will be healthier than that of one that does not."

Out of 110 applications received by TERI this year, 18 companies were shortlisted and the final awards will be given on June 17. The selection of the awards are based on a questionnaire filled by the company and a case study on the environmental initiative undertaken. After shortlisting the companies, experts from TERI visit the site to check on the authenticity of the environmental initiative.

The case studies were evaluated on the basis of a few pre-set parameters, like pollution prevention-proactive practices, process improvements and modifications undertaken resulting in environmental improvement, waste reduction and energy or resource conservation.

Scientific research and technological innovation-research or technological innovations that have been implemented or demonstrated for addressing environmental issues.

Environmental benefits-success and effectiveness of the programme, both in terms of environmental and economic benefits. Potential model for business commitment-the replicability or transferability of the practices, outcomes or experience of the project.

The jury members for selecting the awards are Justice J S Verma, former-chairperson, National Human Rights Commission and former chief justice of India; Vishwanath Anand, vice-chairperson, National Environment Appellate Authority; Suman K Bery, director-general, National Council of Applied Economic Research; Sanjaya Baru, chief editor, The Financial Express; and R K Pachauri, director general, TERI.

In Category I, five companies were shortlisted: M K Electric; Chemfab Alakalis Ltd; Shriram Alkali and Chemicals; The Orchid—An Ecotel Hotel and Hitech Arai.

In Category II, five companies were shortlisted: Andhra Paper Mills Ltd; Sanghi Spinners India Ltd; Shree Cements Ltd; Star Paper Mills Ltd and Samcor Glass Ltd.

In Category III, eight cases were shortlisted: Orient Paper Mills; Grasim Industries Ltd; Bharat Petroleum Corp. Ltd; Hindustan Lever Ltd; Chennai Petroleum Corp. Ltd; Harihar Polyfibres; Hindalco Industries Ltd and Hero Honda Motors Ltd.

How are the TERI Corporate Environmental Awards different from other similar awards? Mr Pachauri explains, "I am not aware of any other award dealing with environmental performance where such rigorous evaluation and objective scrutiny is carried out in determining the winner.

Not only is the technical and economic evaluation of each entry carried out by a team of researchers from TERI, but the final decision is taken by a very eminent panel of judges chaired by a former chief justice of India. It is the result of the objectivity and rigour of the process that has given these awards the prominence they have attained in a short period of time.

Another feature of the award, which is worth mentioning, is the subdivision of companies on the basis of turnover. Hence, the performance of a small unit is not evaluated against that of a large enterprise, which may have very different managerial and technological capabilities. The awards are differentiated on the basis of size of the enterprise."

Last year, TERI received some 89 entries; this year, it is 110. Mr Pachauri does not think the numbers are low. "Firstly, a jump of over 25 per cent in the entries received in merely a year is a very encouraging development, but the figure of 110 entries consists of very serious contenders. We accept entries only with a modest processing fee. This eliminates those who may not be serious and those who have only trivial achievements to claim.





## LESSON 31: THE CONCEPT OF FRINGE BENEFITS

### Learning Objectives

- Contribution Of Other Factors On The Concept Of 'Fringe Benefits
- Coverage of benefits

The primary effect of fringe benefit type of compensation is to retain the employee in the organization on long term basis. There is little or no evidence that the tremendous variety of supplementary pay plans often termed fringe benefits served to motivate employees to higher productivity.

In a study of 550 white collar employees, it was concluded that the average employee was aware of about one half of the supplementary pay programme feature- this despite and unusually comprehensive and active programme of communication with respect to employee benefits available. One of these firms most costly and widely publicised benefits - a disability wages was essentially unheard of by 60% of those responding to the questionnaire. When asked if they felt that they knew enough about these plans over three quarters replied that they did. In a second study in another company 249 new hires were queried concerning their knowledge of benefits explained during a comprehensive induction programme. A correlation between knowledge and attitude towards the company's fringe benefit programmes proved to be quite low.

Despite the absence of motivational affects employee benefit programme make up a significant portion of most personnel department budgets. Therefore it should be a major concern in any organization to make their employees abreast about the fringe benefit programmes in order to motivate them and thereby improving the status of their organization.

### Contribution Of Other Factors On The Concept Of 'Fringe Benefits'

For instance,

- (i) Rising prices and cost of living has brought about incessant demand for provision of extra benefits to the employees.
- (ii) Employers too have found that fringe benefits present attractive areas of negotiation when wage and salary increases are not feasible.
- (iii) As organizations have developed more elaborate fringe benefits programmes for their employees, greater pressure has been placed upon competing organizations to match these benefits in order to attract and keep employees.
- (iv) Recognition that fringe benefits are non-taxable rewards has been a major stimulus to their expansion.
- (v) Rapid industrialization, increasingly heavy urbanization and the growth of a capitalistic economy have made it difficult for most employees to protect themselves against the adverse impact of these developments.

Since it was workers who were responsible for production, it was held that employers should accept responsibility for meeting some of the needs of their employees. As a result, some benefits-and-services programmes were adopted by employers.

- (vi) The growing volume of labour legislation, particularly social security legislation, made it imperative for employers to share equally with their employees the cost of old age, survivor and disability benefits.
- (vii) The growth and strength of trade unions has substantially influenced the growth of company benefits and services.
- (viii) Labour scarcity and competition for qualified personnel has led to the initiation, evolution and implementation of a number of a compensation plans.
- (ix) The management has increasingly realized its responsibility towards its employees and has come to the conclusion that the benefits of increase in productivity resulting from increasing industrialization should go, at least partly, to the employees who are responsible for it, so that they may be protected against the insecurity arising from unemployment, sickness, injury and old age. Company benefits-and-services programmes are among some of the mechanisms which managers use to supply this security.

A "tripartite" concept of individual protection has developed in recent years. First, every individual is expected to be at least partially responsible for his own present and future well-being. Second, industry is now expected to protect its workers from the hazards of life. Finally, the government is involved in supporting and financing worker assistance programmes. The contribution of these three parties varies in accordance with the nature and purpose of the various employee benefits-and-services programmes.

A number of factors influence the decision to set up a particular employee benefits and services programme. According to Nielson, the criteria governing such a programme are:

- (a) Cost;
- (b) The ability to pay;
- (c) The needs of the employees;
- (d) The bargaining strength of the trade union;
- (e) Tax considerations;
- (f) Public relations;
- (g) Social responsibility; and
- (h) The reactions of the employees.

The following table summarizes the factors, key forces and their potential impact on benefits:

**Table 1**  
**Factors Likely to Shape Future Benefits and Their Relative Impact**

Relative Impact of Forces on Benefits		
Some	Moderate	Strong
1. Better labour-force education 2. Growth in white-collar versus blue-collar occupations 3. Relative growth of minorities and increased participation in work force 4. Growth in relative youthfulness of work force 5. Growth in female component of work force 6. More technological changes 7. More urbanization	1. Rise in individual influence 2. Extension of unionization, new unions 3. Medical advances (e.g. transplants, life extension) 4. Participative planning with institutional members	1. More leisure time, vacations, holiday 2. Pressure from established unions 3. New public welfare programme 4. Minority, frustrations and pressures.

### Coverage of Benefits

Benefits consist of items or awards which are supplementary to normal pay. Some – such as pensions and sick pay – are essential entitlements, so the common term ‘fringe benefits’ is perhaps misleading.

Certain provisions of the maintenance of adequate standards of living have been underwritten by the state, which has legislated for employees and employers alike to, bear some of the cost. They are awarded to anyone who meets certain qualifying conditions and as such are independent of the employer’s discretion and performance considerations.

Other benefits such as cars, medical insurance and ‘perks’, are more in the nature of optional extras and as such may be part of the recruitment retention and incentives strategies of the organization. Entitlements include the following:

#### a. Pension Provisions

Pensions are generally regarded as the most important benefit after basic pay: they are a kind of deferred pay, building up rights to a guaranteed income on retirement (or to dependants, on death) They are financed by contributions from the company, with facilities for contribution by employees as well.

#### b. Sick Pay

It is understandable that sickness or other enforced absence from work would haunt workers with the prospect of lost earnings, unless there was some sort of provision for genuine sufferers. Many employers supplement the state benefit by additional sick pay schemes, which may be tailored to the organization’s particular objectives (looking after long serving employees, or generosity from the outset to attract recruits’

#### c. Maternity Leave and Maternity Pay

Benefit given to the female employees of the organization.

#### d. Holidays

This is a benefit, which is very much taken for granted, but it was only recently working Time Regulations 1998) that any formal entitlement to annual leave was formulated. Employees who have been continuously employed for 13 weeks are entitled to 15 days’ leave per annum, rising to 20 days for leave commencing after November 1999.

There is no statutory right to ‘customary’ holidays (public holidays, Christmas etc) although these may be granted by contract terms. Additional holiday entitlements may be regarded as a fringe benefit, including sabbaticals and long-service leaves.

Other benefits which may be offered include the following:

### Company Cars

It is a highly-regarded benefit in the UK, especially among managerial staff for whom they have connotations of status, despite the reduction in tax incentives over the years – and those whose work requires extensive road travel (eg. sales and service staff).

### Transport Assistance

Examples may include loans for the purchase of annual season tickets, or bulk buying of tickets by employers for distribution to staff.

### Housing assistance, perhaps in the form of

Allowances to staff who have been transferred or relocated – removal and traveling expenses, lodging, convincing fees and so on or assistance with house purchase – bridging loan, preferential mortgage terms.

### Medical Benefits

Say private medical and/or dental insurance. Some medical services may also be provided at the workplace: for example eye and hearing tests (where relevant to the industrial context).

### Catering Services

Most commonly, subsidized food and drink at the workplace or Luncheon Vouchers.

### Recreational Facilities

It is a subsidy and organization of social and sports clubs or provision of facilities such as a gymnasium or bar.

### Allowances

For telephone costs, professional subscriptions or work related reading matter. Discounts or preferential terms on the organization’s own products services. Bank employees, for example, may receive: a mortgage subsidy; discounts on unit trusts or insurance products; bonus interest on accounts or savings plans; or reduced interest rates on overdrafts and loans.

### Educational Programmes

In-house study opportunities, or sponsorship of external study (not necessarily work-related).

### Family-friendly Policies

Such as workplace nurseries, term-time hours contracts, career break schemes.

It has been recognized that certain benefits must be supplied by the organization for its employees, regardless of whether it wants to or not. With few exceptions, the hiring of any employee requires the organization to pay social security premiums, workmen’s compensation, etc.

Similarly, the payment of these costs by the organization provides the employee with financial protection at retirement, termination, or as a result of injury, and it also provides to the workers’ dependants in case of the employees’ death.

**The National Association of Manufacturers has indicated the following classification of fringe benefits**

- (a) Premium Payments for the period of time a worker has worked; for example, payment on daily or weekly basis, holidays, overtime pay, shift differentials, the cost of living bonus, bonus in lieu of vacation.
- (b) Payment for special duties, such as working on grievance redressal procedures and labour contract negotiations.
- (c) Payment for health and security benefits: These include retirement plans, social security payments, savings plans, profit-sharing plans, group life insurance, medical, surgical and hospital insurance, accident and sickness insurance, supplemental employment benefits, payments under the Workmen's Compensation Act, disability insurance, old age and survivor insurance, and unemployment compensation.
- (d) Payment for time not worked, which includes payment for sick leave and for time during which an employee is under medical care, payment for holidays, vacations, witness time, voting time, excused absence, lunch periods, rest periods, work-up time, reporting pay, severance pay, payment for call-all-time, call-back time, dressing time, portal-to-portal time and wet-time.
- (e) Payment for employee services, including cafeteria subsidies, union credit, house financing, parking space operations, etc.
- (f) Other expenditure, such as that incurred on making Christmas gifts or offering Christmas bonus, on educational reimbursements, employee uniforms, work clothes, safety equipment or allowance, laundry allowance, supper money or meal allowance.

**The United States Chamber of Commerce classifies benefit items into five Categories**

**These are**

- (a) Payments that have to be made under any specific legislation;
- (b) Pensions and such other payments as have been agreed upon;
- (c) Paid rest period, lunch periods, wash-up time, travel time, time taken to change clothing, and get-ready time;
- (d) Payments for time during which an employee has not put in any work at all; and
- (e) Other items, including profit-sharing payments, bonus, etc.

**Cockman, however, has made a two-fold classification of Fringe benefits**

- (i) Those which are offered on the basis of status - car, entertainment facilities, holiday, foreign travel, telephone, security-insurance and medical benefits, children's educational facilities; and work benefits - office accommodation, secretarial services, management training, company scholarships; and
- (ii) Those which are key benefits, that is, share schemes, profit sharing, retirement, benefits, counseling services, and house purchase facilities.

On the basis of their identification, however, benefits may be classified as under:

**a. Employee Security Payments: These include**

- (i) Employers contribution stipulated in legal enactments: old age, survivor, disability, health and unemployment insurance;
- (ii) Payments under the Workmen's Compensation Act;
- (iii) Supplemental unemployment benefits;
- (iv) Accident insurance;
- (v) Pensions;
- (vi) Contributions to saving plans and health and welfare funds.

**b. Payment for Time not Worked**

Under these are included call-back and call-in pay; clean-up time; health-in-the-family leave; family allowance; holiday pay; layoff pay; medical time; paid lunch periods; portal-to-portal time; pay for religious holidays; reporting pay; pay for rest periods; severance pay; paid sick leave; payment for time spent on collective bargaining and on the redressal of grievances; vacation pay; pay for the time spent in offering evidence in a court of a law or other statutory bodies; and payment for the time spent on casting one's vote at election time.

**Rest Period**

Among office jobs and those jobs requiring heavy exertion, high repetition, or diligent concentration, certain "breaks" - popularly known as a 'Rest period' or a 'Coffee break' - are allowed during the day to allow the worker to rest. The idea is to allow the worker some mental and physical diversion from his job.

**Holidays**

Certain days in the year are stipulated as paid holidays. In Western, Countries like USA, USSR and U.K., Christmas, New Years, 'Thanks giving, Labour day, are particularly included, on which the employees are paid and they do not have to work.

In India, Independence Day, Republic Day, Gandhi Jayanti, Deepavali, Dashara, Holi, Id, Christmas, Gurunanak Jayanti, Mahaveer Jayanti are gazetted holidays.

**Vacations**

Paid vacations vary from 15 days to 1 month in a year. These are given to the employee after he has put in a specific period of time. The rationale behind the paid vacation is to provide a break in which the employee can refresh himself.

**Sick Leave**

provides an employee pay when he is out of work due to illness. Full pay for a specified number of "permissible" sick days are granted to the employees.

**Severance Pay**

This provides a one-time payment when an employee is terminated. This is done on humanitarian ground.

**Leave of Absence**

This covers leave of absence for which pay is provided. Educational leave is given to managers or management trainees during the training period.



## LESSON 32: CONCEPT OF EMPLOYEE SERVICES AND FRINGE BENEFITS IN INDIA

### Learning Objective

- Introduction to the Concept of Employee Services
- Special Features of Employee Service Programme
- Drawbacks of Employee Service Programme
- Fringe benefits in India

### Introduction to the Concept of Employee Services

In addition to the above fringe benefits, organizations also provide a wealth of services that employees find desirable.

These services are usually provided by the organization at no cost to the employee or at a significant reduction from what might have to be paid without the organization's support. These services are provided at the discretion of the management and are generally of some concern to trade unions when they engage in collective bargaining with the employees. These services include:

- (i) Services related to the type of work performed, including subsidies for the purchase and upkeep of work clothing and uniforms and of the various types of tools used by a worker in the course of his work;
- (ii) Eating facilities, which include the provision of company restaurants, cafeterias, canteens, lunchrooms, vending machines, and fully or partially subsidized food;
- (iii) Transportation facilities, including parking lots and bus services;
- (iv) Child care facilities, comprising nurseries and day care centers for children;
- (v) Housing services, including company-owned housing projects and subsidized housing;
- (vi) Financial and legal services, including sponsoring of loan funds, credit unions, income-tax service, legal aid, saving plans, and group insurance plans;
- (vii) Purchasing services, such as company-operated stores and discounts on company products and services;
- (viii) Recreational, social and cultural programmes, including athletics, beauty parlors, social clubs, recreational areas, orchestras, entertainment programmes, parties, picnics, libraries and reading rooms.
- (ix) Educational services, which include sponsorship for off duty courses, educational leave, tuition fee refunds, and scholarships for employees and their children;
- (x) Medical services, including plant infirmaries, clinics and hospitals, counseling services and referrals to community social services;

(xi) Outplacement services, which include contacts with other employers in the area, help in writing up resumes, and secretarial assistance.

(xii) **Flexi time:** The workers are permitted to build up their 'flexible work day' around a core of mid-day hours (such as 11.00 to 2.00). It is called 'flexi time' because the workers themselves determine their own starting and stopping time. For example, they may opt to work from 7.00 to 3.00 or 11.00 to 7.00.

### Special Features of Employee Service Programme

- (1) Since less time is lost due to tardiness, the ratio of man-hours worked to man hours paid increases.
- (2) Absenteeism is reduced and sick-leave cut down.
- (3) The hours actually worked seems to be more productive, and there is less slowing down toward the end of the work day.
- (4) It reduces the tedium associated with the timing of the employees' work and democratizes the work.
- (5) The distinction between the management and professional workers is reduced and more authority is delegated by supervisors.

### Drawbacks of Employee Service Programme

- (i) Flexitime is complicated to administer and may be impossible to implement where large group of workers must work independently.
- (ii) It requires the use of time-clocks or other time records, which might irritate the workers.
- (xiii) Cafeteria Services: one of the recent developments in this field has been the formulation of the cafeteria compensation concept or what is known as 'smorgasbord.'

Depending on their age, their educational and income levels, their life styles and other forms of preference, different categories of employees need and demand different combinations of benefits and services.

It may be pointed out here that no company provides all these benefits and services. Those that are provided are determined by the needs of employees and the preferences of a company.

Among the benefits and services which are most commonly offered are life insurance, health insurance, pension, unemployment compensation, protective clothing and equipment, rest periods and vacations.

Some benefits, such as holidays, vacation and pension, enable employees to meet their self-actualization needs; they make it possible for them to be away from their job, participate in other activities and share in other experiences even while they continue to receive their wages or salaries.

These benefits, moreover, satisfy one's need for esteem in that they are often looked upon as indicators of one's personal worth.

For example, a typical young man generally desires to have direct wages and educational assistance, while an older employee often opts for pension and health insurance services.

The cafeteria compensation concept generally involves the idea "that each employee ought to design and tailor his own indirect compensation programme by personally picking and choosing the benefits and services he would desire to have from among the many such benefits and services provided by his company.

Choice and decision generally depend upon the discretion of each individual employee and not on a management fiat or a centralized collective bargaining agreement.

### **Fringe Benefits in India**

When the Employers' Federation of India conducted a study of fringe benefits in this country, it was revealed that, in 1960, 981 companies, which were included in the survey, paid a little over Rs. 2,148.3 million in wages and fringe benefits, and that the latter was about 21.3 per cent of their total wage bill in that year.

The fringe benefits were high in the mining (24.84 per cent of the wage bill) and plantations industries (24.3 per cent of the wage bill), and were comparatively low in the manufacturing sector (19.99 per cent of the wage bill).

In each of these three sectors, however, variations were considerable. In the mining industry, the percentage of fringe benefits varied from 24.5 to 27.88, while in the manufacturing sector it varied between 13.42 and 32.11, followed by the cigarette industry (31.42) and aluminum, brass and copper industries (30.56).

A break-up of fringe benefits by types revealed that, of the total amount paid on fringe benefits, that which was paid for the time not worked and for profits and bonus was the highest, accounting for a little more than 9 per cent of the total wage bill.

Payments which had to be made under legislative enactments were between 6.1 per cent and 7.5 per cent of the total, while voluntary welfare schemes accounted for 5.36 per cent of the wage bill.

In the plantation industry, however, these welfare schemes formed 9.4 per cent of the wage bill, while in the other two (mining and manufacturing industries), they respectively accounted for 4.12 per cent and 3.4 per cent of the total wage bill.

A considerable proportion of fringe benefits was in the shape of monetary bonus and constituted about 5 per cent of the wage bill. The bonus was of various kinds - profits bonus, attendance bonus, service bonus, gratuity payments, etc. The quantum of the bonus varied from sector to sector.

### **Payments for Time not Worked**

These payments were fairly substantial in the manufacturing industry (5.35 per cent), the mining industry (4.81 per cent) and plantations (3.24 per cent). In the manufacturing sector, the percentage of expenditure on this item varied between 3.06 and 10.42.

Industries which spent a relatively larger sum on this item were cigarette manufacturing and distributing (10.42 per cent), petroleum refining and selling (7.15 per cent), chemicals and allied industries (7.11 per cent) and shipbuilding (6.60 per cent).

### **Statutory Fringe Benefits**

These benefits are generally social security, and include gratuity and pension payments, the employer's contribution to the employees' provident fund account and health insurance scheme.

The employers' contribution to statutory provident fund constitutes by far the largest item of expenditure, accounting for 4.23 per cent of the total wage bill in the plantations, mining and manufacturing industries put together.

The expenditure on employees' state insurance contributions by the manufacturing industries was 0.36 per cent, while that on gratuity account was 0.59 per cent.

The "other expenditure" incurred under statutory regulations and tribunal awards was on compensation paid to workers, welfare cess payments in the coal mining industry and on the supply of protective clothing in the plantations industry. The expenditure on maternity clothing in the manufacturing and mining industries.

### **Voluntary Benefits**

Retirement benefits, medical care, compensation for injuries and disablement, subsidized food and housing, educational and cultural facilities, payment on life insurance premia, the maintenance of canteens, cafeterias, assistance to co-operative societies - these are some of the benefits accounted for 9.40 per cent of the total wage bill in the plantations industry against 3.74 per cent and 4.12 per cent in the mining and manufacturing industries respectively.

The social security benefits voluntarily provided by companies include provident fund, gratuity and pension.

The medical assistance schemes voluntarily provided by employers were the largest single item of expenditure, and accounted for 1.80 per cent of the total expenditure of 5.36 per cent voluntarily incurred by them.

The plantations industry spent 4.78 per cent of its total wage bill on this particular voluntary service against only 0.84 per cent spent by the manufacturing industries. The latter's expenditure on canteens, however, was about 0.70 per cent of its total wage bill against that of 0.07 per cent spent by the mining industries.

In the manufacturing industries, nearly two-thirds of the benefits were in the form of profit and bonus, of payments for time not worked and of contributions by employers to social security benefits. In the plantations and mining industries, however, this percentage was 57 and slightly more than 50 respectively.

Apart from the general fringe benefits for employees, there was a wide range of other benefits as well. Some of these benefits are: Rifle allowance to watchmen, cycle allowance to peons, free driving licences for drivers, compensation for a waiting period of three days, free quarters, water and electricity; free uniforms to certain categories of employees, conveyance allowance when no transport is provided by the company, travel concessions,

assistance to buy spectacles, provision of snacks during night shifts, shoe allowance of 20 paise and an allowance of 37 paise per hour if a worker attends education classes; sale of company products at concessional rates, benevolent fund assistance if a worker is struck down by tuberculosis or cancer, scholarships to employees' children; employees' tours of government projects, study leave, gift of a wrist watch after a meritorious service of ten years, presents to employees on the occasion of their marriage, co-operative bank facilities, festival allowance, free libraries and facilities for inpatient hospital accommodations.

### Assignment

1. Should Fringe benefits be called 'Fringes'? Why or why not?
2. Identify the major economic hazards of employee life and cite specific programme that relate to each hazard.

Sample Employment Agreement for Executives, which shows the various types of benefits for executives.

This Agreement (hereinafter referred to as the "Agreement") made and executed at [Place] this [Date], by and between [Company's Name] a company incorporated under the Companies Act, 1956 and having its registered office at [address](hereinafter referred to as the "Company", which expression shall, unless it be repugnant to the context or meaning thereof, be deemed to mean and include its successors and assigns) of the ONE PART AND [Employee's Name], Indian Inhabitant residing at [address](hereinafter referred to as the "Executive", which expression shall, unless it be repugnant to the context or meaning thereof, be deemed to mean and include its successors and assigns) of the OTHER PART.

Where As the Company is desirous of employing the Executive and the Executive wishes to accept employment with the Company, on the terms and subject to the conditions set forth in this Agreement.

Now it is agreed by and between the parties hereto as follows:

#### 1. Employment

The Company shall employ the executive and the Executive shall serve the Company, as a (specify the category of employment/service) of the Company, with such duties and responsibilities as may be assigned to the Executive by the President/CEO of the Company and as are normally associated with a position of that nature.

The Executive shall devote her best efforts and all of her business time to the performance of her duties under this Agreement and shall perform them faithfully, diligently and competently and in a manner consistent with the policies of the Company as determined from time to time by an officer of or President/CEO of the Company. The Executive shall report to the General Manager, (specify) Office of the Company.

The Executive whilst working in the Company shall not engage in activities outside the scope of her employment if such activities would detract from or interfere with the fulfillment of her responsibilities or duties under this Agreement or require substantial time or services on the part of the Executive. The Executive shall not serve as a director (or the equivalent position) of any company or other entity and shall not receive fees or any other remuneration for work performed either within or outside the scope of her employment without prior

written consent of the President/CEO of the Company. This consent shall not be unreasonably withheld.

#### 2. Term of Employment

The Executive's employment by the Company under this agreement shall commence on the date of this Agreement and subject to earlier termination pursuant to Clause 5 or 7, shall terminate on (specify date). This Agreement may also be extended as needed by a written amendment as discussed in Clause 8.

#### 3. Compensation

As full compensation for all services rendered by the Executive to the Company under this Agreement, the Company shall pay to the Executive the compensation set forth in Schedule A attached hereto. This schedule may be amended from time to time in writing by the Company and the Executive.

#### 4. Fringe Benefits; Expenses

A. The Executive shall be entitled to receive all health and pension benefits, if any, provided by the Company to its employees generally and shall also be entitled to participate in all benefit plans, if any, provided by the Company to its employees generally.

B. The Company shall reimburse the Executive for all reasonable and necessary expenses incurred by her in connection with the performance of her services for the Company in accordance with the Company's policies, upon submission of appropriate expense reports and documentation in accordance with the Company's policies and procedures. The Company will reimburse the Executive for the expenses involved with her acquisition and business-related use of a portable cellular telephone.

C. The Executive shall be entitled to Three (3) weeks paid vacation annually, to be taken at times selected by her, with the prior concurrence of the General Manager to whom the Executive is to report.

#### 5. Disability or Death

A. If, as the result of any physical or mental disability, the Executive shall have failed or is unable to perform her duties for:

- a. period of Sixty (60) consecutive days, the Company may, by notice to the Executive subsequent thereto, terminate her employment under this Agreement as of the date of the notice without any further payment or the furnishing of any benefit by the Company under this Agreement (other than accrued and unpaid basic salary and commissions and expenses and benefits which have accrued pursuant to any plan or by law).
- b. The term of the Executive's employment under this Agreement shall terminate upon her death without any further payment or the furnishing of any benefit by the Company under this Agreement (other than accrued and unpaid basic salary and commissions and expenses and benefits which have accrued pursuant to any plan or by law).

#### 6. Non-competition; Confidential Information; Inventions

A. During the term of the Executive's employment under this agreement, the Executive shall not, directly or indirectly,



engage or be interested (as a stockholder, director, officer, employee, salesperson, agent, broker, partner, individual proprietor, lender, consultant, or otherwise), either individually or in or through any person (whether a corporation, partnership, association, or other entity) which engages anywhere in India in a business which is conducted by the Company on the date of termination of her employment, except that she may be employed by an affiliate of the Company and hold not more than 2% of the outstanding securities of any class of any publicly held company which is competitive with the business of the Company.

B. The Executive shall not, directly or indirectly, either during the term of the Executive's employment under this Agreement or thereafter, disclose to anyone (except in the regular course of the Company's business or as required by law), or use in any manner, any information acquired by the Executive during her employment by the Company with respect to any clients or customers of the Company or any confidential or secret aspect of the Company's operations or affairs unless such information has become public knowledge other than by reason of actions (direct or indirect) of the Executive. Information subject to the provisions of this paragraph shall include, without limitation:

- (i) procedures for computer access and passwords of the Company's clients and customers, program manuals, user manuals, or other documentation, run books, screen, file, or database layouts, systems flowcharts, and all documentation normally related to the design or implementation of any computer programs developed by the Company relating to computer programs or systems installed either for customers or for internal use;
- (ii) lists of present clients and customers and the names of individuals at each client or customer location with whom the Company deals, the type of equipment or computer software they purchase or use, and information relating to those clients and customers which has been given to the Company by them or developed by the Company, relating to computer programs or systems installed;
- (iii) lists of or information about personnel seeking employment with or who are employed by the Company;
- (iv) prospect lists for actual or potential clients and customers of the Company and contact persons at such actual or potential clients and customers;
- (v) any other information relating to the Company's research, development, inventions, purchasing, engineering, marketing, merchandising, and selling.

C. The Executive shall not, directly or indirectly, either during the term of the Executive's employment under this Agreement or for a period of One (1) year thereafter, solicit, directly or indirectly, the services of any person who was a full-time employee of the Company, its subsidiaries, divisions, or affiliates, or solicit the business of any person

who was a client or customer of the Company, its subsidiaries, divisions, or affiliates, in each case at any time during the past year of the term of the Executive's employment under this Agreement.

For purposes of this Agreement, the term "person" shall include natural persons, corporations, business trusts, associations, sole proprietorships, unincorporated organizations, partnerships, joint ventures, and governments, or any agencies, instrumentalities, or political subdivisions thereof.

D. All memoranda, notes, records, or other documents made or composed by the Executive, or made available to her during the term of this Agreement concerning or in any way relating to the business or affairs of the Company, its subsidiaries, divisions, affiliates, or clients shall be the Company's property and shall be delivered to the Company on the termination of this Agreement or at any other time at the request of the Company.

E.

- (i) The Executive hereby assigns and agrees to assign to the Company all her rights to and title and interest to all Inventions, and to applications for Indian and foreign patents and Indian and foreign patents granted upon such Inventions and to all copyrightable material or other works related thereto.
- (ii) The Executive agrees for herself and her heirs, personal representatives, successors, and assigns, upon request of the Company, to at all times do such acts, such as giving testimony in support of the Executive's inventorship, and to execute and deliver promptly to the Company such papers, instruments, and documents, without expense to her, as from time to time may be necessary or useful in the Company's opinion to apply for, secure, maintain, reissue, extend, or defend the Company's worldwide rights in the Inventions or in any or all Indian patents and in any or all patents in any country foreign to the Indian, so as to secure to the Company the full benefits of the Inventions or discoveries and otherwise to carry into full force and effect the text and the intent of the assignment set out in Clause 6E(i) above.
- (iii) Notwithstanding any provision of this Agreement to the contrary, the Company shall have the royalty-free right to use in its business, and to make, have made, use, and sell products, processes, and services to make, have made, use, and sell products, processes, and services derived from any inventions, discoveries, concepts, and ideas, whether or not patentable, including, but not limited to, processes, methods, formulas, and techniques, as well as improvements thereof and know-how related thereto, that are not inventions as defined herein, but which are made or conceived by the Executive during her employment by the Company or with the use or assistance of the Company's facilities, materials, or personnel.

If the Company determines that it has no present or future interest in any invention or discovery made by the Executive under this paragraph, the Company shall release such invention or discovery to the Executive within Sixty (60) days after the Executive's notice in writing is received by the Company requesting such release. If the Company determines that it does or may in the future have an interest in any such invention or discovery, such information will be communicated to the Executive within the 60-day period described above.

(iv) For purposes of this Clause 6E, "Inventions" means inventions, discoveries, concepts, and ideas, whether patentable or not, including, but not limited to, processes, methods, formulas, and techniques, as well as improvements thereof or know-how related thereto, concerning any present or prospective activities of the Company with which the Executive becomes acquainted as a result of her employment by the Company.

F. The Executive acknowledges that the agreements provided in this Clause 6 were an inducement to the Company entering into this Agreement and that the remedy at law for breach of her covenants under this Clause 6 will be inadequate and, accordingly, in the event of any breach or threatened breach by the Executive of any provision of this Clause 6, the Company shall be entitled, in addition to all other remedies, to an injunction restraining any such breach.

## 7. Termination

The Company shall have the right to terminate this Agreement and the Executive's employment with the Company for cause. For purposes of this Agreement, the term "cause" shall mean:

- A. Any breach of the Executive's obligations under this Agreement;
- B. Fraud, theft, or gross malfeasance on the part of the Executive, including, without limitation, conduct of a felonious or criminal nature, conduct involving moral turpitude, embezzlement, or misappropriation of assets;
- C. The habitual use of drugs or intoxicants to an extent that impairs the Executive's ability to properly perform her duties;
- D. Violation by the Executive of her obligations to the Company, including, without limitation, conduct which is inconsistent with the Executive's position and which results or is reasonably likely to result (in the opinion of the President of the Company) in an adverse effect (financial or otherwise) on the business or reputation of the Company or any of its subsidiaries, divisions, or affiliates;
- E. The Executive's failure, refusal, or neglect to perform her duties contemplated herein within a reasonable period under the circumstances after written notice from the General Manager, or the President of the Company, describing the alleged breach and offering the Executive a reasonable opportunity to cure same;

F. Repeated violation by the Executive of any of the written work rules or written policies of the Company after written notice of violation from the General Manager or the President of the Company;

G. Breach of standards adopted by the Company governing professional independence or conflicts of interest. If the employment of the Executive is terminated for cause, the Company shall not be obligated to make any further payment to the Executive (other than accrued and unpaid base salary and commissions and expenses to the date of termination), or continue to provide any benefit (other than benefits which have accrued pursuant to any plan or by law) to the Executive under this Agreement.

## 8. Miscellaneous

- A. This Agreement shall be governed by and construed in accordance with Indian laws, applicable to agreements made and performed in Indian, and shall be construed without regard to any presumption or other rule requiring construction against the party causing the Agreement to be drafted.
- B. This agreement contains a complete statement of all the arrangements between the Company and the Executive with respect to its subject matter, supersedes all previous agreements, written or oral, among them relating to its subject matter, and cannot be modified, amended, or terminated orally. Amendments may be made to this Agreement at any time if mutually agreed upon in writing.
- C. Any amendment, notice, or other communication under this Agreement shall be in writing and shall be considered given when received and shall be delivered personally or mailed by Registered AD Post with, Return Receipt to the parties at their respective addresses set forth below (or at such other address as a party may specify by notice to the other): (specify addresses)
- D. The failure of a party to insist upon strict adherence to any term of this Agreement on any occasion shall not be considered a waiver or deprive that party of the right thereafter to insist upon strict adherence to that term or any other term of this Agreement. Any waiver must be in writing.
- E. The invalidity or unenforceability of any term or provision of this Agreement shall not affect the validity or enforceability of the remaining terms or provisions of this Agreement which shall remain in full force and effect and any such invalid or unenforceable term or provision shall be given full effect as far as possible. If any term or provision of this Agreement is invalid or unenforceable in one jurisdiction, it shall not affect the validity or enforceability of that term or provision in any other jurisdiction.
- F. This Agreement is not assignable by either party except that it shall inure to the benefit of and be binding upon any successor to the Company by merger or consolidation or the acquisition of all or substantially all of the Company's assets, provided such successor assumes all of the obligations of the Company, and shall inure to the benefit of the heirs and legal representatives of the Executive.

## LESSON 33: ADMINISTRATION OF BENEFIT PROGRAMME AND SERVICES

### Learning Objectives

- To know Benefit Programmes for Management
- To understand problems raised by Benefit Programmes
- To learn administration of Benefits and Services

### Introduction to the Concept of Benefit Programmes for Management

Special considerations and policies apply to the benefit programmes for the management, for which a different benefit structure is provided because of the fact that many legal considerations do not operate in their case.

For example, management personnel do not receive overtime allowance or payment; nor are they governed by trade union considerations or agreements. Managers generally are not entitled to, nor do they expect, many of the benefits and services to which employees in general are entitled.

However, management personnel are generally required to contribute in part to their insurance, gratuity, pension and provident fund. Tax exemptions become more important and meaningful for them as they advance in the management hierarchy.

The personnel department is generally responsible for the coordination of the plans for the administration of these benefits and services. For this purpose, it seeks the advice of the various departments, calls for their suggestions and anticipates the emergence of possible problems.

The final approval of the plans formulated for the management personnel, however, is the prerogative of the top authority of an organization.

### Problems Raised By Benefit Programmes

Many problems arise when these programmes are adopted and administered. These are:

#### i. Charge of Paternalism

When too many benefits and services are offered to employees, a feeling develops that employers are playing the role of parents and the workers are looked upon as their children. Moreover, the latter sometimes develop the feeling that these benefits and services are their "right" - which is not really so.

#### ii. Excessive Expenditure

The administration of these benefits and services is a fairly costly affair, involving large outlays of direct and indirect financial expenditure, and often involves a great deal of paper work.

#### iii. Fads Become Fashionable

With the introduction of these benefits and services in one company, other concerns vie with one another to introduce them as well. Credit unions and severance pay are examples of

benefits which were once considered to be novel but are now commonplace in industry.

#### iv. Maintenance of the Least Productive Workers:

With an increase in benefits and services, employees, particularly when they are not very productive, tend to stick to their jobs, and are not interested in changing them.

#### v. Neglect of Other Personnel Functions

When a management becomes more concerned about the provision and administration of benefits and services, it often pays very little attention to other aspects of personnel programmes. Over-emphasis on these benefits and services may often develop a concern among the employees for their future security rather than for their present productivity.

The relationship between a company's benefits-and-services programmes and employee motivation for increased production is what weak.

### Administration of Benefits and Services

Organizations fumble while administering employee benefits and services. Organizations have seldom established objectives, systematic plans and standards to determine the viability of the programmes.

The main problem is the lack of employee participation. Managers, too, take little interest in the benefits programme and trade unions are almost hostile to the schemes. Managers are not even aware of the organization's policy towards benefits and their contribution to the quality of corporate life.

Trade unions entertain a feeling of alleviation as the benefits are likely to erode their base. These problems can be avoided if steps are taken:

- (i) to establish benefit objectives;
- (ii) to assess environmental factors;
- (iii) to assess competitiveness;
- (iv) to communicate benefit information;
- (v) to control

### Future Trends in Reward Management

The considerable developments in reward management that have taken place recently are associated with changes in the economic and competitive environments in which businesses operate and the ways in which they respond to these external challenges.

Reward management strategy is an extension of the organization's business strategy. trends in reward practices can only be forecast in the light of predictions on how business strategies and the programmes flowing from them are likely to develop. There is no doubt that changes in reward management over the last decade have been in response to changes in business strategies and practices which in turn have responded to changes in the competitive environment.

These changes have been well summarized by Rosabeth Moss Kanter when she defines her model of the post entrepreneurial corporation as a leaner organization with fewer 'extraneous' staff which 'focuses on doing only those things in which it has competence' she suggests that the post entrepreneurial computation 'represents a triumph of process over structure... in contexts requiring speed and dexterity, what is important is not how responsibilities are divided but how people can pull together to pursue new opportunities'.

Increasingly, people have had to learn how to function in constantly changing roles; indeed, how to carry out simultaneously a number of different roles. They have to achieve a balance between concentrating on their own areas of skill and responsibility and working together with others.

Businesses have had to look very hard at the ways in which they employ people, using value-added analysis techniques to ensure that each step carried out in a work process and decision sequences augment the previous step.

In developing business strategies and the HR and reward strategies that flow from them, organizations have been driven by the need to satisfy demands for flexibility, continuous development and team work. To make the best use of their distinctive competences they have had to attract, retain motivate and develop distinctive people. And, importantly, they have to ensure that they get value for money from their reward practices.

It is these business trends which, have governed the most important reward management developments in recent years, namely: a more strategic focus, a more flexible approach to job evaluation, greater focus on external relativities, job family modelling, broad banding, the assessment of inputs (competences) as well as outputs in performance management processes, competence-related pay, team pay and flexible benefits.

So far as business change is concerned, there is no evidence that there will be any significant future difference in its nature or direction, at least in the short to, medium term. Of course the pace of change will vary; governments and recessions will come and go; and the ED and the possible single currency will make a difference. And, following the change in Government, there may be changes in the attitudes to corporate governance' and an increased emphasis on the responsibility of businesses to their stakeholders.

It is interesting to remember the CBI/Hay 1995 survey findings<sup>2</sup> that almost half the 480 UK organizations surveyed had changed some aspect of their pay strategy or policy in the previous two years. The areas most affected were pay structure, pay progression and the introduction of profit related pay.

For these organizations, the emphasis in the next few years is more likely to be on consolidating and testing innovations rather than on seeking new nostrums. This will particularly apply to such developments as broad banding, competence-related pay and team pay.

The CBI/Hay survey established that 'the most significant factor driving change in pay and benefit policy are the need to strengthen the link to business performance, cost control,

support for organizational change, and recruitment and retention pressures...

The need for more flexibility in pay and benefits is likely to become more urgent. Businesses which are still contemplating the changes required to improve the effectiveness of their reward processes will be taking account of these factors.

### **The CBI/Hay survey found that:**

13 per cent of responding organizations planned to introduce team pay;

30 per cent were making changes in their benefits packages, mainly to allow more flexibility; 17 per cent planned to introduce a broad banded pay structure;

13 per cent intended to introduce a formal performance management process.

The 1996 IRS survey of 270 private 'sector companies<sup>3</sup> found that 54 per cent intended to revise their reward practices in the next 12 months. The initiative most often mentioned was PRP, cited by 36 per cent of those contemplating a change, followed by competence-related pay (33 per cent).

So the future does not necessarily include any quantum leaps in reward management policy and practice. But environmental and organizational demands are encouraging developments such as those set out by Murlis.

Well-developed career management programmes that enable employees to see how they can manage their own progression in an environment where promotion' is rarer and more significant when it happens, and when building experience in different roles is the way to progress;

Well-designed and implemented performance management processes that often embrace the use of competences and 'so support development, as well as the achievement of objectives, and which link credibly to performance-related pay progression and other variable pay schemes;

Line management skilled in interpreting market data, making local pay decisions and operating and communicating the policies needed for this new environment;

Well-validated salary market 'anchors' for the new roles, which managers can review and use as background for pay budgeting and pay progression decisions;

Strong, locally based financial control and modelling systems to support decision making and help ensure the prevention of pay drift.

### **Case: The Ineffective Incentive**

George Morales had worked at the Adams Company for 8 years in the extrusion press department. He had progressed from his break-in job of laborer to sawyer, leadout, and the top job of heater and press operator. The functions of the press operator are to operate the press, act as lead man of the crew, and arrange his work into an orderly sequence. George had spent most of his time on a press of 2,500-ton capacity, although presses of larger capacities were available.

An incentive system had been installed in the press area and was based on the load and extrusion cycles to determine the standard minutes. The actual time to perform the job was

divided into the standard minutes to determine the efficiency of the crew.

George had performed satisfactorily for a long period of time in all classifications, particularly in that of operator. He was considered as having a pleasing personality and being an efficient operator with an average efficiency of 116 percent, an excellent coordinator of his four-man crew, and highly concerned with the quality of the work he made his crew turned out. He was in good health, and his attendance record was considered perfect.

The firm's profits have been decreasing the past 18 months owing to the effects of

Management competition. Management decided to investigate the methods of performing the work in each department, the objective being to improve methods wherever possible to areas costs. Some layouts in the press area were modified to the extent that crew uses could be reduced. George's crew was reduced by one crewmember.

About this time, George's attitude and performance changed markedly for the worse. His immediate supervisor found it necessary to caution him several times, first on the availability of his work, then his grouchy attitude which verged on insubordination, and internally his attendance. His supervisor could not determine any satisfactory reason for this nation. It appeared to him that George was just not trying or that he was not paying attention to what he was doing. The supervisor was also unable to determine the reason for the grouchy attitude, except George saying he "didn't feel good."

The supervisor must have much time to let the situation ride because the poor quality of George's work was beginning to show up in other process centers. This caused his own superior to get into the act. When the poor quality began reaching the final inspection department, "the roof fell in." The plant superintendent, the general superintendent, and the department supervisor were now on the supervisor's neck. An immediate meeting was held with the supervisor by the plant's top management where he unfolded his meager story. Since this was not an adequate explanation, it was decided to bring George into the meeting. While waiting for him to appear, the general superintendent convincingly advanced his theory that George was offering resistance to the change in methods. The department supervisor objected to his theory since no trouble had been experienced in prior similar situations. When George arrived, he was asked to state why his production had worsened, but he declined to offer any more information than that he had given to his supervisor. He was informed that he would have to improve immediately or be dismissed. He was told he would be given 1 week to make the transition in recognition of his long period of satisfactory service. The proper union officials were informed of all the facts and the proposition. The union officers were perplexed about the change in George but, being aware of his poor performance, reluctantly went along with the arrangement.

The department supervisor was the sole individual not in agreement with the rest. He first quizzed the immediate supervisor again and obtained no new information. He felt somewhat disappointed in him for not being closer to the man

and having some idea of what had caused the sudden change. The department supervisor then talked to several union leaders and other members of the organization. None had any additional information. George had been part of the gang up to the time his work performance changed; since then he had become a lone wolf. The union and informal group leaders were aware of the seriousness of his situation if he did not change, and felt that they had let the department foreman down in not being able to shed any light on the case.

The first 3 working days of the weeklong waiting period went by with no change. On the fourth day the department supervisor ran into George in the restroom. He asked him what he intended to do. George replied that he guessed they would just have to fire him. The department supervisor looked at his worried strained face—the previously happy youth looked as though he had aged many years in a short time. The department supervisor asked George what he and his wife were doing about this problem. This question caused George to break down completely; he even cried. A private place was found, and he and George talked. His wife had left him. This was the man's problem.

He refrained from telling anyone of this because he had bragged so much of the good relationship he and his wife had, and now that she had left him, he was ashamed to mention it. The department head could do little but sympathize with him. Remarkable: enough, George's performance improved the next day.

The department supervisor informed his superiors of what had happened. The plant superintendent was elated, but the general superintendent, while saying the department supervisor had done a good job, was very cool. The recovery for George was slow but positive. The general supervisor continued to "ride" both the department foreman and

George about the slow recovery. The general supervisor's attitude was that this complete was in business to make a profit and was not a psychological correctional institute. The general supervisor persisted in taking some disciplinary action. The department supervisor resisted and won out at the expense of some lowering of status in the eyes of his superior.

The operator fully recovered his composure in another few weeks and approached his jovial former self. He again talked and joked with his fellow workers. His efficiency returned to his prior average and his quality was again high.

## Questions

1. Why did the general superintendent believe that resistance to changes in methods caused George's behavior?
2. Should George have received some type of discipline for his declining quality of work, grouchy attitude, and poor attendance?
3. What do you think of the behavior of the immediate supervisor? If you were his superintendent, would you have permitted defiance of your wishes in this case?

## LESSON 34: CONCEPTS OF COMPENSATION SURVEY

### Learning Objectives

- To know the Concept of Compensation Survey
- To know Compensation Survey Methodology

### Introduction to the Concept of Compensation Survey

Salary survey provides employers with the current and accurate compensation information needed to attract and retain quality employees. The survey allows competitors to share current wage information with each other while maintaining complete participant confidentiality.

Compensation or salary surveys play a central role in the pricing of jobs. Virtually every employer therefore conducts such surveys for pricing on more jobs.

### Am employer may use salary surveys in three ways

1. Survey data are used to price benchmark jobs that are used to anchor the employer's pay scale and around which its other jobs are then slotted based on their relative worth to the firm.
2. 20% or more of an employer's position are usually priced directly in the market place, based on a formal or informal survey of what comparable firms are paying for comparable job.
3. Service also collect data on benefits like insurance, sick leave and vacation time and so provide a basis on which to make decisions regarding employee benefits.

The Following table shows a compensation survey form:

Name of organization participating in the survey: _____		Industry: _____	
Address: _____		Date this form was completed: _____	
Code No.: _____		Title: _____	
Data furnished by: Name _____			
1. Briefly describe major products (or services) of your reporting unit: _____			
2. Employment: Total number of employees in company, division, or plant for which survey data is reported: _____			
Hourly _____			
Nonexempt salaried _____			
Exempt salaried _____			
Total _____			
3. General increase and structure adjustments:			
a. During the past twelve months, has your firm granted a general increase to employees in the following classifications?			
Hourly	_____ No	_____ Yes	Amount or % _____ Date _____
Nonexempt salaried	_____ No	_____ Yes	Amount or % _____ Date _____
Exempt salaried	_____ No	_____ Yes	Amount or % _____ Date _____
b. During the same period, did you have a structure adjustment?			
Hourly	_____ No	_____ Yes	Amount or % _____ Date _____
Nonexempt salaried	_____ No	_____ Yes	Amount or % _____ Date _____
Exempt salaried	_____ No	_____ Yes	Amount or % _____ Date _____
4. Merit increases:			
a. Does your firm maintain a merit increase budget for granting pay increases during a time period?			
Hourly	_____ No	_____ Yes	
Nonexempt salaried	_____ No	_____ Yes	
Exempt salaried	_____ No	_____ Yes	
b. If no, what was the approximate salary increase for the last period?			
Hourly	\$ _____		
Nonexempt salaried	\$ _____		
Exempt salaried	\$ _____		
c. If yes (if you have a merit increase budget), it is:			
Hourly	Merit _____ %	Promotion _____ %	Total _____ %
Nonexempt salaried	_____ %	_____ %	_____ %
Exempt salaried	_____ %	_____ %	_____ %
d. What are the dates of your current budget year?			
From _____	to _____, inclusive.		
5. Union? _____ Yes _____ No			
If yes, list by name: _____			
6. Cost of Living:			
Do you grant a cost-of-living allowance? _____ No _____ Yes			
If yes, what is the current amount and group involved? _____			
7. Are any employee groups on automatic progression? _____ No _____ Yes			
If yes, groups, frequency, and amount: _____			
8. Does your firm grant pay increases on an anniversary date or fixed calendar date(s)?			
Hourly	Anniversary Date _____	Fixed Calendar _____	Date(s) _____
Nonexempt	_____	_____	_____
Exempt	_____	_____	_____
9. What is the frequency of your salary increases?			
Hourly	1 _____	2 _____	3 _____ Other _____
Nonexempt	_____	_____	_____
Exempt	_____	_____	_____
10. Any additional information that might help us interpret your pay data: _____			

### Wage Access

#### What it is?

the WageAccess Compensation Survey is an Internet-based multi-industry salary survey that provides employers with the current and accurate compensation information needed to attract and retain quality employees.

WageAccess provides employers with the current and accurate compensation information needed to make critical wage-related decisions.

- Comprehensive
- Current
- Accurate
- Convenient
- Confidential

...the way surveys should be done.

**WageAccess is Comprehensive**

The WageAccess survey contains over 500 benchmark positions. Each position includes a detailed job description to ensure a comparable match is made during the survey data entry process.

**Custom Results**

Survey results are calculated based on the criteria selected and are displayed as mean, weighted mean, median, average low and average high rates of pay.

The innovative WageAccess Internet-based reporting feature allows users to create customized reports from current or historical survey data. Users may select and filter results by using any combination of the following criteria:

- Geographic Location (region, state and metropolitan area)
- Industry
- Annual Revenue
- Number of Employees

**Quartile Analysis**

Participants have the opportunity to run a personalized quartile analysis against the survey results and obtain a detailed report of their organization's wage level percentile ranking against comparable companies in the selected market.

**Pay Practices**

The pay practices report allows users to analyze formal pay grade data collected through the survey. These results offer users a direct comparison of their own pay grade start rates and rate ranges to the pay grade levels reported in the survey results.

**Summary Report**

The WageAccess survey results also include a summary report on trends in turnover, merit increases and pay grade level movement.

**WageAccess is Current**

Survey participants may contribute data to the survey at any time during the year. All data is collected confidentially through the WageAccess web site. Upon completion of their survey, participants may immediately access results from data collected in previous quarters of the survey.

Survey data is compiled each quarter of the year and combined with data collected in previous quarters for calculation of annualized results. An aging factor is applied to all previously collected data to adjust for the movement of salaries through the year. This aging process provides users with a much more accurate representation of current pay levels than conventional paper surveys.

Since survey data is collected year-round and previously collected data is appropriately aged, survey results are effectively never more than 90 days old.

**WageAccess is Accurate**

All survey participants are required to provide actual pay information in addition to salary grade ranges. This allows for an accurate and detailed picture of current wage levels for the job market.

To assure the validity of the survey results, participants are encouraged to review the job descriptions and provide survey

data for only those positions that match their own with at least 75% accuracy.

At the close of each quarterly collection period, an extensive review and audit of the raw survey data is conducted to ensure its accuracy and consistency.

**WageAccess is Convenient**

Companies can participate in the survey by clicking on the 'Sign-Up Now' button at the top of the page and providing some basic information. Participants will then receive an e-mail containing a login ID and password to get started with the survey.

All survey data entry can be completed at any computer with access to the Internet. The survey does not need to be completed in one session; the survey entry function is designed to allow participants to start, stop and restart the process without losing previously input data.

**WageAccess is Confidential**

Participants can be assured that the WageAccess survey results are reported maintaining complete confidentiality.

Individual participant data is never displayed as part of the survey results nor is raw survey data transmitted over the Internet during the reporting process.

The WageAccess Internet web servers, databases and networks are designed to ensure the reliability, performance and security necessary to provide survey data when and how you want it, and to ensure that the transmission of your sensitive and confidential compensation data is protected.

**Survey Methodology**

The WageAccess Compensation Survey is designed to be easy to use and provide the most accurate and valid results possible. The survey methodology details the special attention given to how survey data is collected and audited, and how the survey results are calculated, analyzed and presented.

**Collection of Data**

Participants are required to report accurate and actual rates of pay to the survey. A key factor for ensuring the collection of valid survey data is the requirement that participants calculate and submit the actual average rates of pay for employees in a position as well as the highest and lowest rate of pay. Estimates are not acceptable.

At the end of each calendar quarter (March 31, June 30, September 30 and December 31), survey data that has been collected during that quarter is compiled for reporting purposes. It takes approximately one month to audit, validate and calculate the survey data before the results become available on the WageAccess web site. The results for that collection period are available on the first day of the month following the close of the calendar quarter (February 1, May 1, August 1 and November 1). However, once a participant has signed up for membership and submitted their survey data, they will have immediate access to survey results collected in the previous quarterly collection period.

**Quality Match Rating**

A rating scale is used to identify job-matching errors and reveal discrepancies in position responsibilities and functions.

Participants are asked to rate by percentage of accuracy how their position matches the survey job description (75%, 85%, 95% and 100% accuracy). Participants should only report data to a particular position in the survey if they feel their position matches the survey job description with accuracy of least 75%.

### **Auditing**

Since data is submitted to the survey directly by the participants, it is assumed that the participants have completed the survey in an accurate and thorough manner. However, occasionally errors in input may occur. Once survey data has been collected, it is reviewed by the Synergy staff and a thorough statistical analysis and auditing process is performed to identify any discrepancies in the data. Individual participants may also be contacted to verify the accuracy of this data.

### **Aging the Data**

New survey data is compiled quarterly and combined with previously collected data to calculate the results for each quarter of the year. An aging factor is applied to all previously collected data for the year to adjust for the movement of salaries through the year. Since the survey data is collected from each participant annually, previously collected data is never aged past one year.

The aging factor is proprietary to Synergy. It is derived from a combination of statistical metrics, including the Consumer Price Index (CPI) as reported by the Bureau of Labor Statistics (BLS), BLS-reported annual changes in national salary data, actual reported WageAccess salary data trends and other economic parameters. For example, assume that the aging factor is calculated at 4% for the current year. All data previously collected during the first quarter of the year would be increased by 1% before it is combined with the data collected in the second quarter of the year.

This aging process provides participants with a much more accurate picture of the market's current level of pay, thus resolving the 'stale' data problem that occurs with most surveys.

### **Calculating the Results**

WageAccess state-of-the-art Internet-based reporting feature allows participants to create custom reports from current and historical survey data. Users may select and filter data by using any combination for the following factors:

- Geographic Location (Region, State and Metropolitan Area)
- Industry
- Annual Revenue
- Number of Employees

After executing the query, the names and locations of the corresponding companies are displayed to allow users to validate their selection. If the selection yields fewer than five companies, for confidentiality and statistical accuracy, the data will not be made available and the user must broaden the selection.

Based on the user's selections, the following statistical calculations are available:

### **General Survey Results**

The survey results allow participants to view the survey data based on the selected criteria through a number of commonly used descriptive statistics.

#### **Mean**

The mean is the calculated average of pay for a position as reported by the selected group of companies. This calculation is obtained by dividing the sum of the average rates of pay for the selected position from each company by the number of companies. The mean is generally the preferred measure of central tendency in that each company is treated with equal weight and it reflects the value of each average rate of pay in the sample.

#### **Median**

The median is the midpoint or center rate in a series of average of rates of pay as reported by the selected group of companies that have been organized from lowest to highest rate. The median is also a good representative of central tendency, however, it is not affected by extremely high and low rates of pay for a position.

#### **Weighted Average**

The weighted average is another type of calculated average of pay for a position as reported by the selected group of companies. The weighted average is obtained by first multiplying the number of incumbents in the position by the average rate of pay at the company and then dividing the sum of that product by the total number of incumbents at all selected companies. This measure is useful in that it provides a higher weighting to larger companies employing larger quantities of employees in a position.

#### **Average Lowest Rate of Pay**

The average lowest rate of pay is the calculated average of lowest pay for a position as reported by the selected group of companies. The calculation is obtained by dividing the sum of the lowest rates of pay for the selected position from each company by the number of companies.

#### **Average Highest Rate of Pay**

The average highest rate of pay is the calculated average of highest pay for a position as reported by the selected group of companies. The calculation is obtained by dividing the sum of the highest rates of pay for the selected position from each company by the number of companies.

#### **Average Start Rate**

The average start rate is the calculated average starting rate of pay for a position as reported by the selected group of companies. The calculation is obtained by dividing the sum of the highest rates of pay for the selected position from each company by the number of companies.

#### **Average Rate Range Min**

The average rate range minimum is the calculated average minimum rate of pay in a structured pay grade system for a position as reported by the selected group of companies. The calculation is obtained by dividing the sum of the highest rates of pay for the selected position from each company by the number of companies.



### Average Rate Range Max

The average rate range maximum is the calculated average maximum rate of pay in a structured pay grade system for a position as reported by the selected group of companies. The calculation is obtained by dividing the sum of the highest rates of pay for the selected position from each company by the number of companies.

### Job Data Parameters

Job data parameters are reported as the percentage of the selected companies whose employees in this position normally match the following parameters:

- Pay Type (Hourly or Salary)
- FLSA Status (Exempt or Nonexempt)
- Eligible for Bonus
- Average Bonus Percentage Received (of those eligible for bonus)
- Receives Commission
- Commission Rate Received
- Receives Tips
- Average Tip Rate Per Hour Received (of those who receive tips)
- Supervisory Position

Union Position

### Quartile Analysis

The quartile analysis allows users to make a direct comparison of their own data to the survey results, including a detailed report of their company's percentile ranking in the selected market.

### Percentile

Percentile is calculated as follows: in a series of average of rates of pay that have been organized from lowest to highest rate, a percentage of the average rates of pay will fall below this number and the remaining percentage will fall above this number. Based on the selection criteria, the quartile analysis will show average rates of pay for the position at the 10th, 25th, 50th, 75th and 90th percentiles.

### Pay Practices

The pay practices section allows users to compare their own methods of compensating employees through a formal pay grade system to the methods of other survey participants in the selected group of companies.

### Compa-ratio

The compa-ratio is a tool that is used to compare average rates of pay with the midpoint of a rate range. A score of 1.0 indicates that the average rate of pay for this position is the same as the midpoint of the rate range. A score that is greater than 1.0 indicates the average rate of pay exceeds the midpoint of the rate range. Likewise, a score of less than 1.0 indicates the average rate of pay is lower than the midpoint of the rate range.

### Rate Range Comparison

These results offer a direct comparison of the participant's own pay grade Start Rates, Minimum, Midpoint and Maximum rates to the pay grade levels reported in the survey results.

### Data Quality

The Wage Access Compensation Survey has been designed to ensure the collection of quality survey data, which will, in turn, yield extremely accurate and valid results

### Auditing

A thorough statistical analysis and auditing program is run on all survey data submissions to flag possible errors due to data entry, incorrect position matches and outliers. Survey participants may be contacted to verify the accuracy of this data. In addition, audit control procedures are employed to eliminate any possibility of system errors, calculation errors or data corruption.

### Job Descriptions

The WageAccess survey contains over 500 benchmark positions. Each position includes a detailed job description, including levels of responsibility, autonomy and knowledge required, to ensure a comparable match is made during the survey data entry process.

### Match Quality

To assist in the validity analysis, a rating scale is used to help identify discrepancies in position responsibilities and functions. Participants are asked to rate, by percentage of accuracy, how their position matches the survey job description (75%, 85%, 95% and 100% accuracy). Participants should only report data to a particular position in the survey if they feel their position matches the survey job description by at least 75% accuracy.

### Participant Education

Throughout the WageAccess survey, participants are provided with detailed instructions, examples and tools to assist them in accurately completing the data entry process.

### Participant Responsibility

Finally, survey participants are reminded that it is their responsibility to ensure that the data they provide is accurate. Other participating companies have put a lot of time and effort in contributing to this survey and expect that the information they receive will be based on quality data.

It is imperative that participants report actual and accurate rates of pay to the survey. To achieve accurate results that reflect the current market trends, participants must do the calculations and report actual average rates of pay. It may seem like more work, but the results are worth it!

### Uses of Compensation Surveys

- To know what the competitors are paying;
- Development of more integrated pay structures covering all categories of employees;
- Extend flexible benefit schemes;
- Align pay strategy more systematically with business strategy;
- Treat employees as stakeholders who have the right to be consulted on
- and involved with any reward management developments;
- Achieve the integration of reward and other HR processes and practices for example, human resource development;
- Use variable pay rather than consolidated pay increases;

- Examine more rigorously the cost effective schemes of payment;

### Article

#### Nightmare no more !

A survey conducted by AIMA (The All India Management Association) on retention served to identify ... Granting periodical promotion and adequate salary raise to ...

High employee turnover is every manager's nightmare, especially when trained manpower is hard to get. There may not be a 'quick-fix' to this problem, but implementing a good number of retention strategies can definitely work for you.

Career counselling, conflict resolution and employee welfare programmes are some benefits being offered to employees. Companies who are innovative where retention strategies are concerned finally emerge as winner.

#### The survey

A survey conducted by AIMA (The All India Management Association) on retention served to identify the most prevalent practices in retention management. Companies that have a turnover of 25 crore with an employee strength of 50 were chosen and grouped into 4 categories, manufacturing, marketing, services and hi-tech.

#### The results

- Out of 135 companies that participated, one in four software companies and one in two manufacturing companies admitted to facing a problem related to employee retention.
- Career shift is a common feature in the junior management of every organisation. The turnover may be as high as 7% in hi-tech firms and may figure around 7% in manufacturing companies.
- Vibrant work atmosphere, dress code and flexi timings are some popular factors that favour employee retention.

### Retention strategies that work

Providing in-house training facilities, change management coaching, and leadership skills and personal development plans for key employees.

#### Providing performance bonuses

Providing memberships at health clubs, and organising social events at regular intervals, conduct sporting events sponsored by the company.

#### Providing subsidised food

Increasing organisational transparency to allow employees to understand the importance of different roles in the organisation.

Granting periodical promotion and adequate salary raise to motivate and enthuse employees.

Provide Employee Stock Options (ESOPS) to encourage joint ownership in the organisation.

Human capital is the most important resource of any company and high flyers play a big role in its success and effective retention management is the only way to ensure you have the best minds on working for you!

### Notes

## LESSON 35:

### PLANNING COMPENSATION FOR EXECUTIVES AND KNOWLEDGE WORKERS

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#### Learning Objectives

- To understand who are Executives and knowledge workers?
- To know what is Knowledge-Work?
- To understand the Total Compensation Approach
- To Link Pay to Business Objectives
- To know Sales Management & Selling Skills

#### Human Resources Management

This activity of the HR person deals with the design of a remuneration system. There are various factors affecting this such as the size and structure of the organisation and the industry in which it operates, strength of employee unions, the position of the person and his importance to the organisation, the demand of particular skill sets in the industry and above all the profits of the company.

The aim of the HR person would be to formulate a remuneration policy in such a way that employees give optimal performance and feel they get a fair deal, new employees are attracted to the organisation, and the organisation is able to retain existing employees. It is also designed in such a way that it serves as a motivation tool for employees to perform better.

In order to arrive at a value for a job, companies carry out an exercise called as job evaluation. Job evaluation tries to address the following issues:

1. What is the value of the job to the organisation?
2. How to arrive at this value in a fair manner so that employees accept it?

The job analysis and performance appraisal, which we have discussed earlier, also contributes a lot to the job evaluation process.

#### Who is an Executive?

A person or group having administrative or managerial authority in an organization. The chief officer of a government, state, or political division.

#### Who are knowledge workers?

As we enter the knowledge-era, one of the critical challenges for HR professionals would be to design practices and systems for managing the "Knowledge Workers." However, even after forty years when Peter Drucker had coined the term, the definition of knowledge worker - and the understanding of the professionals it describes - remains far from clear. More so, because it is loosely used to describe a wide array of people ranging from a software professional to the operator who works with a CNC machine. It is not surprising that many consider it just another buzzword popularized by the skilled and tech-savvy, upward mobile professionals to enhance their own market value.

So who are the knowledge workers? To equate the terms with specific professions like IT professionals or consultants is too limiting and narrow a definition. On the other hand, using it to describe anyone who uses brain instead of muscles to do work - as Drucker did - is too general (obviously, a software programmer or an investment analyst cannot be put in the same basket as an accountant who only totals up the ledger).

#### What is Knowledge-work?

It may be more appropriate to first define and understand what "knowledge-work" is all about in order to understand those who do it, and the implications for managing them. There are three key features, which differentiate knowledge-work from other forms of conventional work.

Firstly, while all jobs entail a mix of physical, social and mental work, the basic task in knowledge-work is thinking - it is mental work, which adds value to work. Unlike the salesman who interacts, negotiates and persuades to achieve his targets, or the shop floor operator who performs physical operations (does things), the knowledge worker adds value to work through mental activities. Knowledge-work involves activities such as analyzing and solving problems, deriving conclusions, and applying these conclusions to other situations.

Naturally, the effectiveness of the knowledge worker would depend on the mental skills and mastery of certain intellectual discipline and expertise (e.g., knowledge of theoretical frameworks, model-building, problem-solving techniques, etc.). This is a key factor, which distinguishes a punch-key operator sitting in front of a PC terminal from a software programmer.

Secondly, the kind of thinking involved in knowledge-work is not a step-by-step linear mental work. For instance, the accountant who calculates the payroll knows the exact mental steps to follow to achieve the desired results. Payroll calculation involves thinking, but only to the extent of processing information; it is not knowledge-work. But this may not be true of the work of a consultant, who has to be creative and non-linear in his thinking (i.e., work out how to think) to develop solutions for the client.

The third distinctive feature of knowledge-work is that it uses knowledge to produce more knowledge. When the software professional uses his knowledge of writing codes to increase the efficiency of the programme, or when the investment analyst uses his knowledge of markets to develop an investment strategy, they are creating new ways of applying knowledge. Thus, knowledge-work is more than mere application of known knowledge; the outcome of knowledge-work is creation of new knowledge.

#### A Total Compensation Approach

Executive Compensation and knowledge workers needs a range of compensation planning, and services in such vital areas as salary administration, organisation structure, short and ...

Companies of all size may wonder about the direction that executive pay will take over the coming years, and what trends will emerge that could impact not only on corporate success, but survival as well.

An organisation understands that effective compensation and benefits plans are critical to success in today's highly competitive business environment. A shortage of qualified talent and demands for more stringent executive accountability and long-term commitment, conventional has quickly become obsolete, requiring a more creative approach as well as new compensation techniques and vehicles.

As HR professional, needs to recognise the trends, develop effective programmes to meet executive compensation objectives and build company value. Compensation package combines typically two distinct disciplines, Executive Compensation and Executive Benefits.

Executive Compensation needs a range of compensation planning, and services in such vital areas as salary administration, organisation structure, short and long term incentive plan design sales compensation, executive perquisites, and retirement benefits.

Executive Benefit practice focuses on design, funding and implementation of nonqualified executive benefit plans. Before revising the existing benefit programme, HR team provides a critical analysis of current programmes to identify potential cost savings and ways to improve benefit design.

HR team quantifies executive's perceptions of various benefits so that corporate funds are used in the most efficient, meaningful and motivating manner possible. HR team also needs to look at offering significant wealth accumulation strategies and programmes without seriously impacting corporate finances.

A six-step process method to deliver and administer executive benefits more effectively: -

- Discussion of objectives of the executive benefit programme
- Planning the preliminary design
- Exploring funding and security alternatives
- Developing a final plan
- Analysing and selecting funding vehicles
- Developing Implementation Plans and Executing Effective Plan Administration

The HR team member together weighs the tax and accounting effects, as well as the cost and benefit tradeoffs of each plan, resulting in a total executive compensation programme that is strategically, economically and culturally sound.

Results of these studies are then combined to create strategic recommendations in such areas as pay positioning relative to the competitive environment, the right mix of salary, benefits and incentives and the timing of short vs. long term incentives; linkage of incentives to corporate, business unit and individual performance; the relationship between performance and incentive plan payouts; and the role of benefits and perquisites in compensation programmes. Based on these recommendation, HR Team designs specific, strategic changes to existing programmes and implements.

## Begin with Objective Review

The compensation design process must include an objective review of existing practices. Invariably, some plans should be retained as is, because they are working well and serving a useful purpose. But there will be others that should be axed, because they no longer fit your needs, or are being abused. And there will third group, namely whose practices that serve good purpose, but may require re-design. Perhaps their objectives can be achieved in a different way, or at a lower cost or by combining them with other programmes.

## Link Pay to Business Objectives

Once this review is complete, the next step is to develop a series of pay programmes linked to specific business programmes linked to specific business objectives. This will send a clear message about the firm's direction and performance expectations throughout the management structure. At the same time, it will also reassure even the most daring and productive executives who also appreciate financial security and stability. This is a fundamentally shift in thinking and it gains ground, it promises to result in equally fundamental shift in the competitiveness of Industries worldwide.

A Company that is in short term financial trouble or heading toward bankruptcy needs effective short-term solutions to enhance the likelihood of survival. Some value added compensation plans actually undermine a troubled company's survivability because they encourage management to take on debt.

Since debt is often available at a cost below that of equity, the formula's underlying assumption is that good management will use that capital to create returns that exceed the associated interest of debt. However, a company in trouble is often over-leveraged, and additional debt could force into bankruptcy.

Other value-added compensation plans measure only long-term results. Whatever management does over the short term has little effect on the plan's measurement criteria.

But it is over the short term that the company's fate hangs in the balance. So for the financially troubled companies, the compensation programme should encourage the company's short-term survival. Once that is ensured then the company can adopt a value added compensation plan that will improve long term results.

Hence, Executive pay is a discipline that requires a concentration of creative energies, not unlike those invested in the development of a product line. In fact, one should think of pay programmes as a product they require constant new thinking to keep up with the competition; they must be sold to customers and they have varying shelf lives.

## Sales Management & Selling Skills

### The Best Laid Plans

**Sales Compensation is what it's all about!...**

When it comes to paying sales professionals, there is no one-size-fits-all. Some companies pay commission based on sales, while others blend in stock options, incentives and special bonus plans. Options abound, yet the common thread that

runs through all successful sales compensation plans are the corporate goals.

### Sizing It Up

Sales managers must consider many variables when tailoring a compensation plan. Compensation plans must take into consideration the overall industry and the company's position. Are your sales goals based on orders or bookings? Are you a start-up? Is your objective to secure new clients, increase average order size or reduce selling expenses? Do you want to introduce new products, focus on existing profitable products or increase activities like cold calling? The compensation plan to adopt would depend on your answers.

### Cost of Sales

Calculating the Cost of Sales (COS) is an important part of planning a compensation package. For a quick COS ratio, simply take the salary plus commissions earned and potential bonus opportunities, and divide by the revenue generated by the sales professional.

### Examining the Styles

Compensation plans can be based on a periodic review of results, but must include several measurements of revenue and profitability. All compensation plans should include "accelerators" such as increased commission rate when salespeople achieve target levels. Here are a few examples:

#### Profit-Based Plans

Commission rates change as profit levels increase. These may be based on invoice, product or monthly averages. Revenue Quota or Unit Placements Plans: Compensation is based on sheer volume achieved over the previous sales period or on a percentage of quota achieved.

#### Break-Point Plans

Break points or target levels are based on attaining specified levels of production. Balanced Plans: Compensation based on profit, revenue and growth is provided in these plans.

#### Customer Service and Customer Satisfaction

These plans are based on improvement as shown in customer surveys and account growth.

#### Third Party or Distribution-Supported Sales Compensation

Most of these plans include a base salary with a limited commission linked with revenue growth over previous periods.

### Choosing the Best Match

With these compensation options in mind, let's look at some scenarios to see what type of plan works best:

1. If your company has high revenue growth objectives with little competition, use Break-Point plans or programmes with high base salaries and low commission plans.
2. If your company has a "protect and grow" revenue objective, slow growth and many competitors, use a profit-based plan and ensure that compensation accounts for growth, with bonuses being provided for new accounts.
3. If your company's goal is to maintain revenue and focus on new account conversion programmes, focus on growth or quota-based compensation. Remember that compensation includes not just salary or commission, but the overall

package of benefits. A good package may include profit-sharing, stock options, vacation, insurance and other company-sponsored plans.

Organisations in transition or positioned for high growth should develop programmes based upon a six-month period. This time length allows management to test theories, make adjustments and still protect the company. This also protects the salesperson from unrealistic programs that limit their income opportunity. Don't ask salespeople to do too many things at once. Most compensation and incentive plans link rewards to only two or three aspects of job performance. They should be linked to the firm's highest-priority sales and marketing objectives. Get input from your sales team prior to the rollout of the new plan. This will ensure their buy-in and raise questions and concerns. Taking time to create an effective plan that fits properly and pays off in earned commission and achieved corporate goals.

### Tutorial Activity 1.1

The performance management system at Enron allowed executives, managers and ... Compensation and incentives. Having a percentage of your pay based on ... by Dr John Sullivan

#### Did HR cause the downfall of Enron?

HR professionals continually claim that they are "strategic" and that they have business acumen but almost universally, the response of HR professionals to the collapse of Enron has been silence. Why the silence? What current business issue could have more strategic relevance than one of the top10 biggest firms in the world declining into bankruptcy?

The failure of Enron not only resulted in a decrease in shareholder value but essentially in the elimination of it! Employees have lost most if not all of their retirement funds, job security (and maybe their jobs,) and possibly part of their employability due to the "tainted reference" of being associated with the Enron debacle. Maybe HR professionals failed to see the impact that HR had on the failure?

#### This article is designed to make you think

You won't agree with everything in this "think piece" but that is not the goal. If you only take away a few new thoughts, then it has served its purpose. . Are you are one of the few HR executives that upon hearing the story of Enron's collapse immediately thought about the significant role (and responsibility) the HR team could have played? If so then you are clearly already a strategic HR thinker.

If your next thought was "I need to re-look at my own people systems within my own organization to identify and prevent similar problems, then you need to read no further. If however your thoughts were then (and maybe still are now) that this was an "accounting and vendor problem" then you should read further and hopefully begin to think differently. This article is an outline of how HR failures, omissions and a narrow "tactical view" of the HR role contributed to a catastrophic company failure.

“Bad people management practices caused the biggest bankruptcy in U.S. history... about that, there can be no doubt”

I’m still not buying into HR taking responsibility! Now before you dismiss this notion take a step back and think. Did Enron fail because of bad equipment, actions by the competitors or a collapse in the financial markets or the economy? The answer, of course, is no.

### Did the collapse come from

- A one time slip in judgment
- A few unrelated mistakes or

A pattern of unethical and possibly illegal acts coupled with a series of deceptions that can only indicate that the culture and values of Enron had degenerated

A pattern of errors this broad could only result from management systems with serious flaws.

Ok, if you are not buying into HR’s responsibility then answer the question “who is responsible for developing systems to build and maintain a company’s value and culture”? Since there is no “values and culture” department the answer lies with the only department with company wide responsibility for developing systems to measure and reward behaviors, values and performance...HR. And yes, of course other functions contributed (for example accounting and finance) but such a wide spread series of errors in judgment can only result from poorly designed or implemented reward, training and performance management systems.

Wide spread errors like these can only be caused by badly designed people processes and systems. If you think of HR in the more traditional backroom “overhead” role with no direct responsibility then now might be the time to re-think that attitude and approach. If a large number of people in many different departments make independent errors (and when those errors have similar characteristics) the “cause” can’t be random. A large volume of similar bad “judgments” and violations of company values can only be as a result of bad processes and systems. In this case, the only systems that can cause this wide of a range of similar errors can only be reward, performance appraisal, communications, hiring and training.

### What did HR do wrong?

HR took too narrow of a view of its job. “Just talking about” the culture and values is not the same role as developing people management systems that actively reinforce those values through metrics, rewards and punishments. It developed human resource systems within Enron that:

#### Measured and incented the wrong things.

Its benefits systems failed to meet its fiduciary duty to protect its employee’s retirement earnings.

Its performance management system did not punish (and may even have encouraged) workers, managers and executives who took unreasonable risks.

In brief, Enron failed because of the people it hired (or failed to terminate) and the HR systems it implemented that incorrectly appraised and incented risky and unethical behavior. The failure occurred because the different departments within HR failed to follow through with their jobs as stewards of the company (A

more detailed list of each HR failure is found later in this article).

### How HR could have saved Enron ?

Enron’s fall was not really a rapid one. The stock had dropped from 80 to 10 over the course of several months (prior to the ultimate crash), so there was time for managers and HR to identify problems and act to correct them. Obviously I don’t have time to go into the hundreds of possible errors that can cause a company’s downfall, but given what we currently know from public information, here are some likely failures and missteps by the HR function. It’s important that you look at these failures not just because they happened at Enron, but also because they could help identify similar problems at your own organization.

Because not all of the evidence against Enron is in yet (and I have not been a consultant to Enron) I have made estimates about what happened. However, I believe that you will find that the following list is a reasonable estimate of what HR did wrong and what you might be able to do to prevent such catastrophe at your organization.

#### Benefits Mis-Management.

The most obvious mis-management error is the appearance of inequity by setting retirement fund rules that restricted employees from selling holdings in Enron stock, while allowing senior management to sell large volumes of theirs.

It is also clear that the message sent to employees (by HR and the executives) about the need to diversify their 401(k)’s was clearly ineffective because some employees had Enron stock as a majority of their 401(k) portfolios. Because HR has a fiduciary responsibility to adequately represent and protect the interests of shareholders, many of whom were employees and retirees, benefits departments need to take a more active role in ensuring that the message gets through. This means benefits must proactively “run the numbers” to monitor the percentages of their own company’s stock that is held in 401(k)’s until average holdings fall below 20 percent, and where necessary, strengthen the message that is sent to employees outlining the negative consequences of holding too much of any company’s stock in 401(k) portfolios.

#### The company culture and values

HR often assumes the role of the “builder and maintainer” of the culture and the organization that is responsible for maintaining values and ethical behavior within the company. Clearly the Enron culture “got out of hand” and HR failed to keep it within reasonable parameters. The “new” culture that evolved (grow the business at any cost) from their original mission clearly killed the company. HR must realize that when the size of “new hire” group in a rapid growth company exceeds the size of the “long tenure” group, the company’s culture (which originally made the company strong) will invariably become “diluted” due to an over-abundance of outside influences.

#### Performance management and appraisal

The performance management system at Enron allowed executives, managers and employees (who made major errors) to go unidentified and unpunished. HR developed a

performance appraisal system that failed to immediately identify potential problems and it failed to put “teeth” in its performance management systems that would severely punish (or fire) individuals that kept secrets, took excessive risks or that violated the company’s values or ethics.

As a result, HR inadvertently sent a message to employees and managers that results, regardless of how they are obtained, are all that matters. “Blind faith” and a reliance on value statements and a once a year performance appraisal system must be supplemented by safeguards and precision performance monitoring systems when the company’s business model shifts from a normal risk to a high-risk one. HR leaders in companies operating SPE’s (special purpose entities) and trading derivatives can’t be naive about the risks involved. Performance management and monitoring systems must be designed to fit the level of risk that’s established in the company’s business model.

### Compensation and incentives

Having a percentage of your pay based on performance is an excellent practice. However making the rewarded percentages “too high” can essentially “over incentive” employees to take unreasonable risks. The large incentives for rapid growth, stock price growth and short-term gain drove behavior beyond reasonable limits at Enron.

Employees must be able to make mistakes and then to report them rapidly. That’s how organizations learn. In reverse, having large penalties for failure can encourage secrecy and the “hiding” of mistakes, so that no one learns from them.

It’s also highly likely that the executive compensation packages at Enron (especially the CFO) were so large and focused on short-term results and stock price increases that they incented (or even hiding) risks that would not have occurred without such benefits.

HR should have known that risks could be outrageously high in the derivative trading and offshore investment business. As a result, they should have taken a conservative approach toward incenting and rewarding “risk taking” and “results” (regardless of how you got them).

Senior executives were continually telling employees (erroneously) about the high likelihood of large stock price growth and HR clearly failed to recognize and communicate that their message needed to be toned down.

HR and other communications systems failed to incent or encourage “whistleblowers” to criticize or speak out about questionable business practices. Only a single employee’s warning message (which happened to be at a vice presidential level) reached the top.

A culture that castigates or stifles individuals who criticize management or questionable practices needs to be monitored and changed. If HR is to have an impact on business decision making practices, it must develop formal and informal feedback and communication mechanisms that ensure that the “alternative perspective” is always heard. HR must make it easy for employees to anonymously complain as well as proactively “seek out” employee opinions and concerns.

HR must develop systems that encourage employees to identify and “out” employees and managers that take unacceptable risks and that violate our values.

In another communications failure, HR allowed the wrong start date of the 401(k) stock selling freeze to be announced, so that even when employees were actually free to sell stock...they didn’t know it.

### Training

Clearly the training provided in the areas of acceptable risks, ethics, reporting and performance monitoring were either ineffective or the incentives to ignore the training were so strong, that they negated any impact it might have had. HR must ensure that training effectiveness is measured based on performance, results and an actual change in behavior

### Hiring and retention

With its dramatic growth and large-scale hiring, Enron’s hiring standards could not always be met while their assessment tools were inadequate (especially in the areas of ethics, risk-taking and honesty in communications). Clearly the new breed of “traders” that were hired differed significantly from the old “oil drillers” that previously dominated the company.

HR hiring and retention systems that worked with the “oil drillers” became ineffective when the company’s business model shifted into a riskier “trading” mode. The lesson to be learned by HR is that the people management systems that “worked” when the company was smaller and had a different “mix” of employees must evolve with the changing business model and employee population mix.

### Conclusion

The many human resource failures that contributed to Enron’s demise should send a powerful message that an opportunity for HR to become as prominent as other recently popularized business functions. Although the final determination of which factors contributed the most to Enron’s failure might take years to resolve. But it is already clear that the human element in Enron’s failure played the largest part. Numerous individuals made bad decisions that resulted in a catastrophic failure. All companies make bad decisions. But, those companies who have effective HR departments also tend to have performance management systems and metrics that catch errors early.

HR must learn to become proactive and to develop “smoke detectors” which can help identify “bad people and people processes” long before they can have a major negative impact on their company. HR must also look more closely at the design of compensation systems to ensure that the incentive to “speak out” (about unreasonable risks and ethical concerns) is at least as high as the incentive to keep quiet.

It’s also clear now that the 64 page ethics manuals and crystal clear value statements (that include respect and integrity) are not enough to change everyone’s behavior from bad to good — especially when huge egos are involved. Unfortunately, the cost for learning that lesson will be thousands of jobs, many ruined retirements and the loss of billions of dollars.

“Business is not unlike sports. When a team loses big you can’t blame the equipment, the fans or the accounting department.

May be you didn't buy all of the arguments but I hope it did make you think. And one last thought. Does you HR department currently have systems that would "warn" you if your own firm had the same problems occurring as Enron did? We all know that the answer in most cases is sadly...No!

## Notes

[illegible][illegible]



## LESSON 36: PLANNING COMPENSATION FOR MANAGERIAL AND PROFESSIONAL JOBS

### Learning Objectives

- To learn how to develop a compensation plan for professionals.
- To understand the basic compensation elements.

Developing a compensation plan to pay executive, managerial, and professional employees is similar in many respects to developing a plan for any employees. The basic aims of the plan are the same in that the goal is to attract good employees and maintain their commitment. Furthermore, the basic methods of job evaluation-classifying jobs, ranking them, or assigning points to them, for instance-are about as applicable to managerial and professional jobs as to production and clerical ones.

Yet for managerial and professional jobs, job evaluation provides only a partial answer to the question of how to pay these employees. Such jobs tend to emphasize no quantifiable factors like judgment and problem solving more than the production and clerical jobs. There is also a tendency to pay managers and professionals based on ability-based on their performance or on what they can do rather than on the basis of static job demands like working conditions. Developing compensation plans for managers and professionals, therefore, tends to be relatively complex, and job evaluation, while still important, usually plays a secondary role to non salary issues like bonuses, incentives, and benefits.

### Compensating Managers

**Basic Compensation Elements** There are five elements in a manager's compensation package: salary, benefits, short-term incentives, long-term incentives, and perquisites.

The amount of salary managers are paid usually depends on the value of the person's work to the organization and how well the person is discharging his/her responsibilities. As with other jobs, the value of the person's work is usual determined through job analysis and salary surveys and the resulting fine-tuning of salary levels.

Salary is the cornerstone of executive compensation: It is on this element that the others are layered, with benefits, incentives, and perquisites normally awarded in some proportion to the manager's base pay. Benefits (including time off with pay, health care, employee services, survivor's protection, and retirement coverage) Short-term incentive are designed to reward managers for attaining short-term (normally yearly) goals. Long-term incentives are aimed at rewarding the person for long-term performance (in terms of increased market share and the like). Perquisites (perks for short) begin where benefits leave off and are usually given to only a select few executives based on organizational level and (possibly) past performance. Perks include use of company cars, yachts, and executive dining rooms.

Executive compensation tends to emphasize performance incentives more than do other employees' pay plans, since organizational results are likely to reflect the contributions of executives more directly than those of lower echelon employees.

The heavy incentive component of executives' compensation can be illustrated with some examples of the highest-paid U.S. executives. In 1995, for instance, the CEO of General Electric earned a salary of \$2,000,000, a short term bonus of \$3,250,000, and long-term compensation of \$16,740,000. For the chairperson of Rockwell International, his salary component was \$815,000 and the bonus was \$2,000,000 for total compensation of \$2,815,000. The chairperson of Coca Cola earned a salary of \$1,680,000, a bonus of \$3,200,000, and long-term compensation of \$8,000,000 for a total of almost \$13,000,000.

In general, bonuses today equal 25% or more of a typical executive's base salary in many countries, including the United States, United Kingdom France, and Germany. There is considerable disagreement regarding what determines executive pay and, therefore, whether top executives are worth what they are paid. At the lower management levels (like first-line supervisor), there is no debate; supervisors' pay grades are usually set so that their median salaries are 10% to 25% above those can the highest-paid workers supervised. And many employers even pay supervision for scheduled overtime, although the Fair Labor Standards Act does not require them to do so.

It is at the top-management levels that questions regarding pay abound. The traditional wisdom is that a top manager's salary is closely tied to the size of the firm. Yet two experts who tested this idea for the 148 highest-paid executives the United States concluded, "The level of executive responsibility is not an important variable in determining executive compensation. Instead, say these experts, an executive pay is mostly determined by the industry in which he or she works, and the corporate power structure, since executives who also serve on their firms' board directors can heavily influence how they get paid.

Yet there is conflicting evidence. In one study, for instance, the researcher: found that a statistical analysis of the total cash compensation of the chief executive officers of 129 companies showed that they were paid for both responsibility and performance. This researcher found that four compensable factors-compasses, profitability, number of employees, and experience-accounted for 83% the differences in pay. Therefore, it appears "that there are rational, acceptable and abiding principles that govern the total cash compensation of top executive & in manufacturing firms.

In any case, shareholder activism is combining with congressional reform and other changes to tighten up the restrictions on what firms pay their top executives. For example,

the Securities and Exchange Commission voted in 1992 to approve final rules regarding executive compensation communications. The chief executive officer's pay is always to be disclosed as well as other officers' pay if their compensation (salary and bonus) exceeds \$100,000. And for bankers, the Federal Deposit Insurance Act of 1991 contains a prohibition on excessive compensation. One result is that boards of directors must act responsibly in reviewing and setting executive pay. That, says one expert, includes determining the key performance requirements of the executive's job; assessing the appropriateness of the firm's current compensation practices; conducting a pay-for-performance survey; and testing shareholder acceptance of the board's pay proposals.

The general trend today is to reduce the relative importance of base salary and boost the importance of short- and long-term executive incentives. The main issue here is identifying the appropriate performance measures for each type of incentive and then determining how to link these to pay. Typical short-term measures of shareholder value include revenue growth and operating profit margin. Long-term shareholder value measures include rate of return above some predetermined base.

### Managerial Job Evaluation

Despite questions regarding the rationality of executive pay, job evaluation is still important in pricing executive and managerial jobs in most firms. According to one expert, "the basic approach used by most large companies to ensure some degree of equity among various divisions and departments is to classify all executive and management positions into a series of grades, to which a series of salary ranges is attached.

As with no managerial jobs, one alternative is to rank the executive and management positions in relation to each other, grouping those of equal value. However, the job classification and point evaluation methods are also used, with compensable factors like position scope, complexity, difficulty, and creative demands.

### Compensating Professional Employees

Compensating non supervisory professional employees like engineers and scientists presents unique problems. Analytical jobs put a heavy premium on creativity and problem solving, compensable factors not easily compared or measured. Furthermore, the professional's economic impact on the firm is often related only indirectly to the person's actual efforts; for example, the success of an engineer's invention depends on many factors, like how well it is produced and marketed.

The job evaluation methods we explained previously can be used for evaluating professional jobs. The compensable factors here tend to focus on problem solving, creativity, job scope, and technical knowledge and expertise. Both the point method and factor comparison methods have been used although the job classification method seems most popular. Here a series of grade descriptions are written, and each position is slotted into the grade having the most appropriate definition. Yet, in practice, traditional methods of job evaluation are rarely used for professional jobs since it is simply not possible to identify factors and degrees of factors which meaningfully differentiate

among the values of professional work. "Knowledge and the skill of applying it", as one expert notes, "are extremely difficult to quantify and measure".

As a result, most employers use a market-pricing approach in evaluating professional jobs. They price professional jobs in the marketplace to the best of their ability to establish the values for benchmark jobs. These benchmark jobs and the employer's other professional jobs are then slotted into a salary structure. Specifically, each professional discipline (like mechanical engineering or electrical engineering) usually ends up having four to six grade levels, each of which requires a fairly broad salary range. This approach helps ensure that the employer remains competitive when bidding for professionals whose attainments vary widely and whose potential employers are literally found worldwide.

## Current Issues in Compensation Management

### The Issue of comparable Worth

#### The Issue

Should women who are performing jobs equal to men's or just comparable to men's be paid the same as men? This is the basic issue in comparable worth. Equal pay legislation in the United States and other industrialized countries has a history of debate over whether "equal" or "comparable" should be the standard for comparison when comparing men's and women's jobs. For years, "Equal" was the standard in the United States, though "comparable" was and used in Canada and many European countries. As a result of court rulings though, some experts now believe that comparable worth may become the standard in the United States.

The issue of comparable worth refers to the requirement to pay equal wage: for jobs of comparable (rather than strictly equal) value to the employer. In a limited sense, this means jobs that while not equal are at least quite similar" such as assemblers on one line versus assemblers on a different assembly line. In its broadest sense, though, comparable worth includes comparing quite dissimilar jobs, such as nurses to fire truck mechanics or secretaries to electricians.

### Comparable Worth and Job Evaluation

The issue of comparable worth has important implications for an employer's job evaluation procedures. In virtually every comparable worth case that reached a court, the claim revolved around the use of the point method of job evaluation. Here each job is evaluated in terms of several factors (like effort, skill, and responsibility) and then assigned points based on the degree of each factor present in the job. As a result, point plans actually encourage assigning comparable worth ratings to different jobs. There are two sides to the problem. In the more familiar case, two positions such as Clerk-Typist and Junior Engineer might be evaluated as having the same number of points and, therefore, comparable worth. This would seem to imply that both jobs should be paid the same, although in practice market wage rates may be much higher for the male dominated junior engineers than for the female-dominated clerk-typist.

There is also the possibility of bias in the job evaluation plan itself. In particular, some traditional job evaluation point plans tend to result in higher point totals for jobs traditionally held by males than for those traditionally held by females. For example, the factor “supervisory responsibility” might heavily weight chain-of-command factors such as number of employees supervised and downplay the importance of functional authority or gaining the voluntary cooperation of other employees. The solution here is to rewrite the factor rules in job evaluation plans so as to give more weight to the sorts of activities that female dominated positions frequently emphasize.

### Implications

Some argue that avoiding comparable worth problems doesn’t mean quantitative job evaluation methods like point plans must be discarded; just used more wisely. For example, one approach is to stress prevailing market rates in pricing jobs, and then only use an evaluation method (like the point method) to slot in those jobs for which a market price is not readily available.

Another practical solution is to allow employers to price their jobs as they see fit but to ensure that women have equal access to all jobs, as do men; the idea here is to eliminate the wage discrimination issue by eliminating sex-segregated jobs. To avoid comparable worth problems, questions to ask include: Are your job duties and responsibilities clearly documented either by a job analysis questionnaire or a job description? Are they reviewed and updated annually? When was your pay system last reviewed? If more than three years have passed, serious inequities could exist.

Do you have any circumstances where your system indicates that jobs are comparable, even in the marketplace, but you are paying those jobs occupied by females or minorities less than predominantly male and/or white jobs?

When was the last time you statistically checked the effect of your pay system females and minorities? Could it be that you have discrimination in fact though not in intent? Is your pay system clearly documented in a salary administration manual? If not, the credibility and defensibility of your pay practices are ripe for challenge.

Are you complying with state comparable work laws? Many states have passed their own comparable work laws, and states tend to broadly interpret laws mandate equal pay for comparable work. In some states, workers may collect substantial back pay and other damages by showing a wage disparity even when the comparable jobs seem substantially different on the surface.

### The Issue of Pay Secrecy

There are two opposing points of view with respect to the question of whether employees should know what other employees in the organization are being paid. The basic argument for open pay is that it improves employee motivation, and the thinking here is as follows:

If employees believe that greater effort does not result greater rewards, then, generally speaking, greater effort will not be forthcoming. On the other hand, if employees do see a direct

relationship between effort and rewards, then greater effort will result. Proponents of open pay contend that workers who do not know each other’s pay cannot easily assess how effort and rewards are related, or whether they are equitably paid, and as a result of this motivation tends to suffer. (They cannot, for example, say “smith doesn’t work hard and so is paid less than ones, who does work hard”).

The opposing argument is that in practice there are usually real inequities in the pay scale, perhaps because of the need to hire someone “in a hurry,” or because of the superior negotiating ability of a particular applicant. And even if the employee in a similar job who is being paid more actually deserves the higher salary because of his or her effort, skill, or experience, it’s possible that lower-paid colleagues may convince themselves that they are underpaid relative to the higher-paid individual.

The research findings to this point are sketchy. One study found that managers’ satisfaction with their pay increased following their firms’ implementation of an open-pay policy.

A survey conducted by the Bureau of National Affairs found that fewer than half the firms responding gave employees access to salary schedules. Those not providing such information indicated, among other things, that secrecy prevents much quibbling. “salary is a delicate matter. . .,” open pay “could well lead to unnecessary strain and dissatisfaction among managers . . .,” and open systems too often create misunderstandings and petty complaints. The author of this study notes that whether the inequities result from a growth situation or some other factor, it is clear that some inequities and openness are incompatible. The implication for compensation management seems to be that a policy of open pay can, under the best of conditions, improve employees’ satisfaction with their pay and possibly their effort as well. On the other hand, if conditions are not right-and especially if there is any lingering inequities in the employer’s pay structure moving to an open-pay policy is not advisable.

### The Issues of Inflation and Salary Compression

Inflation and how to cope with it has been another important issue in compensation management.

For example, salary compression means that longer-term employees’ salaries are lower than those for workers entering the firm today, and it is a result of inflation.

#### Its symptoms include

- (1) Higher starting salaries, which compress current employees’ salaries;
- (2) Unionized hourly pay increases that overtake supervisory and nonunion hourly rates.

Dealing with salary compression is a tricky problem. On the one hand, you don’t want your long-termers to be treated unfairly or to become inordinately dissatisfied and possibly leave with their accumulated knowledge and expertise. On the other hand, mediocre performance or lack of assertiveness, rather than salary compression, may in many cases explain the low salaries.

In any case, there are several solutions. As distasteful as it is to many employers to pay employees just for seniority, you can institute a program of providing raises based on longevity.

These raises could be distributed in flat dollar amounts, or as a percentage of base pay, or as a combination of the two. Second, a much more aggressive merit pay program can be installed. They at least help reduce the morale problems associated with pay compression, since employees know they have the potential for earning higher raises. Third, supervisors can be authorized to recommend "equity" adjustments for selected incumbents who are both highly valued by the organization and also viewed as unfairly victimized by pay compression.

Inflation has also put some pension plans in peril. An executive who retired at the beginning of 1982 had lost over 50% of the purchasing power of a fixed dollar company pension by today, for instance—a frightening state of affairs for retirees whose pensions are not indexed to inflation. While the rate of increase of consumer prices has recently slowed, some fear that inflation is only dormant and that rapid price increases will again occur.

Particularly in periods of high inflation, employers try to cope with inflation's impact in several ways. More employers grant across-the-board salary increases either in lieu of or in addition to performance-based merit increases. Others change their pension plans to index them to inflation so that the value of the pension payments increased along with the rise in the price of goods. Others change the compensation mix to decrease the emphasis on taxable income like wages and salary and to substitute nontaxable benefits like flexible work hours, dental plans, day care centers, and group legal and auto insurance plans.

The cost-of-living adjustment (or COLA) clause is sometimes pushed by unions as another way to cope with inflation. The COLA or escalator clause is designed to maintain the purchasing power of the wage rate and operates as follows. Specified increases in the Consumer Price Index trigger increases in the wage rate, with the magnitude of the increase depending on the negotiated COLA formula. The most common formula provides a one-cent per hour wage adjustment for each 0.3% or 0.4% change in consumer prices. Nonunion employees often then receive a similar adjustment. Periodically, the employer takes a portion of the dollar COLA adjustment and builds it into the employee's base salary, a procedure known as "baking in." COLAs have become less of a concern to unions as inflation has moderated. The United Auto Workers and the General Motors Corporation first adopted the COLA clause in 1950; a study by the Bureau of Labor Statistics indicates!

That about 40% of the major union contracts negotiated recently (covering 6.5 million workers) contained COLA provisions, down from 58% and 9.3 million workers in 1980. In fact, General Motors Corporation is eliminating COLAs for its 125,000 salaried employees. It had previously instituted a pay-for-performance system and, pleased with the results, decided to expand it to all salaried workers.

## Assignment

Working individually or groups conduct salary surveys for the following positions to know the current trends –

a. Entry-level accountants.

b.Entry-level Software engineer.

What sources would you use? What conclusions did you reach?  
If you are a HR manager of a firm what would you recommend  
that you pay for each job?

## Notes

This image shows a full page of white paper with horizontal grey ruling lines. The lines are evenly spaced and run across the width of the page, providing a template for handwriting practice or general writing. There are no margins, text, or other markings on the page.

## LESSON 37: INTRODUCTION TO DOWNSIZING

### Learning Objective

- Introduction to the Concept of Downsizing
- To understand Downsizing And Organizational Culture
- To know Downsizing with relation to Executive compensation

### Introduction to the Concept of Downsizing

Downsizing as a positive and purposive strategy, a set of organizational activities undertaken on the part of management of an organization and designed to improve organizational efficiency, productivity, and/or competitiveness. Downsizing thus defined falls into the category of management tools for achieving desired change, much like “rightsizing” and “reengineering”.

Clearly, the definition is overly expansive. Downsizing may and very likely will impact or impinge on systemic change efforts such as the introduction of “total quality management,” “reengineering,” or “reinventing” initiative. They are not one and the same.

Downsizing does not necessarily imply a reduction in the assets of the organization; for example, an organization may contract out a function that was previously done by permanent employees. The elimination of the jobs of the employees constitutes downsizing.

### The Paradox of Downsizing

Information will be examined as a prime determinant in the value of a stock. Specifically, the choice of how many workers a firm will hire or fire may be interpreted as news that signals the health of that firm. Downsizing will be defined in the context of a special case of the labor input strategy of a firm. Questions relating to how downsizing functions as a signal of firm health will be raised, and the methods for answering those questions will be presented. The economy was strong, inflation was falling, and real GNP was growing at a steady, confident pace. Corporate profits had reached historically high levels, and investors were on a buying spree in the stock market, pushing it from one record close to the next.

Unemployment had fallen to a level that many economists felt was consistent with non-accelerating inflation. Expectations of inflation were abated, and the boom seemed to be poised to last for a long time, with no economic downturn in sight. At the same time, the major corporations in the US appeared to be firing workers by the hundreds of thousands, and job insecurity had risen to a surprisingly high level. Regardless of seniority, the company’s profitability, or the surging demand for the firm’s outputs, the threat to an employee of finding a pink slip in the next pay envelope was real and widespread. No job seemed safe.

The above statements, describing the US economy in the mid 1990s, seem inconsistent not only with a standard textbook characterization of an economic boom, but also with any historically observable relationship between the labor market and other economic arenas, such as the financial market or the goods market. Politicians and unions pointed to the greed of corporate America, and the insensitivity of management to the contributions and value of workers.

Standard micro economies was at a complete loss to explain the phenomenon. If strong firms were anticipating a greater demand for their products during the economic boom, and labor costs were not rising excessively relative to productivity, why were firms firing workers? The term “downsizing” was coined to describe the action of dismissing a large portion of a firm’s workforce in a short period of time, particularly when the firm was highly profitable.

In a standard downsizing story, a profitable firm well-poised for growth would announce that it was firing a large percentage of its workforce. The equity market would get excited, and initiate a buying frenzy of the firm’s stock. This goes counter to a standard micro-economic analysis, in which a weak firm anticipates a slump in the demand for its products, and lays off workers, while a strong firm foresees a jump in the demand for its products, and hires more workers to increase production.

Investors care about downsizing, since it contains severe implications for the short-term profitability and even the long-term growth of a company. A downsizing is quite unlike a traditional layoff: in a layoff, a worker is asked to temporarily leave during periods of weak demand, but will be asked back when business picks up. In a downsizing, the separation between a worker and a firm is permanent. A downsizing is also not a dismissal for individual incompetence, but rather a decision on the part of management to reduce the overall work force.

Through a downsizing, the management inadvertently (or perhaps deliberately) signals to investors what the future economic health of the firm is. In the 1980s, the largest layoffs were executed by weak companies, who were looking market share to foreign firms, or had large drops in demand for their products.

Downsizing were clearly regrettable, but understandable, as they helped the firms to survive. Such a large amount of workers was certainly unnecessary for a firm doing a smaller volume of sales, so the workers were released in large numbers over short intervals of time. Investors noticed that major layoffs were taking place, and downgraded their expectations of the firm’s future profitability, so they dumped the stock.

Yet, this perfectly logical explanation seems inconsistent with what was actually taking place in corporate boardrooms and on the trading floors of the New York Stock Exchange of the

1990s: companies ridding themselves of workers by the thousands were strong, and had bright economic futures ahead of them. Upon learning of downsizing, the alleged signals of firm weakness, investors went on a buying spree, and sent the company's stock price soaring.

**This paradox leads to the first two questions addressed in this thesis:**

1. Why does the value of a firm increase when it announces a downswing, especially since downswing is supposedly a signal the rough economic times ahead?
2. Why do strong firms Lay off workers in a boom, but not in a recession?

Another simultaneous-and possibly related-phenomenon in the 1990s is the popularity of a new form of compensation for executive management. Instead of being paid in cash, many are now compensated in stock options. If downsizing as a strategy increases equity value (investors buy the stock of downsizers), then it increases management's compensation, and appears all the more attractive.

This leads to the next issue, which seriously questions an ideology which both academics and businessmen hold dear: that stock options improve firm value by aligning the interests of owners and managers. This thesis will show that stock options are not the cure-all that many claim them to be:

**Did the proliferation of stock options in executive ompensation contribute to the wave of downsizing, especially downswing that engendered short-term gains, but reduced long-term firm value?**

By re-aligning management's interests with stockholders, the managers care more about the perceived value of the firm, not the actual value of the firm. The stock price is based only on the perceived value-a function of the limited information which shareholders can obtain.

3. Managers will undertake strategies that will improve the perceived value of the firm, and to the extent that the two are correlated, as a by-product, management mayor may not improve the actual value of the firm. This raises an ambiguity about the relationship between downsizing and the actual strength of a firm:
4. Is downswing a signal of the strength of a firm? If so, why do firms in similar situations in a given market follow markedly different employment policies?

Lastly, downsizings mayor may not be surprising to the extent that they are anticipated or accompanied by other news pertaining to earnings or mergers. There may be a systematic under or over-reaction to a given news variable. The downsizing announcement is relevant if it changes the expectation of the future cash flows that a stock will generate:

5. Does the stock market under or over-react to a downsizing? if so, what should an investor do following the announcement of a downsizing?

## Downsizing and Organizational Culture

A noted scholar recently assessed downsizing as "probably the most pervasive yet understudied phenomenon in the business world" (Cameron, 1994). While we have become numbed by the near daily accounts of new layoffs, a New York Times national survey finding is perhaps more telling: since 1980, a family member in one-third of all U.S. households has been laid off (New York Times, 1996). By some measures, downsizing has failed abjectly as a tool to achieve the main *raison d'être*, reduced costs.

A truer and fuller understanding of the forces shaping and thrusting downsizing forward today comes from an appreciation of increased global competition; changing technologies, which in turn are profoundly impacting the nature of work; increasing availability of a contingent work force (Fireman, 1994); and shifting balance of power among organizational constituents away from rank and file employees and in the direction of shareholders and the chief executives who serve as their proxy. W4en we conceptualize downsizing within these broader frameworks, it becomes clear that we are speaking of downsizing both as a response to and as a catalyst of organizational culture change.

This article will later provided a formal definition of "organizational culture". For the moment, it is suggested that culture is to an organisation what personality is to an individual. As with personality, change takes time and may be hard to discern, especially for persons inside the organisation.

This article will argue that, ultimately, the most prominent effects of downsizing will be in relation to culture change not in relation to saved costs or short-term productivity gains. Key drivers of organizational culture will tend to shape an organization's approach to downsizing. For whose benefit does the organization exist? What are the basic assumptions among people who work in the organization?

**What are the basic Assumptions the Organization and the Employee make in relation to each other?**

Establishing a direct link between downsizing and organizational culture is not an easy matter, however, as the following example will demonstrate. The Chief Executive Officer of Apple Computer recently bought himself more time with disgruntled shareholders by promising to take forceful action on a number of fronts, including downsizing.

The executive cited "five crises: lack of cash; declining quality; a failed operating system development project; Apple's chaotic culture; and a fragmented strategy" (Mark off, 1997).

How do you connect downsizing, which is one of a number of actions being taken, with corporate culture, which is only one of a number of "crises" being solved in a manner and to a level that establishes a positive relationship? .

Another reason that it is difficult to draw a specific link between downsizing and organizational culture is that there are many different variations and approaches to downsizing. A distinction has been made between proactive downsizing, which is planned in advance and usually integrated with a larger set of objectives, and reactive downsizing, which would be typified by cost-cutting as a last resort after a prolonged period

of inattention to looming problems by management (Kozlowski et. al., 1991). Work force reductions can range from forceful in nature, i.e., involuntary reductions, to the milder approaches, such as resignation incentives and job sharing (Sutton and D' Aunno, 1989). There are different ways of deciding "who stays, who goes" from the outwardly arbitrary to criterion-based (Brockner, 1992).

There are different modes of planning, ranging from secretive sessions to open discussions and solicitation of ideas from employees. There are different standards of notice of terminations, including relatively harsh same day terminations as well as more generous 90 day or longer notices. There are even differences in internationality, i.e., reductions can be planned to present employees with as little a break as possible from.

what they have known in the past or they can be designed to be deliberately disruptive to the status quo (Noer, 1993).

### **Downsizing Impact on Culture**

For organizations, particularly the IBM's and Digital Equipment's of the world which long resisted layoffs, it is hard to image that the organizations or their cultures have remained anything close to intact. Getting back to the questions posed earlier:

#### **1. For whose benefit does the organization exist?**

It seems clear that organizations exist less today for the well-being of rank-and file employees than they once did. With the Dow shattering all records, it seems clear that the shareholders have the upper hand in making critical corporate decisions. They are partnered with CEO's who received an average pay raise in 1995 of 23% (Washington Post, 3/5/96). Just look at who is prospering and who is not.

#### **2. What are the basic assumptions among people about working relationships in the organization?**

The basic assumptions about working relationships have changed, in ways that can not yet be well assessed. It appears, at least, that relationships tend to be less "familial" and more competitive than in the past.

What is the worth of what have traditionally been termed commitment and loyalty? We just do not know? What is the impact of the feeling that the organization is a community even a family - with relatively stable long-term working relationships? And how will that play out in terms of cooperation given to others as opposed to "backstabbing" in the intense competition for scarce resources? We can only be sure that things have changed, not how.

#### **3. What are the basic assumptions the organization and the employee make in relation to each other?**

The basic assumptions by employees and organizations about their employment relationship have changed from long-term and stable, with organizations expected to make accommodations to avoid laying people off to more short-term and contingent. Researchers such as Bridges and Noer forecast a more happy future for those who adapt to the changing times in the new scenario, but that is a difficult forecast to test.

Organizations usually have some degree of flexibility about how they reduce personnel expenses. Decisions to inflict pain upon employees as part of the process may very well reflect an effort to "bust" the existing culture. Decisions to minimize pain may reflect an effort to reinforce the existing culture.

### **Downsizing**

#### **Executive compensation**

##### **It starts with the CEO**

Chief executive officers (CEOs) get paid lots of money for being the top employees in the company. Why do they get paid so much? Like athletes and actors, CEOs provide a level of talent that is required to produce the desired product - in this case, a strongly performing company. The skills and responsibilities that come with the job of CEO are extreme and the number of people who can fill these roles is limited. That is why the market has determined that people with these skills are worth a lot of money to their companies.

Only about 20 percent of a CEO's pay is base salary; the rest is made up of incentives based on the company's performance. The rationale is that if the company is performing well and the shareholders are making money, then the CEO should share in that success.

A CEO's compensation package affects everyone within a company. Often it can be considered the yardstick by which all other employee benefits and bonuses are measured and negotiated. Moreover, the CEO's compensation may be an indicator of how well the company is performing.

This performance, in turn, could translate into a more generous compensation package for individual employees who are savvy negotiators.

When companies establish pay structures, they define the compensation for the highest- and lowest-paying jobs before filling in the compensation for the jobs that fall in between in the traditional

#### **Chief Executive Officer**

Plans and directs all aspects of an organization's policies, objectives, and initiatives. May require a bachelor's degree with at least 15 years of experience in the field. Relies on experience and judgment to plan and accomplish goals.

May preside over board of directors. Source: Salary. Com the compensation for the jobs that fall in between. In the traditional internal equity method of establishing a pay structure, the CEO's compensation sets a ceiling for the company, and each level below is compensated at a comparably lower level. If you know how well the CEO is compensated, you can get a sense for how generous the company is likely to be toward other employees as well.

#### **CEOs make most of their Money through Incentives**

As a general rule, base salary accounts for just 20 percent of a CEO's pay. The other 80 percent comes from performance-based pay.

Base pay for the core role and responsibilities of the day-to-day running of the organization. This amount is very often less

than \$1 million because the IRS has imposed tax restrictions on “excessive” compensation.

Annual bonuses for meeting annual performance objectives.

Long-term incentive payments for meeting performance objectives to be achieved for a two- to five-year period. These awards are sometimes described as performance shares, performance units, or long-term cash incentives.

Restricted stock awards as an incentive to assure the executives are strongly aligned with the interests of shareholders. Because restricted stock awards have an actual cash value when they are granted, the proxy table shows these in dollars, not in shares.

Stock options and stock appreciation rights (SARs) for increasing share price and increasing the shareholders’ returns. Options have very favorable accounting treatment for the company, which is why they are so common. Option grants are always shown as a number of shares underlying the option.

In a subsequent table in the proxy is an estimation of the present value of each option grant assuming a 5 percent and a 10 percent increase per year in the stock price, or using a mathematical model (e.g., Black Scholes) to predict the value of the option.

#### **Total Compensation for CEOs goes beyond Cash and Stock**

Although typically excluded from pay calculations, executive benefits and perquisites are disclosed in the summary compensation table and the retirement plan section of the proxy. They include the following.

Supplemental executive retirement plans (SERPs), which may keep the executive whole (that is, make up the difference) or better from a tax regulation that prevents the executive from receiving a pension benefit that exceeds ERISA limits (\$135,000 per year or less based on the pension plan). For a CEO making \$2 million a year, a \$135,000 benefit may be inadequate for maintaining a comparable lifestyle.

Executive insurance plans that provide a source of retirement income and a richer death benefit to the executive’s family. These plans are used to guarantee retirement benefits from bankruptcy. Unlike standard retirement plans that receive protection from bankruptcy by the federal government, SERP benefits can be lost in the event of bankruptcy.

Miscellaneous executive perquisites and other compensation for various programs or negotiated deals that don’t properly fit into the above categories, including perks such as country club dues and financial planning. These are often small numbers that disclose imputed income amounts for those additional special benefits, but can also include some very large amounts for items such as loan forgiveness, special insurance programs, relocation expenses, etc.

At most companies, most of a CEO’s pay comes from stock or stock option gains. At investment banks, most of it comes from annual bonuses. Companies that pay the lion’s share of

compensation in the form of stock options may pay little or no retirement. You can tell by looking for a retirement table in the proxy statement.

If the words “SERP,” “ERISA-excess plan” or “Top Hat plan” appear in the proxy, then retirement is an important part of the executive’s remuneration. If not, then the executives are expected to retire on their ability to make and save money on their cash and equity earnings.

#### **Pay philosophies often tie pay to company performance**

The company’s Compensation Committee Report on Executive Compensation contains specifics about your company’s compensation philosophy, which affects all employees. It covers the following.

How well your company pays relative to its peers?

#### **Who the company sees as its peers?**

How the company’s stock has performed relative to its peers and to the stock market as a whole?

How the company prefers to reward its executives through its total pay practices, i.e., what proportion of an executive’s total pay comes from salary, bonus, stock options, and long-term cash plans?

How the company measures its performance net income (NI), earnings per share (EPS), return on equity (ROE), return on assets (ROA), revenue growth, etc?

What criteria are used for determining the size of bonus payments: corporate results, divisional results, individual goals; or whether payments are discretionary?

The degree to which your company is a success may be answered in the annual and long-term incentive payout columns in the summary compensation table. If you see large bonus payments, then it is likely that your company is successful. Stock option grants and gains are also important to look at.

This information can be gleaned from three tables in the proxy statement: the stock option grants table; the aggregate option exercises in the last fiscal year and fiscal year-end option value table; and the total return to shareholders table. If there are large gains from stock option exercises and substantial amounts in both vested and unvested stock options, it may be an indicator that the company is well managed in the opinion of shareholders. Good five-year shareholder returns in the total return to shareholders table would certainly validate this opinion.

Nonprofit organizations typically offer compensation weighted heavily toward base salary. In response to competitive concerns, bonuses are becoming more prevalent as are special tax deferral programs that help executives save for retirement. Unlike comparable programs in for-profits, very few of these programs are broad-based. Participation is limited to a select few.

Some watchdog organizations have been critical of the amounts paid to chief executives of nonprofit organizations. But these employers counter that they are competing for senior talent with for-profit organizations that can offer incentives such as stock options that are not available to them.



### Cash Compensation is the Norm in Non-Profits

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### Workers can force change

Fortunately, CEO pay is an area in which workers can act directly through their union pension funds. Arguably, CEO pay is a direct deduction from corporate profits. This means that, insofar as CEOs receive excessively generous pay packages, the excess comes directly out of money that should be going to shareholders.

In such a situation, the fiduciary responsibility that pension fund managers have to the fund not only allows them to try to rein in CEO pay, but also legally obligates them to make such an effort. Unless it can be shown that high CEO pay has somehow led to better corporate performance (the existing research indicates the opposite), pension fund managers are obligated to bring this pay under control to increase the returns to the fund.

It is often argued that CEO pay cannot be controlled, because it comes mostly in the form of stock options. In some cases, stock prices go up enormously, and the CEO benefits along with all the other shareholders. In fact, it is a simple matter to cap the gains that a CEO can earn from rising stock prices.

Contracts can be structured to Dean Baker and Archon Fung ensure that CEOs have plenty of incentive to work hard to raise stock prices but prevent them from gaining unlimited wealth if they happen to get lucky and the stock price escalates. For example, the total gains from stock options could be capped within the contract at \$3 million per year, with any additional gains being returned to the firm.

Proponents of the current system, in which CEOs can earn tens or hundreds of millions of dollars through stock options, often argue that these packages are necessary to tie the CEO's interests to those of the shareholders. They raise the concern that CEOs may otherwise attempt to further their own security as top managers rather than maximize the price of the company's stock. Although there is a legitimate concern here, no one has produced evidence that these sorts of packages are necessary for that purpose.

Even if the potential gains were measured in the millions, instead of in the tens of millions, CEOs would still have enormous incentives to increase stock values. Furthermore, even if a CEO reached a cap on the value of options in an existing contract, he or she would still have incentive to perform well, because in most cases he or she would be in search of another contract, either from the CEO's current firm or from a new one.

That firms have felt the need to evade standard accounting procedures (as determined by Financial Accounting Standards Board in their treatment of options) points to the fact that CEOs did not get their fat packages through the natural operation of the market.

Union pension funds are large enough actors in the market that if they began to demand such caps, it would have a substantial impact. In principle, other investors could also gain from imposing such caps. Only the elite few who see the CEO as a friend rather than a cost will be bothered by this approach. If nothing else, union pension funds should be able to ensure that CEOs and other top executives are treated just like all other workers.

### Latest Updates on Downsizing

99th report of Committee on HOME AFFAIRS

The Institute of Training and Management provides induction as well as ... ii) Administration of. ... & extending the scope of new facilities for fringe benefits to the.....

### Good Governance

34.0 Accountability has become the worst casualty because the officers who are to enforce accountability are being increasingly marginalized in the choice of appointing their subordinates to various posts, specially in the field which is the cutting edge vis-a-vis the people. Responsibility and rights are inseparable. There is need to restore the rights of the executive to enable it to discharge its responsibility regarding making itself accountable.

34.To a query posed by the Committee with regard to the specific areas/issues identified, the Government gave the reply that in order to bring about good governance, the areas/issues identified includes – (i) review of administrative laws; (ii) formulation of Citizen's charters by the Central Ministries/Departments as also by State Governments; (iii) setting up of Information and Facilitation Counters in the Ministries/Departments for easy and hassle free access of information by the citizen; (iv) strengthening the public Grievance Redress Mechanism which is in place in various Ministries/Departments of the Central Government; (v) implementation of a minimum agenda for promotion of e-governance for re-engineering of various processes with a view to ensure quicker delivery of public services; and (vi) documentation and dissemination of best practices in the area of administrative reforms.

35.The Committee is of the view that with the help of e-governance, computers, improvement of information technology, Freedom of Information and Citizen's Charters, collection of basic data and information available with the Ministry will show a marked improvement if they are constantly updated. The Committee hopes that not only statistical information but the parameters of decision making also should in due course be made available to the people.

### Rightsizing of the Government

36.0 One of the main themes identified for good governance is rightsizing of Government. The size of Government machinery is critical for the success of any for efficiency and economy in Government. On being asked to elaborate on the

policy paradigm of the Government in this regard, the Ministry in its written replies furnished the following replies:-

- (a) Imposition of 10% cut in the Ministries/Departments w.r.t. the sanctioned strength as on 1 January 1992.
- (b) Restriction on creation of posts both in Plan and Non-Plan.
- (c) Restriction on filling up of posts lying vacant for more than one year.
- (d) Setting up of Expenditure Reforms Commission to suggest a road map for reducing the functions, activities and administrative structure of the Central Government, rationalize the staff and cadres of different services, review the framework of the subsidies and also review the procedure for setting up of Government funded institutions. ERC has given in all ten reports covering 36 Ministries/Departments. The ERC's recommendations are at different stages of implementation.
- (e) That direct recruitment would be limited to 1/3 direct recruitment vacancies arising in the year subject to further ceiling that this does not exceed 1% of the total strength of the Department.

36. In view of the above, the Committee wanted to know the total reduction of staff as on date to which the Government have informed that there has been total deduction of staff of 7.2 lakh from 1993 to 2001 as per explanation as given below:

#### Reduction in Staff

- (a) The transfer of staff from 1 & B to Prasar Bharti 0.40 lakh
- (b) The transfer of staff from Telecom to BSNL 3.56 lakh
- (c) Reduction in staff in Railways 0.78 lakh
- (d) Exclusion of non-Departmental agents of Department of Posts 2.90 lakh

- (e) Reduction in staff in Department of Posts 0.81 lakh

Total 8.45 lakh

Increase in staff

- (a) Ministry of Home Affairs 1.05 lakh
- (b) Department of Revenue 0.25 lakh

Total 1.30 lakh

Net reduction : (8.45 lakh – 1.30 lakh) 7.15 lakh

36.2 With regard to the number of Secretary and equivalent Officers at the time when the policy of downsizing was initiated and after five years as against the present position the Ministry furnished the following information as under:

Year (as on)	Secretary & equivalent
1.1.1992	- 125
1.1.1997	- 119
28.2.2003	- 129

36.3 A perusal of the above figures provided to the Committee mentioned in para 36.1 shows that the reduction is mainly because of the transfer from one area to another area except in the case of Railways and Department of Posts amounting to reduction of 4.49 lakh officials out of the total 8.45 lakh of staff.

36.4 To a question with regard to anticipated and actual impact on the exchequer on account of rightsizing, the Government informed the Committee that around 1,73,000 sanctioned strength as on 1.1.1992. Besides, about 13,000 posts have been abolished so far on the basis of the recommendations of ERC.

The abolition of these 13,000 posts is likely to result in annual reduction of expenditure to the tune of Rs. 120 crores approximately. Further around 30,000 posts have been identified for abolition with reference to restriction on filling up of posts of direct recruitment upto 1/3 DR vacancies arising in the year subject to further ceiling that this does not exceed 1% of the total strength.

37. While appreciating the Government's policy of rightsizing and rationalizing of the Government machinery, it is of the opinion that the functions, activities and administrative structure of each Ministry/Department should be clearly chalked out so that overlapping between them do not take place.

A review of the Ministries/Departments not covered by the Expenditure Reforms Commission may be made with a view to rightsizing and rationalising them. It will be highly desirable to carry out a manpower audit of each Department. Blanket abolition of certain percentage of posts can on the one hand cripple the functioning of one Department and another Department warranting even greater reduction will escape. A meaningful manpower audit of each Department alone can make this exercise truly rational.

38. In this context, the Committee pointed out that in reply to information sought with regard to total strength of officials in Groups A, B, C and D for 1992, 1997 and 2003, the Ministry informed that information about group-wise strength in 1992 is not available. The Committee, therefore, recommends that downsizing should be followed up vigorously in its pursuit to improve administrative efficiency and effectiveness.

39. The Committee also wanted to know the details of staff rendered surplus consequent to the right sizing exercise of the Government. The Ministry informed that as on 1.3.2003, 272 staffs have been rendered surplus – 5 from Group 'A', 24 from Group 'B', 241 from Group 'C' and 2 from Group 'D'. The detailed Department/Ministry-wise break-up is as given below:

TABLE – XIII

	Name of Ministry	No. of Staff
1.	Ministry of Agriculture	7
2.	Ministry of Civil Aviation	4
3.	Ministry of Small Scale Industries	15
4.	Ministry of Labour	17
5.	Ministry of Home Affairs	2
6.	Ministry of Shipping	1
7.	Ministry of Information and Broadcasting	119
8.	Ministry of Steel	4
9.	Ministry of Textiles	101

10.	Ministry of Tourism	1
11.	Ministry of Urban Development and Poverty Alleviation	1

40. The Committee is of the view that the Government cannot downsize its personnel meaningfully without enlisting the support of major political parties.

Therefore, the Government should hold all party meeting to arrive at a consensus to execute the recommendations of the Fifth Pay Commission which recommended the downsizing of Government while recommending greatly enhanced pay scales. This is a matter of national interest and we cannot afford to delay it indefinitely. The result of manpower audits will be really helpful in getting the required consensus.

## Notes

## LESSON 38: VOLUNTARY RETIREMENT SCHEME

### Learning Objective

To know and understand the below mentioned points:

- To know the Voluntary Retirement Schemes (VRS)- Exit Policy- Its Effects
- To learn the Procedure for Voluntary Retirement Scheme
- To get aware of the Merits and Demerits of voluntary retirement scheme

### Voluntary Retirement

The Government of India adopted a new economic policy whereby it relaxed and in certain cases removed restrictions on import and export. This resulted in significant changes in industrial and business sectors. One of the important aspects of the liberalised economic policy is the Exit Policy.

Under this policy the government has allowed business and industrial establishment, to reduce their excess staff and employees. The reduction of excess staff is a result of restructuring of organisations due to modernising, applying new technology and new methods of operation, so that the industrial organisations could operate economically and withstand the competition with companies and organisations which have accepted foreign collaborations, innovative methods and technology upgradation, rendering some employees surplus.

Since the procedure under Industrial Disputes Act 1947, for retrenching involves a lot of legal hurdles and complex procedures, the Government authorised schemes of voluntary retirement of employees after offering them suitable voluntary retirement benefits, and giving some tax relief on such payments to employees who are eligible to retire voluntarily under the guidelines issued by the Government and Income Tax authorities.

In the Five Year Plans which were adopted and implemented by the Government it had established and developed public sector undertakings to create employment and also to augment the increased demands of industrial goods, fertilisers and other core industries. The encouragement given to public sector was so significant that it created employment opportunities on a mass scale.

Most of the public sector undertakings were not cost effective. The trade unions have been opposing retrenchment under the existing labour laws. The government, therefore, found a solution to the problem of surplus staff by allowing voluntary retirement both in public and private sectors.

The human resources in the industrial sector have become surplus on account of

- (a) existing level of technology
- (b) will become surplus with adoption of newer technologies and technological up-gradation.

If the textile industry adopts latest technology in manufacturing units, 15 million workers in the industry would be out of their jobs, around 2-4 million workers are found surplus in the various sick industrial units all over India. Similarly, millions have been found surplus in government undertakings.

### Effects of Excess Manpower

- (1) Excess manpower results in high labour costs which increases the production cost and thus ending in high product or service costs.
- (2) It reduces the competitive ability of the enterprise.
- (3) Excess manpower in any business activity or industrial establishments reduces employee efficiency and labour productivity.
- (4) Surplus human resources pose threat for technology up-gradation which is essential in the competitive market.
- (5) Surplus labour may result in poor industrial relations and unrest amongst labour.

### Reducing Excess Manpower - Problems, Legal Aspects and Solutions

As already pointed out earlier the Industrial Disputes Act, 1947 as it is existing puts restrictions on employers in the matter of reducing excess staff by retrenchment, by closures of establishment. The unions strongly oppose any plans of retrenchment and reduction of staff and workforce. The Government had taken a decision to amend the Labour Laws, whereby the employers could trim its workforce legally after complying with the conditions of the labour laws.

However, the unions in our country have been opposing such amendment of labour laws. For reasons, which include political reason, the Government has not implemented its decision to amend the Industrial Disputes Act, 1947.

However, a way was found by allowing employers including those in the government undertakings, to offer voluntary retirement schemes to off-load the surplus manpower. The voluntary retirement schemes were not vehemently opposed by the Unions, because the very nature of its being voluntary and not using any compulsion.

### Exit Policy

Voluntary Retirement Schemes - have been legally found to be giving no problem to employers, employees and their unions. The essence of the voluntary retirement scheme, which is approved by the Government - involves voluntary separation of employees who are above the age of 40 years or have served the company or establishment for minimum 10 years.

The company, may offer different separation benefits to employees in different age groups subject to overall benefits which are tax exempted up to a limit of Rs. 51akh, Public sector undertakings, however, have to obtain prior approval of the

government before offering and implementing the voluntary retirement schemes.

### The Reasons for Proposing VRS

- (1) Recession in business
- (2) Intense competition, which makes the establishment unviable unless downsizing is resorted to
- (3) Changes in technology, production process, innovation, new product line
- (4) Realignment of business - due to market conditions
- (5) Joint-ventures with foreign collaborations
- (6) Takeovers and mergers
- (7) Business re-engineering process
- (8) Product/Technology obsolescences.

### Procedure for Voluntary Retirement Scheme

The employer has to issue a circular communicating his decision to offer voluntary retirement scheme - mentioning therein.

- (a) The reasons for downsizing
- (b) Eligibility i.e. who are eligible to apply for voluntary retirement
- (c) The age limit and the minimum service period of employees who can apply (Employees who is 40 and above and those who have completed minimum 10 years of service in the establishment.)
- (d) The benefits that are offered. It should be noted that employees who offer to retire voluntarily are entitled as per law and rules the benefits of Provident Fund, Gratuity and salary for balance of privilege leave up to the date of their retirement, besides the voluntary retirement benefits.
- (e) The right of an employer to accept or reject any application for voluntary retirement.
- (f) The date up to which the scheme is open and applications are received for consideration by the employer.
- (g) The circular may indicate income tax incidence on any voluntary retirement benefits which are in excess of Rs. 5 lakhs, which is maximum tax free benefit under such schemes.
- (h) It should also indicate that those employees who opt for voluntary retirement and accept the benefits under such scheme shall not be eligible in future for employment in the establishment.

Steps to be taken for introducing and implementing voluntary retirement scheme

- (1) If the company is public sector undertaking obtain approval of the government.
- (2) Identify departments/employees to whom VRS is to be offered (Target group of employees -age above 40 years and employees with more than 10 years service in the company).
- (3) If there is a union of employees 'in the establishment involve the union by communicating to them the reasons, the target group and the benefits to be offered to those who opt for the scheme.

- (4) Formulate terms of VRS and benefits to be offered are to be mentioned in the circular or communication to employees and decide the period during which the scheme is to be kept open.
- (5) Motivate the managers through counseling.
- (6) Counselling employees is an essential part of implementing the scheme. The counselling should include what the retiring employee can do in future i.e. rehabilitation, how to manage the funds received under the scheme.
- (7) After receipt of applications for accepting VRS, scrutinize, decide whose applications are to be accepted and those whose are not to be accepted.
- (8) For those whose application are to be accepted prepare a worksheet showing the benefits each will receive including other dues like Provident Fund, gratuity and earned leave wages for the balance un-availed earned leave, and tax incidence should the VRS amount exceed Rs. 5 lakhs.

### The challenges in implementing employees Exit

- (1) The reasons and need to introduce VRS should be discussed with all management staff including top management.
- (2) The effect of downsizing including on the work or activities of the establishment carried on is to be considered i.e. post reduction operations to be carried on should also be planned - post plan reduction employee deployment.
- (3) Ensure all concerned employees and managers participate in the decision making to down size.
- (4) The downsizing plan should match with the Strategic plans of the company.
- (5) Transparency should be seen and used in choice of persons to be retired.
- (6) Be prepared to manage the after effects of the downsizing - both social and psychological.
- (7) Motivate employees who will stay with the company, remove their apprehensions and fears, if any.
- (8) Provide professional assistance to employees who agree to accept VRS to plan their post retirement, activities and financial management including, out placement.
- (9) The VRS should be made attractive and no pressures should be used to ease out people.

### Merits of voluntary retirement Scheme

- (1) There is no legal obstacle in implementing VRS - as is predominantly encountered in retrenchment under the labour laws.
- (2) It offers to the employee an attractive financial compensation than what is permitted under retrenchment under the law.
- (3) Voluntary nature of the schemes precludes the need for enforcement, which may give rise to conflicts and disputes.
- (4) It allows flexibility and can be applied only to certain divisions, departments where there is excess manpower.
- (5) It allows overall savings in the employee costs thus lowering the overall costs.

## Demerits of VRS

To certain extent it creates fear, a sense of uncertainty among employees. Sometimes the severance costs are heavy and outweigh the possible gains. Trade unions generally protests the operation of such schemes and may cause disturbance in normal operations. Some of the good, capable and competent employees may also apply for separation which may cause embarrassment to the managements.

It is found in practice that organisations may have to repeat the scheme if there is no response or poor response to the scheme by the employees. However, there are instances when the managements have really made the schemes very attractive by making it “Golden Hand Shake.”

It is incumbent on the establishments that they do not recruit similar staff immediately after the implementation of voluntary retirement scheme. Such recruitment, in spirit and essence is contrary to the principle of staff being excessive or surplus.

### Tutorial Activity 1.1

Voluntary Retirement Scheme (VRS) for the employees of Public Sector Undertakings Short Title:

- (i) This scheme may be called the Punjab State Public Sector Undertakings Voluntary Retirement Scheme (VRS) 2002.
- (ii) This scheme shall apply to all the Public Sector Undertakings (PSUs) including all Cooperative Institutions of the State of Punjab. This will apply to the Subsidiaries of the PSUs defined as entities in which PSUs and/or Govt. hold more than 50% equity.
- (iii) This scheme shall come into force from the date of its notification.

## 2. Objective

- (i) To achieve optimum human resource utilization.
- (ii) To optimize return on investment in PSU.
- (iii) In implementing the VRS scheme, managements shall ensure that it is extended primarily to such employees whose services can be dispensed with without detriment to the company. Care shall be exercised to ensure that highly skilled and qualified workers and staff are not given the option. As there shall be no recruitment against vacancies arising due to VRS, it is important that the organisation is not denuded of talent. The managements of the PSUs shall introduce the VRS with the approval of their Boards and the administrative departments. Under no circumstances shall grant of VRS be construed as a right.

## 3. Definitions: In this Scheme, Unless the Context

Otherwise Requires,

- (a) “Public Sector Undertaking (PSU)” means an entity that is :
  - (i) Created under a Statute of the State Legislature; or
  - (ii) Created under a statute of Parliament, in which case the management & control vests in Govt. of Punjab or
  - (iii) Created under the Companies Act 1956 in which the Govt. of Punjab, holds equity share more than 50% of those issued or A Cooperative Society as defined under

the “Punjab Cooperative Societies Act, 1961, as amended from time to time including Apex

## Cooperative Institutions

(b) “Scheme” means Punjab State Public Sector Undertakings Voluntary Retirement Scheme (VRS) 2002.

(c) “Employee” means a person employed on permanent/regular basis working against regular sanctioned graded post.

## VRS-SCHEME.DOC-2-

- (d) “Service” means a period of permanent or regular employment against graded post as defined in the Service Bye Laws/ Regulations of the PSU.
- (e) “Year” means a financial year commencing on 1st April and ending on the subsequent 31st March
- (f) “Salary” means Basic Pay plus appropriate %age of DA as on the date of applying.
- (g) “Family” means as defined under rule 2.17 of the Punjab Civil Services Rules, Vol. I
- (h) “Request for V.R.” means application submitted for VR, as per specimen proforma annexed as Annexure-A.
- (i) “Competent Authority” means the Chief Executive Officer/ Managing Director of the Public Sector Undertaking concerned.

## 4. Operation of the scheme:

The Scheme shall remain in operation for 6 (six) months from the date of issuance of notification to this effect. The Govt may extend it from time to time.

(i) Within the period of operation:

- (a) In the case of a PSU which does not require budgetary or any other external support to implement the scheme, it shall come into operation upon the approval by the Administrative Department of a resolution of the Board of Directors that the scheme be brought into effect with specified eligibility criteria
- (b) In the case of a PSU, which requires budgetary or any other external support to implement the scheme, it shall come into operation only after the Department of Finance approves a proposal of the Administrative Department based on a resolution of the Board of Directors as in (a) above to this effect.

## Vrs-Scheme.doc-3-

## 5. Eligibility

All persons employed on permanent/regular basis working against regular sanctioned graded post of Public Sector Undertakings will be eligible to seek Voluntary Retirement provided they have completed a minimum of 5 years of service and have at least 5 years of service remaining before their superannuation.

However, the employees falling in the following categories as determined by the concerned PSU are not eligible to seek Voluntary Retirement under the scheme:

- (a) Specialist employees who have executed service bonds and have not completed the period prescribed therein;
- (b) Employees serving abroad under special arrangement/ bonds;
- (d) Employees appointed on contract basis;
- (e) Any other category of employees as may be specifically debarred by the Public Sector Undertaking from seeking retirement under this scheme.

#### Note

In case disciplinary action is pending against an employee, who has sought Voluntary Retirement, the Disciplinary Authority shall, after considering all facts, convey to the Competent Authority whether the request of the employee should be accepted or not. In case the Disciplinary Authority decides that the request of such an employee for Voluntary Retirement be not accepted, the same shall be communicated to the employee in writing and he shall have a right to make an appeal as provided under section 9 (v).

#### 6.Amount of Ex-gratia

An employee seeking Voluntary Retirement under the scheme will be entitled to the compensation consisting of salary of 35 days for every completed year of service and 25 days for every year of the balance of service left until superannuation. The compensation will be subject to a minimum of

#### VRS-SCHEME.DOC-4

Rs.25,000/- or 250 days salary whichever is higher. However, this compensation shall not exceed 80% of the sum of the salary that the employee would draw at the prevailing level for the balance of the period left before superannuation. In case an employee is governed by a retiring/superannuation pension scheme the disbursement of pension shall commence from the month next to the date an employee would have retired in the ordinary course.

#### 7. Mode of payment

100% of the amount of ex-gratia payable to an employee on opting for Voluntary Retirement under this Scheme would be paid in cash within 60 days from the date of his relieving.

#### 8. Other benefits

An employee whose offer for Voluntary Retirement under the Scheme is accepted will be eligible, apart from the ex-gratia defined above, to any benefit that would have been available to him upon superannuation as per the policy extant in the PSU prior to the date of notification of this scheme. It is clarified, however, that an employee shall not be eligible for both retrenchment compensation and ex-gratia under this scheme but shall have to opt for one of the two.

#### 9. Procedure

- (i) An eligible employee may submit request opting for Voluntary Retirement under the scheme to the Competent Authority through proper channel in a prescribed proforma (Annexure-A), which shall be available in the PSU.

#### Vrs-Scheme.doc-5

- (ii) The Competent Authority may after considering the application and after giving an opportunity to the applicant

of being heard, pass a speaking order within a period of 3 months, either accepting or rejecting the request.

- (iii) In case the Competent Authority fails to pass an order rejecting the request by the due date as given at sub para (ii) above, the request would be deemed to have been accepted and the employee would be retired.
- (iv) A copy of every order made under paragraph (iii) above shall be given to the employee.
- (v) An employee who is aggrieved by an order of rejection may within thirty days from issuance of such orders file an appeal before the Administrative Secretary of the Department under which the concerned PSU falls, whose decision shall be final and binding.
- (vi) The date of acceptance of VRS by the competent authority will be treated as date of voluntary retirement.

#### 10. General Conditions

- (i) Arrears of wages due to general revision of pay scales etc. shall not be included in computing the eligible amount.
- (ii) Only completed years of service shall be reckoned for arriving at the minimum eligible service.
- (iii) Fraction of service of 6 months and above shall be reckoned as one year for the purpose of calculating the ex-gratia. Fraction of service less than 6 months will be ignored for the purpose of calculating the ex-gratia.
- (iv) The salary shall be calculated on the basis of last salary drawn by an employee/officer.
- (v) No employee shall be allowed to withdraw the request made for voluntary retirement under the scheme after it has been accepted by the Competent Authority.
- (vi) The Competent Authority shall have absolute discretion either to accept or reject the request of an employee seeking Voluntary Retirement under the scheme. The reasons for rejecting the request of any employee seeking Voluntary Retirement shall be recorded in writing by the Competent Authority.

#### Vrs-scheme.doc –6

- (vii) All payments under the scheme and any other benefit payable to an employee shall be subject to the prior settlement/re-payment in full of loans, advances, returning of Govt.'s property and any other outstanding due against him and payable by him to the PSU concerned.
- (viii) All payments made under the scheme shall be subject to deduction of tax at source as per Income Tax Act 1961 wherever applicable.
- (ix) An employee who seeks voluntary retirement under this scheme shall not be eligible for re-employment in Govt., any PSU or any of its subsidiaries. A complete data/record, on website of all those employees of the Public Sector Undertakings/Corporations, who have availed the VRS shall be retained. While making future recruitments no person out of these shall be retaken in service.
- (x) In the event of the death of an employee, whose request for voluntary retirement under the scheme has been accepted, the compensation, which would have become due and payable

to the deceased employee, shall be paid to the person nominated to receive such dues.

(xi) The benefits payable under this scheme shall be in full and final settlement of all claims of whatsoever nature, whether arising under the scheme or otherwise to the employee (or his nominee in case of death). An employee who voluntarily retires under this scheme will not have any claim against the PSU concerned of whatsoever nature and no demand or dispute or difference will be raised by him or on his behalf, whether for re-employment or compensation or back wages including employment of any of his relative on compassionate grounds in the service of the PSU or for any other benefits whatsoever.

(xii) The vacancy caused by Voluntary Retirement shall stand abolished.

(xiii) The Govt. reserves the right to withdraw this scheme at any time it thinks fit and its decision in this respect will be final.

### 11. Enabling Rules

(i) The Public Sector Undertakings must consider the Voluntary Retirement Scheme (VRS) and pass an order adopting it.

(ii) The scheme shall come into effect only after requisite approval as laid down in Para 4 is received. However, the PSU may circulate this scheme & obtain response of the employees, in order to determine the financial and other implications.

#### Vrs-Scheme.doc-7

(iii) No PSU/Administrative Department may make any change to the scheme without seeking comments of the Finance Department and obtaining prior approval of the Council of Ministers to the proposed changes.

### 12. Budgetary Support

(i) Budgetary support will be provided to the loss making enterprises or those making marginal profit and to the sick enterprises for implementing VRS only in case bank credit is not available. However, before seeking budgetary support in cases of unviable/sick PSUs other sources of funding should be fully explored such as asset securitisation and bank loan against government guarantee for funding VRS.

(ii) State Renewal Fund in its present form will cease to exist.

#### VRS-SCHEME.DOC-8

### Annexure –A

Application to seek voluntary retirement

The Managing Director/Chief Executive Officer,.....Name of the PSU.....(Through Proper Channel)

### Subject

Voluntary Retirement

Sir/Madam,

I hereby opt to seek Voluntary Retirement from the services of the ..... (Name of the PSU) in accordance with the terms and

conditions stipulated in the Punjab State Public Sector Undertaking Voluntary Retirement Scheme (VRS) 2002, circulated vide No. ....

dated ....., which I have carefully read and have understood the contents of the same.

2. I accept the terms and conditions stipulated in Punjab State Public Sector Undertaking Voluntary Retirement Scheme (VRS) 2002, unconditionally and irrevocably.

3. I furnish the required particulars in the APPENDIX enclosed for consideration of my offer to seek Voluntary Retirement from the services of the ..... (PSU) under the above scheme w.e.f. ....

Thanking you,

Yours faithfully,

Signature of the Employee

Place:..... Designation:.....

Name:.....

Dated: .....

Vrs-scheme.doc-9

### Appendix

To be Filled in by the Employee

### PART-I

#### S. No. Particulars

1. Name of the Employee/ Officer

:

2. Employee PF No.

:

3. Designation

:

4. Date of Birth

:

5. Age as on (Last date of the Scheme)

:

6. Date of Joining the PSU (Excluding the temporary period, if any)

:

7. No. of completed years of service as on (last date of the scheme)

:

8. Date of attaining the age of Superannuation

:

9. Salary as on (last date of the scheme)

- Basic Pay

- D.A.

Total:

:

10. Has the employee executed any bond? Give details thereof.

:



11. Has the employee undergone any specialised intensive training within the organisation or outside? If so, give details thereof :

12. Has the employee taken loans from the organisation? If yes, give details thereof head-wise, such as HBA/Vehicle Loan or any other. Give details of amount of loan sanctioned and the outstanding balance as on (last date of the scheme)

:

**Vrs-Scheme.doc-10**

13. Whether the employee has been imposed any Major or Minor Punishment during the preceding years. If yes, give details:

14. Whether any disciplinary action is pending?

:

**Part-ii**

**15. I hereby certify:**

(a) That the information given above is complete and true.

(b) That I hereby opt to seek Voluntary Retirement from the services of the .....  
(Name of the PSU) in accordance with the terms and conditions stipulated in the Punjab State Public Sector Undertakings Voluntary Retirement Scheme (VRS)2002, which I accept unconditionally and irrevocably as .....  
dated .....

(c) That I hereby authorise the .....(Name of the PSU) to recover and adjust all loans/dues etc. payable by me whatever kind or nature.

(d) That I agree that in case any of the aforesaid statements is found to be untrue, the payment made to me by the ..... (Name of the PSU), under this Scheme, will be recoverable from me without prejudice to any other action that may be taken against me by the ..... (Name of the PSU).

Dated:

Place: Signature of the Officer/Official

**Notes**

## LESSON 39: PAY RESTRUCTURING IN MERGERS AND ACQUISITIONS

### Learning Objectives

To know and understand the below mentioned points:

- To understand the concept- mergers and acquisitions
- To understand profit-sharing schemes
- Job Evaluations & Market Considerations
- Reconciling market & job evaluations

### Restructuring

a means of implementing strategic change aimed at improving performance by reducing the level of differentiation and integration and downsizing the number of employees to decrease operating costs.

### Mergers and Acquisitions

The implications of a merger or acquisition on pay and conditions of employment do not seem to be considered seriously enough in most take-over battles. Executives and employees are too often pawns in a game of chess played by remote grandmasters. However, acquisitions or mergers do not always live up to expectations and one of the principal reasons for failure is the demotivation of managers and staff. This is inevitable if insufficient attention is paid to their needs and fears as well as any existing imbalances between the reward strategies and remuneration levels of the organizations set to merge. This issue has assumed increasing significance as globalization leads to mega-mergers between organizations starting from very different places in the reward philosophy spectrum.

The degree to which staffs are affected by a merger or acquisition does. Of course, vary, at one extreme the holding company adopts a completely 'hands-off' approach, leaving the acquired company to run its own business, in its own way, and with its own terms and conditions of employment as long as it delivers the goods. At the other extreme, the acquisition is merged entirely into the parent company and all terms and conditions of employment are 'harmonized'. The employees affected, however, might have different views about the extent to which the process is harmonious.

Between these two extremes there is a measure of choice. In some cases it is only the pension scheme that is merged. In others, it is the pension scheme and all the other benefits that are harmonized, leaving separate pay structures. In making decisions about what should be done and how, the points on the following check-list should be considered jointly and in advance by the parties concerned.

### Merger and acquisition check-list

#### Executive rewards

1. What is the composition of the executive remuneration package? Information on package structure and service contracts will be needed to assess:
  - (a) Whether the gaps between practice in the two organizations is likely to prove problematic;
  - (b) Whether the values underpinning executive rewards are significantly different;
  - (c) What the priorities are for the executives involved.

### Salary Structure

2. To what extent, if at all, should a common salary be Introduced?

To answer this question information will be needed, first, on the economics and strategy of each business unit to see how far they conform. Then, if the business case emerges, details will be needed on:

- (a) Existing salary structures; .
  - (b) Organization structures, with salaries and grades for each job;
  - (c) The distribution of salaries within each grade;
  - (d) The method of job evaluation used;
  - (e) Policies and procedures for grading or regarding jobs and for fixing salaries on appointment or promotion;
  - (f) Any terms and conditions negotiated with trade unions or staff associations;
  - (g) The similarities and differences between the work carried out in each company and, therefore, the type of people employed.
3. What are The Advantages and Disadvantages of

### Merging Salary Structures?

The advantages seem obvious. A common basis is established throughout the group which facilitates movement and a consistent approach to salary administration.

The disadvantage is the disturbance and potential cost of merging, bearing in mind the regarding and salary increases that might be necessary as well as the expense of job evaluation. Why go to all this trouble if the operations in the respective companies are dissimilar and they are located in entirely different parts of the country? It could even be damaging.

4. If salary structures have to be merged, how should this be done? The choice is between:
  - (a) A full job evaluation exercise involving re benchmarking which may be disturbing, time consuming and expensive but may now have to be looked at in the light of recent equal values cases; or

- (b) The arbitrary slotting of jobs into the new structure using existing job descriptions (if any):- This could result in gross inequities unless full job descriptions are available or there is already a good fit between the two salary structures; or
- (c) A compromise between (a) and (b), slotting in jobs without a full evaluation if the fit is obvious, but evaluating doubtful or marginal cases. Note that if pay is negotiated with a trade union or staff association they would have to be involved and they will obviously fight against any detrimental changes.
- (d) Using this as an opportunity to adopt a new structure based on job family models/generics and broader pay bands.
5. When the merger takes place, should action be limited to the creation of a common grade structure, defining benefit levels but allowing different salary scales to reflect regional or separately negotiated variations in rates?
- It is possible to have common grade structures with different salary levels as long as the differences can be justified by reference to market rates.
6. What should be done about staff whose grade or salary range is changed as a result of merging pay structures?
- To re grade people and adjust their salaries to higher levels could be prohibitively expensive. To reduce salaries could be impossible, especially if there are trade unions in existence who carry any weight at all. It might then be necessary to 'red circle' staff affected by grade changes, that is, give them 'personal to job holder' grading and salary brackets which they retain as long as they are in the same job.

### General Salary Reviews

7. Should general salary reviews be centralized and take place simultaneously in all locations?
- The answer is clearly yes if a common salary structure exists or pay is negotiated centrally. If structures or pay levels vary or if site negotiations continue, then it may be best to maintain local arrangements.

### Performance management and performance related pay

8. Should performance management processes and linked salary procedures be standardized?
- A. It is tempting to say that they should, in the interests of consistency and control and to facilitate career and salary planning for the new group as a whole. But there are strong arguments for maintaining the local scheme if it is operating effectively.
- Managers who are familiar with one system might resent change. They could be forced to accept it but reluctant reviewers are bad at performance management, especially in a year of great uncertainty.

### Salary administration Procedures

4. Should standardized procedures operate throughout the new group?
- A. A bureaucratic centralized approach is inevitable in some organizations, but if local arrangements work well, why change them for change's sake?
- Bonus- schemes

10. Should different arrangements for bonuses be allowed to continue?

A. The answer to this question again depends on how close the links between establishments are. There is much to be said for retaining effective local bonus schemes which have an immediate link to performance as long as they do not conflict too much with group policies.

### Profit-Sharing Schemes

11. What should be done about profit sharing, assuming a scheme exists in one or other or both of the companies?
- A. Clearly, if there has been a complete take-over and the merged company loses its status as a separate profit center or can no longer issue shares under arrangements such as profit sharing share schemes, then the scheme in the company which has been taken over must be discontinued and employees moved into the take-over company's scheme, if one exists. If there is no scheme in that company, consideration would have to be given to some form of compensation which could be as high as three times the average of the last three years' payments.

### Pension Schemes

12. Should the employees of the acquired firm be transferred into the acquirer's pension fund?
- A. This is quite common and, obviously, there is no problem for staff if benefits are better. However, the back-funding of previous pension arrangements in order to pay for improvements can be very expensive, and it may be necessary to maintain separate schemes.

When the pension scheme in the acquiring company is inferior, it may be possible for members to choose under which scheme they will retire in the unlikely event that both schemes can continue.

This could be divisive when staff in the take-over company see that employees in the taken-over company are better off than themselves. However, many employees may leave the taken-over company before retirement and there will only be a handful of genuine anomalies reaching retiring age.

The government regulations on personal pensions and the development of portable pensions would also have to be taken into account. Employees in the acquired firm should be told about their rights and given advice on what is best for them to do in their own-interests.

### Other benefits

13. To what extent should employee benefits be harmonized, for example:
- (a) company cars;
  - (b) free petrol for company cars;
  - (c) life insurance;
  - (d) sick pay;
  - (e) private medical insurance;
  - (f) mortgage subsidy;
  - (g) season ticket and other staff loans;

- (h) lunch arrangements, including luncheon vouchers;
- (i) leave entitlements;
- (j) discount facilities?

The degree to which benefits should be harmonized is, like other areas of reward management, a policy question, the answer to which depends first on the philosophy of the controlling company (the extent to which it believes in centralization and absolute consistency in the treatment of employees) and second, on the circumstances in each company (the degree to which their operations and their geographical locations are linked or adjacent).

Considerable variations in benefit between employees in different parts of a group are undesirable, especially if there is any interaction or interchange between establishments. But a brutal approach to harmonization which significantly reduces the total remuneration of the affected employees will damage morale - will the take over company want its acquisition to be operated by de motivated people?

### Trade Unions or Staff-Associations

14. If a trade union or staff association has negotiating rights, how should they be involved?

- A. It is desirable in these circumstances to enter into discussions as soon as possible. The two companies should already have considered the approach they want to adopt and this will provide a basis for consultation and, where negotiated terms and conditions are affected, negotiation.

### Communication Strategy

Apart from any discussions with bodies representing staff, it is essential to have a communication strategy which ensures that staff in both companies know what is going to happen and how it is going to affect them.

This strategy must be prepared in advance and this implies that the questions in the check-list will have been considered before the merger is announced.

### Restructuring

Restructuring covers events as a result of which the terms, as agreed by the reference entity or governmental authority and the holders of the relevant obligation, governing the relevant obligation have become less favourable to the holders than they would otherwise have been.

These events include a reduction in the principal amount or interest payable under the obligation, a postponement of payment, a change in ranking in priority of payment or any other composition of payment. A default threshold amount can be specified.

This approach purports to adopt an objective approach by identifying specific events that are typical elements of a restructuring of indebtedness. As restructuring events could be those undertaken by a reference entity that would result in the credit quality being improved or remaining the same, the Credit Event under the 1999 Definitions is specified not to occur in circumstances where the relevant event does not result from a deterioration in the creditworthiness or financial condition of the reference entity.

The implications of a merger or acquisition on pay and conditions of employment do not seem to be considered seriously enough in most take-over battles. Executives and employees are too often pawns in a game of chess played by remote grandmasters. However, acquisitions or mergers do not always live up to expectations and one of the principal reasons for failure is the demotivation of managers and staff.

This is inevitable if insufficient attention is paid to their needs and fears as well as any existing imbalances between the reward strategies and remuneration levels of the organizations set to merge. This issue has assumed increasing significance as globalization leads to mega-mergers between organizations starting from very different places in the reward philosophy spectrum.

The degree to which staff are affected by a merger or acquisition does, of course, vary. At one extreme the holding company adopts a completely 'hands-off' approach, leaving the acquired company to run its own business, in its own way, and with its own terms and conditions of employment, as long as it delivers the goods. At the other extreme, the acquisition is merged entirely into the parent company and all terms and conditions of employment are 'harmonized'. The employees affected, however, might have different views about the extent to which the process is harmonious.

Between these two extremes there is a measure of choice. In some cases it is only the pension scheme that is merged. In others, it is the pension scheme and all the other benefits that are harmonized, leaving separate pay structures. In making decisions about what should be done and how, the points on the following check-list should be considered jointly and in advance by the parties concerned.

### Job Evaluations & Market Considerations

You can arrive at appropriate wages for positions on your farm on the basis of two main management tools:

- (1) job evaluations (based on compensable factors such as education, skill, experience, and responsibility), and
- (2) the going rate (or market value) of a job.

### Illegal Pay Differences

It is illegal to base pay differences on such protected personal characteristics as sex, race, color and marital status. The term "protected" is used because employees are safeguarded by law against discriminatory practices based on these personal characteristics. Federal law, established in the Equal Pay Act of 1963, explicitly requires men and women performing the same work to be paid the same with four key exceptions:

[when] payment is made pursuant to

- (i) a seniority system;
- (ii) a merit system
- (iii) a system which measures earnings by quantity or quality of production; or
- (iv) a differential based on any other factor other than sex.

Blatant cases of sex-based discrimination include instances where men and women hold the same jobs yet are paid differently with none of the defensible reasons applying.

Somewhat veiled, but no less illegal, are cases where sex-segregated jobs are equal, except for their titles, and yet are paid differently.

### Job Evaluation

A farmer such as Cecilia who pays different rates for different jobs usually first classifies the jobs on her ranch. Through a job evaluation she rates the jobs on the farm according to their relative “importance.” Each job might be given its own rate, or jobs of comparable importance may be grouped or banded into a single wage classification, or pay grade.

Job evaluations compare positions in an organization with respect to such factors as education, responsibility, experience and physical effort. Figure 7-2 shows a sample job evaluation. In it, for instance, much more value is given to responsibility and education than to physical requirements. The supervisor in this example would earn about twice what an equipment operator would.

Figure 7-2

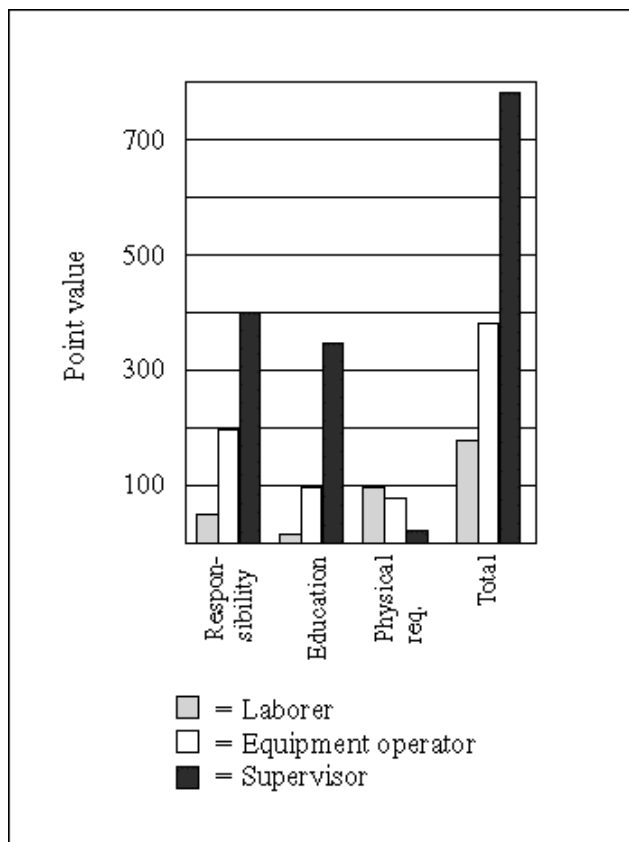


Figure 7-2 uses education as a compensable factor. You may prefer to think in terms of what combination of experience and education would qualify a person for the job. This is an important step for determining the value of the position to be filled. However, when it comes time to hire someone, you may not care what combination of education or experience an applicant has as long as he can do the job.

If education is used as a compensable factor, a bachelor's degree might be worth 200 points, a junior college degree 150, a high school diploma 100, and an elementary diploma 50 points. Some of the jobs in the ranch might require a high school diploma, thus earning 100 points in this category, while others might have no education requirement (0 points allotted)—regardless of the educational qualifications of the person who may actually apply. Similar ratings of jobs would be made for responsibility and other factors worth compensating.

You decide how much weight to allot various compensable factors and how to distribute points within each job. For the job evaluation to be useful, a detailed list of compensable factors needs to be articulated. (The job analysis created during the selection process can help.) You can test the job evaluation by comparing a few jobs

you value differently. Does the tentative evaluation match your expectations? If not, are there any job factors missing or given too much or too little value?

Workers may also participate in the process of evaluating jobs and can add valuable insight into the essential job attributes for various positions.

Personnel involved in evaluating their own jobs, nevertheless, are likely to experience conflict of interest.

Although supervisors will normally make more than those they supervise, this is not always the case. A very skillful welder or veterinarian will probably make more than her farm supervisor. Some workers harvesting at a piece rate often make more than the crew leaders supervising them. Supervisors may be offered additional pay during labor-intensive periods.

Job evaluations, then, reflect the relative value or contribution of different jobs to an organization. Once a job evaluation has been completed, market comparisons for a few key jobs need to be used as anchors for market reality. In theory, other jobs in the job evaluation can be adjusted correspondingly.

### Market Considerations

In practice, results of job evaluations are often compromised or even overshadowed by market considerations. Labor market supply and demand forces are strong influences in the setting of wages. No matter what your job evaluation results may indicate, it is unlikely you will be able to pay wages drastically lower or higher than the going rate.

Supply and demand factors often control wages. When there are many more pickers than available jobs, for instance, the going wage decreases. If few good livestock nutrition specialists are available for hire, they become more expensive in a free market. The market may also influence the migratory patterns of farm workers, for example, whether a worker stays in Mexico or travels to Texas, Florida or Oregon.

Of course, the market is not totally free. Legal constraints affect wages (e.g., equal pay, minimum wage). Labor groups, in the form of unions, can combine forces to protect their earnings. They may prevent employers from taking advantage of a large supply of workers. At times wages are driven so high they disable corporations who cannot compete in a broader international market. Some professional groups can also impact

Wage surveys need to describe jobs accurately as positions may vary widely even for jobs with the same title. Surveys should seek information about benefits given employees (e.g., farm products, housing). Of course, there are other “intangible benefits such as stability, the prestige of the position or the institution [and] the possibility of professional development”.

An important pay decision is whether one will pay the going market rate. Those who pay at or below the market may have difficulty attracting workers. Further, they may find themselves training people who leave for higher paid positions. Merely paying more than another farm enterprise, however, does not automatically result in higher performance and lower labor costs. Even when well paid, workers may not see the connection between wages and their performance. Farmers who pay too much may find it difficult to remain competitive. Furthermore, there are other factors valued by employees besides pay, such as working for an organization that values their ideas and allows them to grow on the job.

In wage setting, it is usually more beneficial to reconcile market information and job evaluation results than to singly rely on either. Unique jobs are more appropriately priced on the basis of job evaluations. You may depend more heavily on the job market for common jobs.

## Notes

[illegible]

## LESSON 40: CASE STUDY

### The Employers' Organization

#### Company background

The Employers' Organisation for local government's (EO) role is to help councils achieve the high standards of people management needed to ensure the continuous improvement of services.

We offer a range of services to local authorities, from free telephone advice and specialist guides to tailor made consultancy services.

#### Essex – Our Approach to Pay Progression

Essex County Council has been going through radical change. Some of that change has been structural but the more important aspect of the change is cultural. We are seeking to move the organisation to a much more customer focused and facing organisation.

#### Situation

One of the mechanisms to support this move has been our approach to pay strategy. We also wanted to implement the Single Status Agreement, which removes the employment conditions divide between some of our staff. The Agreement and the approach we used affected our 9,000 staff.

The cornerstone of our approach was to develop the Essex Competency Framework. This sets out the skills and abilities that our staff need to deliver best quality services for the Council. We then incorporated this into our individual performance management system. This formed the foundation on which we could build our new approach. The principles of the approach are:

- (1) It is simple and consistent
- (2) A member of staff meeting the objectives of their job and their competency statements can expect pay progression
- (3) It fits with the service planning cycle
- (4) Development opportunities are available
- (5) Staff at their maximum pay point undergo performance review and competency development so that further development opportunities can be explored.

#### Process

The new system for these staff moves away from automatic service based increments, although it still uses the national pay spine up to point thirty-four. It is based on four Broad Band Grades that have been determined by using the National Job Evaluation Scheme.

Within each Band the first increment is automatic, then performance is assessed against delivery of objectives - i.e. what needs to be delivered - and the demonstration of competencies - i.e. how it needs to be delivered. Objectives come from the job profile for the individual and the service objectives for the service area.

Around six objectives are required for each job and they need to be constructed in a way that is easily measurable. We provide guidance and training for managers and staff on how to do this effectively. The objectives are set at the beginning of each review year and can be reviewed and amended. We also use statements from the appropriate four Competency Headings from the Competency Framework plus the Technical Professional Competency.

A statement from the Competency Framework sets out what needs to be demonstrated by the individual in their role. An example is: "Seeks regular feedback from customers about services provided and uses this to recommend continuous improvements to the service". This statement comes under the Competency Heading 2 "Customer/Client Orientation" and is the appropriate statement for spinal column point twenty two.

Each of the generic competencies has a defined and prescribed statement for every spinal column point. A few of the statements remain the same at all spinal column points; for example, those around equality and diversity, but most become more demanding the higher the spinal column point.

The selection of the Competency Headings from the Essex Competency Framework may be for individual posts where there are no other similar posts but job families have commonly agreed Competency Headings across the organisation in order that we have consistent levels of service delivery for that function.

There is also a Competency Heading entitled Professional and Technical so that job specific competencies are included e.g. social workers. This framework is flexible enough to cover all jobs and roles within the Council including the Member role. For jobs above spinal column point thirty-four and for Members the Competency Framework is used in a different way.

Each year, the manager will identify the spinal column point for their member of staff as at the first of April. A database will produce all of the appropriate statements under the selected Competency Heading for that spinal column point. These will be recorded on the appropriate form for the individual together with their agreed objectives for the year. The professional technical statements are not prescribed because they relate directly to the area of work and the manager will draft these with the individual, although there is general guidance in place to assist the process.

#### Questions

- (1) What do you understand by the term People Management?
- (2) What is pay progression and discuss its relevance to this case.

#### Case: George Gratuity

George Gridley secured his college training at a large state university. For his first 2 years, he followed a mechanical

engineering curriculum; he then switched to commerce. His major course work centered on motion and time study.

Upon graduation he was hired by Wellington Corporation, a large Chicago firm employing 2,500 workers, to work in its standards department. In Gridley's words:

I was really in a good spot when I graduated. You see, I'm both an engineering and commerce major. You can't beat that combination. I'm just a natural for a standards department because I have the business know-how together with my engineering. Wellington had the best spot for me so I took the job because I could get ahead fastest there. Their interviewer told me when he came over to school to interview us that I had a rare combination his company was glad to find. I went up to Chicago for some additional interviews. I liked them and they liked me, so I took the job.

Gridley reported for work 2 weeks after graduation, having arrived in Chicago 3 days before starting work in order to find a place to live. After the usual processing in the personnel department, he was taken up to the standards department to the office of its chief, Mr. McGuire, who had interviewed George before he was hired. McGuire kept George waiting for 10 minutes and then turned to him. George described this meeting.

I just sat there in McGuire's office watching him work on some papers, not knowing quite what to expect. Finally, he turned to me and said, "Well, Mr. Gridley, are you all set to go to work?" He never did call any of us younger fellows in the department anything but "mister." He told me that there would be a department staff meeting that morning when he would introduce me to everyone. Meantime he gave me the company standards manual and told me I ought to spend several days getting familiar with it. He called his secretary and told her to take me to my desk and get me all the supplies I needed; that ended the interview. He certainly was a cold fish and all the time I worked for him I never could warm up to him. I didn't get any assignment at all the first week but just sat at my desk and worked over the manual. I got to know several of the fellows around me and we went to lunch together.

Gridley was finally assigned to work up the time study on a simple assembly of refrigerator door handles being assembled in a department in which Mason was foreman. When McGuire gave him the assignment, George was so glad to be working he failed to respond with any questions when given the opening by McGuire's query, "Any questions?"

I felt so glad at getting a real job at last that I just said, "I think I can handle this easily, Sir," and left his office. I went and got the drawings for the assembly and studied them for a few hours. Then I went down to Mason's department and told him Mr. McGuire had given me the assignment of working up the refrigerator door handle job. He said that was all right with him. Mason was a crusty old guy who didn't seem to have much education at all. Nobody could remember when he started with the company and he'd been a foreman a long time. I got out the drawings and wanted to talk to him about the job but he sort of brushed them aside and started asking personal questions about me. I figured maybe he couldn't read drawings too easily, so I didn't try that approach again. After I told him about

myself and my education he said, "Well, this ought to be easy for you. Let's go over and look at the job."

There were ten workers assembling the door handles, working for the second day on this job. The first thing that struck George about the job was the casual attitude that seemed to be evident, and the pronounced talking and minor horseplay that continued after Mason and Gridley came over to observe. Mason left almost immediately, saying to the group, "This is Gridley from standards on this new job. He's new with the company."

In talking about it later, Gridley recalled the subsequent developments of that day with some discomfort. He knew that under the union contract, work on a new job was paid for at a guaranteed rate, until the standards and price were set. Then the work went on an incentive basis. But he was scarcely prepared for the complete irreverence with which he was greeted.

Almost the first remark I heard from the group was, "Well, here is the genius who is going to show us how to bust this job wide open without any work at all." You can imagine how the others laughed and what a spot that put me in. I made some comment about "just doing a job" and began observing the assembly work. It seemed to me there was pretty poor discipline in a company where the workers made remarks like that. It got me so that I just automatically reached for a cigarette and started to light it. That same worker saw me and said, "Say, haven't they told you that only fireproof cigarettes are permitted here?" Then I remembered the no-smoking rule. I was so mad by then I just went off to the washroom and smoked. Those damned ignorant workers sure take a lot of pleasure in making life miserable for their betters.

That afternoon George went back to the department and began observing the operation, and made arrangements with Mason and the union steward to time the job on the following morning. Gridley made no suggestions for any assembly procedures changes, figuring he would time the job "as is" rather than force himself to discuss with Mason and the workers some changes he thought might be useful. The principal saving he could see was in proper flow of materials to each work station and he planned to take this into account in working out some standard procedures and estimated prices based upon them. The time study was made the next day as planned.

Gridley immediately took the data back to his desk and spent that day and the following preparing his report. After waiting still another day getting it typed up, he submitted it to McGuire. The figures showed a price of 60 cents a dozen for assembly. McGuire sat down immediately with the report and read it over. It took him only about 10 minutes to go over it, saying not a word to Gridley, who had been asked to wait. Then as Gridley reported:

He family looked up at me and said, "Mr. Gridley, this is a good job. From your repack:" I feel your operating scheme is good and your time data shows consistent results. I chik Mason's estimate on the job some place. Let me get it." He got out a file and found memo sheet that had some handwriting on it. "Yes," he said, "here is his estimate. You know in this company we often have foremen estimate prices on simple jobs, just in



case we can't handle them up here because of a work load. Then we let the foreman's estimate ride. Mason says 62 cents on that job. You never know how these foremen figure those things out. Mason has done a lot of these refrigerator handle assemblies in

his department in the past. Since our study is so close to his figure, I think I'll let his stand. There is only a little better than 3 per cent difference. This is no reflection on you, understand that, Mr. Gridley. I just feel in this instance it would be valuable to the company and to our operations in the standards department to let Mason think his estimate and our study agree."

Can you imagine anything like that? Here I really put out to give them a job and then McGuire goes ahead and uses some off-the-cuff estimate of a foreman who can't even read prints. That doesn't seem to me to be very good management. Does management really want brains around here or are they just going to run the company by-guess-by gosh all the time?

## Questions

1. How scientific is time study? Is George justified in his views of the technique?
2. Assuming that George is correct, what does McGuire get in return for the extra two cents? Is his decision beneficial to the company?

## Notes

## LESSON 41:

TOWARDS UNDERSTANDING INDUSTRY AND LABOUR IN THE POST-MFA REGIME:  
CASE OF THE INDIAN GARMENT INDUSTRY-M. VIJAYABASKAR**Introduction**

The world garment industry is on the threshold of far reaching institutional changes in the near future. Hitherto, despite being one of the most globalised industries in the world, it has also been an exemplar of how trade practices in a 'globalising' world are still distorted in favour of advanced capitalist economies. Over the past three to four decades, trade restrictions, price and quantitative, have come to play a major role in conditioning patterns of the sector's development. However, over the next few years, by 2005 to be specific, the existing institutional constraints on garment production and trade would be removed. The removal of institutional barriers to trade would have important implications for output markets, especially that catered to by low-income economies seeking to industrialise through promotion of the garment sector. In turn, changes in these characteristics, given the labour-intensive nature of garment production, would have a serious bearing upon the labour market, especially in 'labour-surplus' economies like India that attempt to strengthen/sustain their position in the global output market.

The garment sector has been conventionally viewed as a major source of employment generation. Of late, in addition to this dimension, following the success of the East Asian economies, it is also seen as a lead sector in the industrialisation process of low-income economies. Its low skill requirements, and large labour absorption potential has made it the primary source of first non-agrarian employment for the rural populace of these regions. To add, the garment sector is also seen to offer tremendous prospects for employment of women, unlike other traditional manufacturing sectors. Given these factors, it is of great importance to understand the labour market implications of the changes in the international trade regime. In this study, we address this issue in the case of the Indian garment industry. Though the study is confined to an empirical

examination of the possible changes in the prospects for Indian garment manufacture and employment, and challenges that confront Indian policy makers in this regard, obviously its relevance would extend to other regions with similar structural characteristics.

The objectives of the study can be translated into the following research questions to which we seek to find answers here:

**Research Questions**

- What are the characteristics of the market niche that Indian garment producers occupy in the world garment industry?
- What are the key elements that condition/influence the dynamics of global division of labour in the garment industry?
- To what extent has the quota system conditioned this phenomenon?

- What are the sources of competitiveness of Indian garment production? How do they compare with garment production in competing nations?
- What would be the likely impact of a quota-free regime on the prospects of garment exports, from India and consequently, on extent and nature of employment generation in India?
- What would be the nature of policy intervention required to sustain and/or enhance the quality and quantity of employment in the new trade regime?

**Organisation of the Study**

The study is organised as follows. First, we outline a framework to understand the issues under consideration. In the next section, we delineate the major characteristics of the Indian garment industry, and examine its position in the world garment industry. The dynamics of the world apparel market would obviously exert a key influence upon the mode of participation in the world market and consequent production imperatives. The characteristics of the market segments that Indian garment industry caters are identified. To comprehend the sources of competitiveness of Indian garment industry, we then move onto examining the production structure of the Indian garment industry and the factors enabling the formation of such a structure. This exercise is attempted in a comparative frame, relating some of India's structural and performance characteristics with that of a few of its competing countries so as to comprehend India's competitive strength better.

We then move onto anticipate the possible changes in input and output markets wrought by the onset of a quota-free trade regime. Here, we focus on a few important dimensions of the Indian garment sector, and its labour market in particular. The constraints and opportunities for its development are highlighted. Finally, the nature of institutional intervention required to sustain and upgrade the quality and quantity of employment in the garment sector are suggested.

**Methodology****a. A Framework for the Study**

Since we seek to examine the trajectory of a commodity sector embedded in a global division of labour and its implications for labour, we need to use a framework that helps to understand the dynamics of production and trade as impacted by the global division of labour. We find the 'commodity chains' approach as developed by Gereffi and others to be most appropriate for the purpose at hand.

The commodity chains perspective, initially advanced by the world systems theorists (Hopkins and Wallerstein 1986), and enriched by subsequent empirical analyses of Gereffi (1995, 1996, Gereffi and Korzeniewicz, 1994) and others (Bonacich et al 1994, Gibbon 1997, Ramamurthy 2000), facilitates

understanding accumulation processes in sectors where production and distribution functions are dispersed across the world.<sup>12</sup> In a period when nation states are losing their importance in economic decision-making, it is less fruitful to analyse the capitalist system in terms of linkages of nation states. It is obvious for instance, that integration of a national economy, especially one as large as India, with the world market would lead to territorially and sectorally differentiated outcomes. It becomes important therefore to analyse how specific industries are organised globally and to discern the mechanisms of surplus extraction at various points and of co-ordination of dispersed labour and exchange processes. A commodity chain, as defined by Hopkins and Wallerstein (1986, 159), refers to “a network of labour and production processes whose end result is a finished commodity.” To construct a commodity chain, first, the various production processes required for the final product needs to be delineated. Each of these processes constitutes a node in the chain. In relation to each node the following properties may be looked into:

- the geographic loci of the node
- commodity flows to and from the node, and those operations that occur immediately prior to and after it
- relations of production within the node
- dominant organisation of production, including technology and scale of the production unit (pp 160-163).

Gereffi views the globalisation process as one organised by two distinct sets of economic actors. Manufacturing Transnational Corporations (TNCs) who source their components and labour intensive processes of their production from less industrialised regions constitute one set. These sectors are mostly technology and skill intensive and offer substantial economies of scale (automobiles, computers, aircraft, electrical machinery, etc). Profits are derived from scale, volume and technological advances. These constitute producer driven commodity chains (PCCs). Gereffi distinguishes such commodity chains from buyer driven commodity chains (BCCs), which are controlled by big merchandisers, retailers, and trading companies that co-ordinate decentralised production networks all over the world. The third world manufacturers produce finished goods and not components. The buyers normally involve in design and/or marketing, deriving profits from a mix of research, design, sales, marketing and financial services. They are less likely to own production facilities.

In PCCs, the transnational corporations exercise control through command over raw material and component suppliers, as well as forward linkages into retailing. BCCs on the other hand, since they are design and marketing intensive, create high barriers to entry at the brand name merchandising and retail levels where ‘firms invest considerable amount in product development, advertising and computerised store networks to create and sell these items’. Whereas core firms at the point of production control PCCs, control over BCCs is exercised at the point of consumption. The latter production organisation can be best described as one of contract (or specification contracting) manufacturing where the finished consumer goods output of local firms is distributed and marketed abroad by trading companies, branded merchandisers, retail chains or their agents.

The distinction also helps to understand the kind of trajectories that firms need to take to move up the value chain.

Even within low-income economies, Gereffi stresses the need to differentiate the role played by each region in the world economy. Focusing on export production, he outlines five basic international economic roles that peripheral regions may fulfil: (a) The commodity export role (b) the commercial subcontracting role (c) the export platform role (d) the component supplier role and (e) the independent exporter role. There is thus a suggestion of a possible progressive movement from extreme dependent production to one of an independent exporter of manufactured goods. It is also clear that industrial relations and labour market outcomes would be influenced by the kind of roles that peripheral economies/regions play in the global division of labour. The commodity chains perspective thus, offers the possibility of understanding the production organisation patterns in specific regions in terms of their location in the global division of labour.

Next, we need a framework that links up changes in output markets with changes in labour markets. In this regard, the works of industrial organisation theorists like Sabel and Piore, and labour market theorists like Peck would be useful. They are primarily concerned with contemporary changes in global output markets and the possible implications for labour markets as mediated by other institutional factors. Increasingly, it is felt that competition in global markets relies more on innovative capability and an ability to shift from one process or product to another without loss in efficiency. Such ‘flexibility’ in output markets may be derived through deployment of flexible technologies and/or through use of flexible labour. Flexibility in labour use may be obtained either through employment flexibility or through development of functional flexibility among the workers, which may in turn depend on many institutional factors. Hence, these perspectives are useful to relate contemporary changes in global product markets to changes in local labour markets.

## b. Method

The study is largely based on secondary literature and published data sources. Statistics published by the Apparel Export Promotion Council, by garment industry associations, and by multilateral agencies would be used for the purpose apart from studies done in this area by others. To overcome the gaps in secondary literature, we undertake a few interviews with key informants like members of garment producers’ associations and trade union members actively involved in this sector. In this however, we confined to only one region, Tiruppur, which has revealed remarkable dynamism in the export of garments.

In order to understand the national specificities of garment production and its interactive dynamic with the world market, in the following section, we delineate the key characteristics of the Indian garment industry with emphasis on its exports.

## Characteristics of Indian Garment Sector

### a. Changes in Export Composition

Garment exports as a share of manufactured exports from India has risen from 0.3 per cent in 1960/61 to 17 per cent in 1992/93 (Chatterji and Mohan 1993; Exim Bank of India 1995,

5).<sup>2[3]</sup> Chatterji and Mohan distinguish two phases of this growth based on composition of garments exported, their destination and demand vagaries. The first one, during the late 1960s and early 1970s, was led by a tremendous surge in demand for handloom garments due to fashion requirements in the US and Europe.

The second phase, according to Chatterji and Mohan (1993), begins from 1983/84 and has been marked by a relatively more steady growth. From around Rs. 640 crores in 1983/84, it has increased to around Rs. 22,915 crores in 1999 (Exim Bank of India 1995, AEPC, various years). However, this relatively stable growth has been accompanied by changes in the relative shares of segments within the sector (Tables 1 and 2). Of special significance has been the rise of the knitwear segment. From 16.9 per cent in 1983, it has almost doubled to 33 per cent by 1999. That the cotton knitwear segment has led this growth is quite clear, as it alone constitutes 90 per cent of this sector.

**Table 1**

**Segment wise Composition of Indian Garment Exports: 1983-91**

(in per cent value)

Year	Handloom Garments Share	Knitted Garments Share	Millmade Garments Share
1983	6.9	16.9	76.2
1984	4.9	17.0	78.1
1985	3.5	15.6	80.9
1986	1.9	17.6	80.5
1987	1.1	19.5	79.4
1988	0.9	21.2	77.8
1989	0.6	22.0	77.4
1990	0.3	22.5	77.2
1991	0.3	22.7	77.0

**Source: Chatterjee and Mohan 1993, M-104.**

**Table 2**

Segment wise and Fibrewise Composition of Garment Exports: 1991/92 – 1999

(in per cent value)

Year	Knitted Garments			Handloom Garments			Mill made Garments		
	Cotton	Synthetic	Wool	Cotton	Synthetic	Wool	Cotton	Synthetic	Wool
1991-92	22.1	0.9	0.30	0.4	--	0.00	41.3	28.9	0.2
1992-93	26.5	0.9	1.2	0.7	0.2	0.00	46.1	24.2	0.5
1993-94	26.5	1.3	1.8	0.7	0.2	0.00	47.9	20.4	1.4
1995	23.3	1.06	1.46	0.82	0.03	0.00	44.8	25.12	2.29
1996	26.59	1.6	2.48	0.61	0.01	0.02	44.1	23.08	0.98
1997	29.14	1.23	2.52	0.25	0.01	0.01	42.01	23.67	1.33
1998	28.11	1.86	2.26	0.16	0.01	0.02	42.51	24.26	0.81
1999	30.97	2.28	2.16	0.13	0.03	0.03	39.34	23.88	1.18

Source: Handbook of Export Statistics, AEPC, various issues.

However, the share of handloom garments has fallen steadily from 6.9 per cent to 0.3 per cent while that of mill made garments continues to be high at around 70 per cent (Chatterji and Mohan 1993, M-104). This remains so, despite a slow but steady decline in the share of mill made garments. The decline in both these product categories has been compensated by a steady increase in the share of knitwear products. Between 1985 and 2000, knitwear exports have grown at a compound growth rate of 9.63 per cent while that of wovens has grown only at 4.93 per cent (Panthaki 2001, 86).

With regard to the fabric base, cotton garments continue to dominate the export basket. Cotton based garments accounted for nearly 71 per cent of value of garment exports from India in 1999 (AEPC 2000). Synthetic and woollen garments constituted 26.2 per cent and 3.39 per cent respectively in 1999 (ibid) as compared to 9.1 per cent and 6.6 per cent in 1983 respectively (Chatterji and Mohan 1993, M105). In fact, the share of cotton garments in quantity terms is even higher at 81 per cent, indicating a lower unit value of cotton garments as compared to that of synthetic and woollen wear, especially synthetic garments. Comparing the composition of Indian exports with that of South Korea and Hong Kong, Chatterji and Mohan find that there is a “predominance of woven clothing” (M105). Further, they also note a high concentration of items exported. The Exim Bank study notes that five products, viz., women’s blouses, dresses, skirts, men’s shirts and knitted undergarments constitute 61 per cent of total Indian garment exports in 1991 (1995, 12). Since almost all the garments are cotton based, they argue that Indian products compete for only 15 per cent of the global market for clothing (24). On the other hand, Ramaswami and Gereffi argue that a pattern of specialisation is not confined to India and find a similar product concentration in the composition of exports from competing economies like China and Indonesia. In fact, in all these three economies, the top two products account for more than 50 per cent of their total garment exports (125). Further, across all the product categories exported, India’s market segments “mainly fall in cotton, semi-fashion, middle price segment with main product category being T-shirts, men’s shirts, ladies’ blouses, ladies’ dresses and skirts” (Tait 2001, 44). Such specialisation, given the presence of a strong domestic fibre base in cotton may provide India with an edge in an important niche in the global garment industry.

### b. Destination Characteristics

The change in the composition of garments exported also partly reflects changes in the destination of Indian exports. In the initial phases of Indian apparel exports, USSR and Eastern Europe were the biggest importers. Right from the mid-1960s through the mid-1970s, they accounted for roughly over 50 per cent of the market for Indian apparel exports (Chatterji and Mohan 1993, M 99). Since the late 1970s and the beginning of the 1980s, there has been a gradual shift to US and European markets along with the decline of the former East European and USSR markets. By 1999, a major share of Indian garment exports catered to the US and European markets, 29.54 and 33.63 per cent respectively (calculated from AEPC 2000).

Indian exports to these countries have been subject to quantitative restrictions. Along with currency depreciation, this has in fact, governed the relative share imported by these regions from India. While during the early 1980s, the share of the EEC market was around 50 per cent, it declined in proportion to increase in the share of US market, only to again increase and stabilise at 43-44 per cent during the late 1980s and early 1990s (Chatterji and Mohan 1993, M 102; Exim Bank of India 1995, 35). Since quotas allotted in most countries have been fulfilled, analysts expect that the removal of MFA restrictions would enhance the ability of Indian exports to penetrate these markets. Moreover, there has been a slight diversification into non-quota markets in recent years with quota markets' share declining from 82 per cent in 1987 to 74 per cent in 1993 (Exim Bank of India 1995, 7) and to 68 per cent in 1999 (Handbook of Export Statistics, AEPC 1999). These new markets are UAE, Switzerland, Japan, Russia, Saudi Arabia and Australia. Table 3 gives the growth in restrained and non-restrained markets since 1980.

**Table 3**

#### **Growth Rate of Exports of Indian Apparel: 1980-2000 (compounded rate of growth)**

Period	Restrained Markets	Non-restrained markets
1980-84	1.25	32.8
1985-89	11.5	11.9
1989-94	7.5	22.8
1995-2000	4.8	7.8
Entire Period	8.83	17.9

Source: Panthaki (2001, 85).

As can be seen, exports to non-restrained countries have grown at a much higher rate than that for quota countries, indicating a degree of competitiveness of Indian apparel. However, 51 per cent of the garments exported continue to be governed by quota restrictions (Handbook of Export Statistics, AEPC 1999).

### c. Relative Performance

The growth in India's share has been relatively slow, having moved from 1.5 per cent in the 1970s to around 2.4 per cent in 1992 (Exim Bank of India 1995, 7) and then to 2.6 per cent by 1994 (Ramaswamy and Gereffi 1998).<sup>3[4]</sup> Even the latest figures for India's exports place it at only around 2 per cent (Tiruppur Exporters Association 2000). Though the growth of its

exports has moved in tandem with world garment trade, its performance does not compare too well with that of other low-income economies.

Economies like Thailand, Indonesia, Bangladesh, Mauritius, Pakistan and Sri Lanka have achieved higher growth rates during this period as compared to that of India (Exim Bank of India 1995, 8; Ramaswamy and Gereffi 1998, 124). China, for instance, has tripled its share from 4 per cent in 1980 to 15.2 per cent in 1995. Bangladesh has increased its share to 0.9 per cent from near nil exports in the early 1980s. As a result, India's share in 'developing' countries' exports has not improved beyond the 4 per cent mark achieved in 1974 (Chatterji and Mohan 1993, M 96). In fact, India's rank among 'developing and NIE' country exporters has fallen from 5 in 1980 to 8 in 1992 (Exim Bank of India 1995, 8). This relative stagnation assumes further significance in the context of India's advantages in terms of cheap cotton production and availability of large pools of labour. In fact, substantial quantities of cotton fabric and yarn are exported from India to some of these economies from where they are made up into garments and exported. These comparisons tend to indicate a possible loss of markets to its competitors once the quota restrictions are removed.

### d Government Policies and Production Structure

The strategy of import substitution based industrialisation, with emphasis on growth of heavy industry has exerted a strong influence on prospects of the garment industry. Since heavy industries are capital intensive, and given the huge labour surpluses in India, the state assigned a few light goods industries including the garment sector, the role of a labour absorber. Further, since there already existed a strong traditional artisanal garment sector, it was felt that it needs protection from competition by the more 'efficient', modern capital.

Consequently, sectors like the garments were reserved for firms that fall under the 'small scale' sector. Firms with a capital investment limit of less than Rs. three crore<sup>4[5]</sup> are categorised as 'small' and any firm with greater investment need to commit to export more than 75 per cent of its output. Since no time frame is provided for this requirement, it is said that big firms do not will to risk entry into this sector (Chatterji and Mohan 1993, M117). Further, the small firms too would be unable to upgrade their technology, as this would invite a movement beyond the capital ceiling fixed for the small-scale sector.<sup>5[6]</sup> As a result, the Indian garment sector is found to consist of smaller firms as compared to other exporting low-income nations, thereby placing limits on the sector's ability to compete on the basis of productivity (M 116). The resultant fragmentation process is seen to prevent firms from realising scale economies and consequent efficiency. Moreover, given the importance of market information in this industry, traders exert a dominant influence in the export market. Out of 10,000 exporters registered with AEPC, only 250 are manufacturer exporters (M114). As a result, incentives to improve production techniques have not been forthcoming.

It is therefore said that Indian exports depend more on fashion changes than on any inherent competitive strength based on quality or productivity (Chatterji and Mohan 1993). Despite these limitations, Ramaswamy and Gereffi (1998) find that

India has improved its market share in 9 out of its 17 main product categories (129) and further that, there has been an increase in the unit values realised. This appears to have been possible due to the advantages derived from such a decentralised and networked production structure, which enable firms to compete in low-volume segments with greater fashion content as compared to say, China or Bangladesh where the minimum efficient scale of operation is much higher.<sup>6[7]</sup> In fact, Kathuria and Martin (2000), quoting Khanna (1990), cite that all successful exporting firms subcontract much less than **India**. While Indian firms subcontract 74 per cent of their output, countries do not subcontract more than 36 per cent of their output in all other cases. Further, they also contend that investment of Indian firms in processing techniques is very low when compared to other exporting countries (Table 4).

**Table 4**

**Typewise no. of Machines Installed by Apparel Export Firms (nos.)**

	Pre-cutting	Cutting	Sewing	Special	Processing
S. Korea	2.9	12.3	134.3	77.5	31
Taiwan	2.6	7.5	185.1	49.5	12.8
Hong Kong	2.3	13.2	455.4	112.7	27.9
China	2.3	13.2	450.5	104.8	34.4
Thailand	2	12.8	460.8	72.4	21.9
India	0	2.3	103.7	8.6	4.6

**Source: Kathuria and Martin (2000, 10)**

Thus, while government policies have constrained garment producers from competing on the basis of scale economies and improved labour productivity, they have fostered a structure, albeit indirectly, that facilitates production for a more flexible product market. With the removal of reservation for the small-scale sector however, possibilities of entry into large-scale production and benefiting from scale economies, has been facilitated. Further, with a good domestic production base in cotton fibre and lack of import restrictions to upgrade process techniques, Indian garment producers may venture to compete in the mass market as well. Nevertheless, given the strong competition in this segment and absence of a first-mover advantage, it may still be in the 'flexible' market segment that Indian producers retain their advantage in the post\_MFA regime. Simultaneously, it also opens up possibilities for the latter segment to upgrade its quality by taking advantage of availability of new processes.

#### **e. Labour Employed**

Given the fact that considerable section of Indian garment industry is confined to the 'unorganised' or 'informal' sector, conditions under which workers labour is hardly subject to the legal realm. For instance, Gupta reports that only 25 per cent of the total value of garment output is accounted for by firms registered under the Factories Act. Hence, secondary data at the macro-level too are hard to come by in this regard. Time and again, as in many other countries, we observe that labour in the garment industry is subject to harsh working conditions, and paid below living wages (Singh 1990; Kalpagam 1981, 1993;

Alam 1994). Further, given the predominance of 'informal' sector activity, legislation with regard to labour markets are less likely to be enforced as compared to other economies. Tait (2001) provides the distribution of the workforce in the Indian textiles and garment industry as follows (Table 5).

**Table 5**

**Employment within the Textile and Apparel Industry in India**

No	Sector	Employment (in million)
1	Handicrafts	7.1 (18.64)
2	Sericulture (Silk Industry)	6 (16)
3	Readymade garments	3 (7.87)
4	Woollen sector	1.2 (3.15)
5	Handloom	12.4 (32.5)
6	Decentralised powerloom	6.8 (17.85)
7	Man-made fibre/filament yarn	0.06 (0.16)
8	Cotton/man-made fibre/Yarn Textile/Mill Sector	1.14 (2.99)
9	Jute	0.4 (1.05)
	Total	38.1 (100)

**Note:** Figures in parenthesis in Column 3 are the per cent shares of employment in the sector. Above all, the table clearly brings out the heterogeneity of the sector, and the share of the workforce employed in the export sector is still unclear. Employment in the ready-made garments industry is around three million, which is only eight per cent of the total workforce in this sector, seen as a segment of the apparel commodity chain. The Annual Survey of Industries provides data on employment, output and capital used in the factory sector of all the manufacturing industries. Though confined to only a small proportion of the garment sector, we provide the employment figures as it is the only reliable macro-data source available for the Indian economy Table 6).

**Table 6**

Industry Code	No. of Factories	No. of Male workers	No. of Female Workers	Share of Female Workers (in %)
260	1380	24708	7612	23.5
265	2983	7637	148910	95.2

Note: '260'- Knitting mills; '265' -ready made garments sector other than knitting mills where fabrics are cut and sewn into garments.

**Source: Annual Survey of Industries, 1997-98.**

The table indicates the high dominance of women workers in the woven garment industry, while they are relatively less employed in the knitwear sector. However, as stated earlier, the data are hardly representative of labour employed in the numerous subcontracting and household enterprises that populate the 'informal' sector. Given the unreliability of these figures, rather than seek to understand the conditions of labour at the macro-level, or understand the labour market conditions in all centres of the Indian garment industry, we confine our analyses to that existent in Tiruppur, one of the biggest centres of apparel exports and representative of regions undertaking

garment exports in India. Prior to that, in the next section, with a view to capture the structural dynamic of the global apparel industry and the possible impact of it on specific regions, we delineate some of its key characteristics.

### Features of World Garment Industry

a. Wage Cost Differences, strategy of Shifting Location and a leading Sector in Peripheral Industrialisation:

The characteristics of garment production as noted earlier- low sunk costs, relative absence of advanced technology and skills, have always induced apparel firms in the advanced capitalist countries to shift labour intensive operations to peripheral economies. Studies supportive of the 'New International Division of Labour' hypothesis, in fact, view the process of globalisation as a movement from high wage cost regions to low wage cost ones (Frobel, Heinrichs and Kreye 1980). While in the case of garment manufacture in Europe, shifting of production to low wage regions initially took place mostly within the continent<sup>7[8]</sup>, movement to other peripheral countries was largely initiated by apparel manufacturers from the United States of America (USA or US) (Bonacich 1994, 81). This process has its origins in the 1950s when manufacturers began to shift production to Japan to take advantage of the lower wages prevailing there. This sourcing of garments from Japan with still lower wage levels followed the earlier movement of US garment production from the northern part of the country to the less unionised and lower waged southern regions (Markusen 1987, 134).<sup>8[9]</sup> Subsequent to the economic boom in Japan during this period accompanied by rise in wage rates, manufacturers began to shift production to Hong Kong (Jones 1971, 140). From Hong Kong, capital migrated to South Korea and Taiwan to benefit from the lower wages prevalent there (Bonacich et al. 1994, 23). The process of incorporation of other East Asian economies was also aided by the growing foreign direct investment by Japanese firms in neighbouring countries to take advantage of the prevailing low wage rates. The period thus witnessed a trend towards movement of Japanese apparel capital to offshore locations like neighbouring South Korea.

The 1980s witnessed the incorporation of other Asian countries with relatively low wage levels like China, Thailand, Indonesia, Sri Lanka, Pakistan, India and Bangladesh into the world garment trade.<sup>9[10]</sup> Between 1975 and 1990, the share of 'Third World' in the total output of global textiles has increased from 18.6 per cent to 26.1 per cent, and that of clothing from 11.7 per cent to 20.4 per cent (Kiely 1998, 153).<sup>10[11]</sup> During this period, the share of apparel in the exports of the newly industrialising countries (NICs) in fact declined. On the other hand, garment sector has become a growth pole for economies at lower levels of development like Bangladesh, China, Sri Lanka, Indonesia, India and Thailand (Gereffi 1994, 59). Table 7 depicts this process better by detailing the market shares of the leading garment exporting countries over a 15-year period, from 1980 to 1995.

**Table 7**

World's Leading Exporters of Apparel, 1980-95

Countries	Share in world exports		
	1980	1990	1995
Hong Kong	11.5	8.6	6
China	4	8.9	15.2
Italy	11.3	10.9	8.9
Germany	7.1	7.3	4.7
South Korea	7.3	7.3	3.1
US	3.1	2.4	4.2
France	5.7	4.3	3.6
Turkey	0.3	3.1	3.9
Thailand	0.7	2.6	2.9
Portugal	1.6	3.2	2.3
Chinese Taipei	6	3.7	2.1
India	1.5	2.3	2.6
Indonesia	0.2	0.5	2.1
UK	4.6	2.8	2.9
Netherlands	2.2	2	1.8

Source: Ramaswamy and Gereffi 1998, 124

As the table indicates, while the market shares of more industrialised economies and the newly industrialised regions like Hong Kong and South Korea have declined in most cases, that of lower-income economies like China, Thailand, Indonesia, Turkey and India have increased.

This process has also been aided by State promotion of this sector among many of the economies on account of its high labour absorption potential and low technology and skill requirements. Together, they have enabled garment manufacture to attain the status of the most globalised industries. As the leading sector of globalisation, the garment industry continues to increase its share in world trade for manufactured commodities. World garment trade has in fact grown faster than trade in manufactured goods as a whole (Ramaswamy and Gereffi 1998, 124).<sup>11[12]</sup> Accompanying this global expansion, have also been changes in the organisation of production with important implications for garment production in peripheral economies.

### b.Changes in Mode of Organisation

The globalisation process was paralleled by important changes in organisation of the apparel commodity chain. While the initial phase of globalisation was dominated by manufacturing capital in the advanced capitalist economies, it was, from the early 1970s, replaced by retail capital (Bonacich et al. 1994, 83; Fine and Leopold 1993, 107-110). This process was once again facilitated by the requirements of low investment and technology in the industry. Earlier too, the manufacturers did not produce the entire output in-house. They sourced a substantial portion of their output through 'contract manufacturing', whereby they contracted production to small producers, many of them located overseas. The bigger

manufacturers focussed on supplying designs to the producers in the low-waged regions, and ensured control over quality of output sold to wholesalers and retailers in the metropolitan regions. Since traders could undertake the same process of outsourcing as well, wholesalers and retailers sought to bypass the manufacturers and began to source directly from overseas manufacturers.

Importantly, this process transformed the mode of pricing in this industry. While previously, pricing was primarily based on cost of production, with the dominance of trading capital, pricing increasingly was based on what the customers could afford to pay (Bonacich et al. 1994, 83). Since, they could aggressively **market** the output, they could peg the prices at a much higher level as compared to the cost of production. This process has important ramifications for the modes of organising production in the sector since then, with the industry becoming an archetype of a buyer driven commodity chain. Given their relatively less knowledge of production, they competed primarily on the basis of design, marketing and fashion creation. The **market** for apparel has therefore become highly segmented and differentiated as a consequence, with non-price factors playing a critical role in competitiveness in many of these segments.

Over time, the industry has come to be dominated by a few powerful retailers. At present, in the USA, top 10 retailers account for over two-thirds of imports into the US (As a result of their consequent increased bargaining strength vis a vis the supplier manufacturers, it is said that they even demand a profit margin of nearly 50 per cent, further placing pressure on the former's profit margins and hence the workers' wages. The dominance of the retailers has heavily tilted the distribution of costs or surplus along the garment commodity chain in favour of retailers as the following table would reveal (Table 8).

Table 8

Cost Components	Per cent
Retail shop Profit & (Personnel, rent, administration & advertising)	50%
Brand Profit, Overhead and Promotion	25%
Material Costs and Factory Profits	13%
Transportation/Taxes/Import costs	11%
Factory Workers' Wages	1%
<b>Retail Price</b>	<b>100</b>

The table gives the per cent of final retail price as distributed among different nodes in the value chain for a pair of jeans. As can be seen the share of wages amounts only one per cent of the sale price and the same study states that the share of wages in the final price for clothes is normally never higher than five per cent. It also indicates the potential for a less skewed redistribution of surplus to the lower nodes in the chain, enabling producers to pay more wages to **labour** in low wage regions, if producers can move into the more value-adding segments of the commodity chain.

The sourcing of garments from distant locations was found profitable not only because of the low wages, but also due to improvements in transport and communication technologies. Such technological innovations enabled capital to facilitate co-ordination of production in distant locations to take advantage of lower factor costs that prevail in these areas without much increase in transaction costs. Countries with better infrastructure in these areas would therefore gain over those, which lack it. Despite the criticality of these factors, lower wage rates continue to draw capital in this industry (Table 9).

**Table 9. Labour Costs in Apparel Industry across Regions (in US \$/hour)**

Europe	1991	1993	Asia	1991	1993	S. America	1991	1993
UK	7.99	NA	Hong Kong	3.39	3.85	Brazil	0.76	NA
W. Germany	14.81	NA	South Korea	2.75	2.71	Mexico	1.17	NA
France	12.41	NA	Taiwan	3.74	4.61	Argentina	1.81	NA
Netherlands	14.95	NA	India	0.25	0.27	Peru	0.88	NA
Italy	13.5	NA	Indonesia	0.18	0.28	Uruguay	1.59	NA
Ireland	7.5	NA	Malaysia	0.62	0.77	Venezuela	1.38	NA
Belgium	12.57	NA	Pakistan	0.24	0.27			
Denmark	15.91	NA	Philippines	0.46	NA			
Greece	4.26	NA	Sri Lanka	0.39	0.35			
Portugal	2.65	NA	Thailand	0.59	0.71			
Spain	7.11	NA	China	0.24	0.25			
			Japan	7.44	10.64			
US	6.77	NA	Singapore	NA	3.06			
			Bangladesh	NA	0.16			
			Mauritius	NA	1.04			

Source: Moore 1997, Table 2; Ramaswamy and Gereffi 1998, 123.

This table in consonance with Table 7 reveals the growing share of the lower-waged regions in world garment trade. Countries with lower wage costs like China, Indonesia, Thailand and India have increased their share in world trade whereas, most economies with higher average wage costs, have witnessed a decline in their shares.

#### c. Persistence of dominance of Core economies

Though the trend depicted above does lend empirical support to importance of the 'low wage' pull factor, other features of this sector do not lend credence to this view. Despite the growth of garment production and exports from many peripheral economies, there has not been much change in composition of the top exporting nations as Table 10 reveals.



**Table 10. Ranking of Leading Apparel Exporting Countries (1980-95)**

Rank	1980	1990	1995
1	Hong Kong	Italy	China
2	Italy	China	Italy
3	South Korea	Hong Kong	Hong Kong
4	Germany	Germany	Germany
5	Chinese Taipei	South Korea	US
6	France	France	Turkey
7	UK	Chinese Taipei	France
8	China	Portugal	South Korea
9	US	Turkey	Thailand
10	Netherlands	UK	UK
11	Portugal	Thailand	India
12	India	US	Portugal
13	Thailand	India	Chinese Taipei
14	Turkey	Netherlands	Indonesia
15	Indonesia	Indonesia	Netherlands

Source: Calculated from Ramaswamy and Gereffi 1998, 124.

Table 10 reveals a number of interesting features. First, and the most obvious has been the rise of China to the status of world's leading exporter in 1995 from its eighth rank in 1980. Further, its share of 15.2 per cent is the highest held by any country during the entire period. A related observation is the increase in shares of other low-income economies like **India**, **Indonesia** and **Thailand**. The shares of 'semi-peripheral economies', viz., South Korea, Hong Kong and Taiwan (Chinese Taipei), premier exporters in the 1970s, have declined. On the other hand, importantly, despite decreases in their shares, core economies continue to have a significant presence in the global garment exports. In 1995, seven European countries continued to figure among the top 15 exporters apart from the USA. USA has not only increased its share during this period, but has also improved its rank. Moreover, many of these economies meet a substantial portion of their internal demand for clothing through domestic production. USA, for instance, still manufactures 50 per cent of its requirements domestically in 1990 though it had shrunk from the 70 per cent share it had in the domestic **market** in 1980 (Bonacich et al. 1994, 23). In fact, between 1993 and 1995, the share of less industrialised countries in global clothing trade declined from 65 per cent to 53 per cent, indicating a gain for industrialised regions (Hale and Hurley, 7). To understand this apparent paradox, we have to comprehend other forces that impact on the geography of apparel production and hence, on the prospects of low-income regions industrialising through exports of garments. Towards this, in the following sections, we highlight a few other important features of the apparel product **market**.

#### d. Protectionism in the Advanced Capitalist Economies:

Despite the continued presence of core economies in the top ranks of garment exporters, as revealed in Table 10, their shares (other than that of USA) have declined. Further, these economies have witnessed a certain degree of import enetration, especially from the semi-peripheral economies.

To illustrate, between 1983 and 1991, the share of domestic market catered to through imports has risen from 30 to 45 per cent (Taplin and Winterton 1998, 20). Further, the rise in cheap imports of apparel from the lower waged economies has coincided with a phase of growing unemployment in the advanced capitalist economies. In the UK, employment in the apparel sector declined by over 50 per cent in the period 1973 to 1993 (27), while in Germany, employment declined by 2,70,000 during the period 1970 to 1994 (131). This has led to the view that imports have resulted in loss of employment opportunities in these economies (Hoffman 1985).<sup>12[13]</sup> More importantly, a strong lobby of domestic manufacturers and workers has forced core governments to insulate the domestic industry from such imports. Hence, trade restrictions by the advanced capitalist states, both in terms of price and quantity, have come to impact the industry over a considerable period.<sup>13[14]</sup>

The MFA has been revamped thrice since its creation, with each renewal meant to increase the coverage and intensity of the restrictions (Goto 1989, 204). While the MFA sought to impose restrictions on the quantity of different apparel that can be imported from each country, price restrictions were also imposed in the form of duties on other textile products. Discrimination was hierarchical. 'Sensitive' products, i.e., items with higher import penetration met with higher quantitative restrictions. There is a gradation in tariffs imposed as we move from processed to the final finished garment (Goto, 206-207).

The quota system that evolved under the MFA has exerted considerable influence on the structure of production of apparel. While the main objective of the quota regime is to restrict imports into the European and US markets, it has set in motion a process, of quota imposed economies seeking to avoid the restriction by shifting production to other low wage economies that are yet to face quota restrictions. The rise of Bangladesh as a garment exporter is a classic example of this phenomenon (Rhee 1990). Many other Asian economies like China, Thailand and Indonesia too benefit from the relocation of manufacturing by firms in NICs to these countries.

While this process has definitely influenced the movement to relatively low wage cost countries, it has also helped to perpetuate market hierarchies in the industry. Manufacturers in the quota-imposed countries are forced to move into more value added products whose competitiveness is not based on low wages but on quality and fashion. Since there are restrictions on quantity, producers seek to increase their turnover by enhancing the value added to each garment. Segmentation in the apparel market therefore, influences location of production. This is of course not to imply that the quota system is the key determinant of market segmentation. Firms in these countries only seek to move up existing market hierarchies created on the basis of quality, fashion and price.

### e. The fragmentation of the Apparel Market

Fashions have always influenced creation of demand in this industry, especially after the rise of retailers' control of the commodity chain. Given their closeness and greater understanding of the market than manufacturers, these traders sought to compete through market innovations like new designs and fashion marketing rather than through cost reductions by innovations in production techniques. Here again, there are differences across various segments. Women's and children's wear is subject to more fashion based design changes as compared to men's wear (Fine and Leopold 1993, 109). Further, socio-economic and related cultural changes have created a general trend in clothing towards more informal and casual wear since the 1970s. Consumption based identities have begun to play a bigger role in marking one's position in the social hierarchy, thereby facilitating the creation of market niches (Underhill 1998, 77). All these factors have led to the rise of distinct segments in the apparel market.

This trend has accentuated in recent years, when it is said that the recession in advanced capitalist economies has led to a more skewed distribution of income, creating two distinct market segments (Mody and Wheeler 1987; Hoffman 1985). Others point to the rise of post-Fordist life-styles, with consumption being an important marker of one's identity, as responsible for this phenomenon (Underhill 1998; Lash and Urry 1987). The causes notwithstanding, the apparel industry has been divided into two key segments with different characteristics; i.) a vibrant and growing upmarket fashion segment and ii.) a relatively stagnant, low priced and standardised segment.

The former market is highly volatile and characterised by short production runs, fast changing fashions and designs, aggressive marketing and higher mark-ups. In response to market instability, firms target smaller, more rapidly changing market niches, which require quick alteration of product designs. Here, cost advantages do not matter as much as in the mass-market segment. More important is the 'quick response' factor (QR), the ability to deliver in time and adjust production to changing designs and quantities. In other words, 'flexibility' becomes an essential characteristic of production for this segment. Thus, the cost advantage gained in dispersing production to low wage areas tends to be offset by slowness in supply response. Production in distant locations is not suited for such markets, where reorders<sup>14[15]</sup> and fashion obsolescence are common.<sup>15[16]</sup> Further, the quality requirements of the fabric meant for such up-market garment production necessitates confinement of production to countries with better processing technologies. Nevertheless, garments of certain segments that are relatively less intensely driven by fashion and requiring lesser quality may continue to be sourced from distant regions, as the semi-fashion segment to which Indian apparel exports caters.

In sum, despite dispersal to low wage economies, the fragmentation of the apparel market into fashion-determined smaller and smaller niches has enabled the core economies to retain their competitive edge in these segments of the apparel

industry. Another important explanation for the simultaneous dispersal and concentration of apparel production takes into consideration the social embeddedness of production processes and their part played in reducing transaction costs of firms in this sector.

### f. High Transaction Costs Work against Dispersion

A key factor that works against greater dispersion of garment production globally is the amount of transaction costs involved in co-ordinating a global network of decentralised producers and traders. The high vertical and horizontal disintegration in this industry increases the volume and rapidity of inter-firm transactions. The location of production will therefore be also influenced by geographical proximity to suppliers, contractors and final markets, particularly when transactions are "small scale, irregular and involve production for quickly changing niche markets" (Storper and Scott 1990, cited by Christerson and Appelbaum 1995, 1364).

In a cluster of firms in a region, the social embeddedness of production organisation creates extra economic ties that facilitate transactions. Community and ethnic relationships provide certain regions with economic advantages in such a milieu. This is more relevant to the garment sector dominated by vertically disintegrated firms. Firms tend to cluster in regions that have a common ethnic or communal identity that enable entrepreneurs to enter into long term contracts with less risk. Christerson and Appelbaum's study on location of garment industry in East Asia provides empirical support to this argument (1995). It has also been observed that it is easier for Taiwanese and Hong Kong firms as compared to the Korean firms to enter into contracts with overseas Chinese businessmen because of these social networks (Bonacich et al. 1994, 138).

Given the high transaction costs involved, it may not be too feasible for buyers to shift their point of sourcing too often taking into consideration only the labour cost advantage. In fact, studies point to the fact that buyers increasingly prefer to negotiate with more reliable but lesser number of importers rather than many importers (Egan and Moody 1992). Further, the costs of finding and entering into a long-term relationship with new suppliers too would deter buyers from shifting points of sourcing. Given these factors, established suppliers may continue to manufacture for importers even if they lose the labour cost advantage over time. This is likely to be true in the mid-price segment where production costs are a lesser source of competitiveness.

To sum up, though there are various forces at work in influencing the location of garment production, it is still possible to envisage a hierarchy of producers, hierarchy defined by levels of development, wage levels and quality of garments produced. Elson presents six tiers of garment producers, with each country trying to move into the tier above them (1994, 194). Gereffi's depiction of the sourcing of different products from different regions by American retailing firms reproduced below is also very useful to understand this hierarchy (Table 11)

**Table 11 Types of Retailers and Major Global Sourcing**

Representative firms	Type of retailer	Main global sourcing area	Characteristics of buyers orders
Fashion oriented Companies	Armani, Donna Karan, Polo, Ralph Lauren, Boss, Gucci	First and second rings	Expensive designers' products requiring high levels of craftsmanship; orders are in small lots
Department stores	Bloomingdale's, Saks Avenue, Neiman Marcus	Second, third & fourth rings	Top quality, high priced goods sold under a variety of national brands and private labels (i.e. store brands)
Speciality stores brand named companies	Macy's, Norstorm, J.C. Penny, The Gap, The Limited, Liz Claiborne, Calvin Klein	Second, third & fourth rings	Medium to large sized orders, often co-ordinated by department store buying groups (such as May department store company and Federated department store)
Mass merchandisers	Sears Roebuck, Montgomery Ward, J.C.Penny, Woolworth	Second, third & fourth rings	Good quality, medium priced goods predominantly sold under private labels; large orders
Discount chains	Walmart, Kmart, Target	Third, fourth & fifth rings	Low-priced, storebrand products; giant

clearly points to the dominance of core and semi-peripheral economies in the premium up-market segment (Rings one and two), leaving the rest to compete for shares of the lower end of the market segment. Further, the table reveals differences even among the peripheral economies in niches that they cater to, in the global garment market. These differences, it is reasonable to argue, are conditioned by variations in technology and skill levels, and level of control over product markets. To the extent

that these variables can be captured by various quantitative measures of competitiveness, we use a few such measures to understand India's competitiveness in apparel exports.

### Competitiveness of Indian Garment Exports

While garment exports has registered impressive growth relative to the rest of manufactured exports from India, as we saw in an earlier section, India's relative performance vis a vis its competing nations have not been too well. India, as depicted in table 5, falls under ring 3 along with a few other Asian peripheral economies. In this section, based on existing studies and new computations, we seek to measure the competitiveness of India's exports. With the withdrawal of quota and price restrictions from 2005, India, despite having unrestrained access to global markets, may face tougher competition from similar countries seeking to expand their market shares. Hence, it is imperative that measures are taken to meet the possible increase in competition.

Competitiveness, in existing studies, has been measured primarily by a comparison of market shares (Chatterji and Mohan; Exim Bank of India 1995; Ramaswamy and Gereffi 1998). Alternately, as an input measure, labour costs corrected for labour productivity can be used. However, given the high presence of production in the informal sector, data on labour use is insufficient to use. Further, this measure is also difficult to be used as a comparative measure given the impact of exchange rates on wage costs. Given the importance of non-price factors like quality in influencing the competitiveness of garments, unit value realisation may be a better indicator as a measure of competitiveness. This measure, once again, is problematic given the highly fragmented nature of the apparel market. Higher unit values may probably indicate a foothold in a different market segment rather than competition in a similar market. Nevertheless, higher unit values indicate an ability to upgrade, which would be a critical factor in sustaining or improving competitiveness over time. Lastly, given the importance of many non-price factors like quick response, quality of fabric and processing, no single indicator can reflect the extent of competitiveness of Indian garment exports. Consequently, in this section, we draw upon a multitude of indicators to understand this dimension of Indian apparel exports.

To begin with, we compare the market shares of India in the product categories that it exports. The following table (Table 12) depicts the product-wise composition of India's exports.

**Table 12**

Itemwise Composition of India's Garment Exports

Item Description	1991 Million -\$	1991 Share -	1994 Million -\$	1994 Share -
Clothing and accessories	2531.1	100	3711.9	100
Men's outerwear non-knit	94.0	3.7	156.8	4.2
Women's outerwear non-knit	1032.8	40.8	1409.2	38.0
Dresses	191.8	7.6	286.0	7.7
Skirts	85.5	3.4	193.9	5.2
Blouses	510.2	20.2	617.7	16.6
Outer Garments	166.8	6.6	214.6	5.8
Undergarments non-knit	435.5	17.2	724.6	19.5
Men's Shirts	408.6	16.1	659.0	17.8
Of cotton	325.6	12.9	604.5	16.3
Of synthetic fibres	83.0	3.3	54.5	1.5
Outwear knit non-elastic	236.6	9.3	338.5	9.1
Jerseys, pullovers, etc	70.0	2.8	116.0	3.1
Outer clothing accessories	123.5	4.9	175.6	4.7
Undergarments knitted	298.2	11.8	480.3	12.9
Textile clothing accessories nec	106.4	4.2	172.6	4.7
Headgear non-textile clothing	327.5	12.9	429.9	11.6

**Source: Ramaswami and Gereffi (1998, 124)**

As can be seen, at the three digit level, garment categories, women's outerwear non-knit, undergarments' non-knit and undergarments knitted constitute the biggest shares and together account for more than 70 per cent of exports. Even within these categories, specific items like women's blouses and men's shirts dominate the export basket. Next we compare the **market** shares of these and other product categories of Indian exports with few of its competitors (Table 13). This comparison is confined to apparel exports to the USA, the single largest **market** for Indian exports.

**Table 13****Market Share in 16 Categories of MFA Imports of the US, 1996**

Category Description	US Imports \$US Million all countries	India	Bangladesh	Pakistan	Sri Lanka	Indonesia	China	Hong Kong
Cotton women's non knit shirt	891.6	24.9	6.5	1.5	5.9	5.6	7.2	24.8
Cotton men's knit shirt	2919.1	6.4	1.7	10.2	3.0	2.9	5.1	4.1
Cotton men's non knit shirt	2137.3	7.7	7.6	1.3	3.2	5.9	2.9	13.7
Cotton other manufacturers	812.5	21.7	3.2	15.4	1.2	0.5	23.9	0.9
Manmade fibre dresses	904.6	8.7	0.9	0.1	4.9	6.6	18.5	5.7
Cotton other apparel	1157.7	4.7	10.5	2.1	5.3	4.6	15.3	10.3
Cotton women's knit shirt	1937.2	2.6	0.7	2.4	1.5	1.7	2.5	10.5
MMF women's non-knit shirt	555.1	9.0	2.8	0.1	4.2	15.7	20.7	8.6
MMF skirts	419.7	10.9	0.6	0.1	4.5	5.3	8.3	6.6
Cotton dresses	403.4	8.4	3.9	4.1	3.2	3.5	5.4	6.4
Cotton/terry towels	264.2	11.5	3.4	17.9	1.0	0.0	14.8	0.4
MMF women's coats	1066.9	2.6	3.1	0.7	3.3	2.9	15.9	9.6
Cotton skirts	345.0	7.9	4.1	1.9	7.7	4.0	5.6	14.5
Cotton women's coat	354.4	6.3	4.5	0.8	7.6	2.6	21.0	14.3
Cotton sweaters	336.5	5.6	0.7	0.1	1.2	9.6	8.1	23.0
Cotton men's trousers	2942.2	0.7	3.5	0.8	1.9	3.8	3.8	8.1
Cotton women's trousers	2288.7	0.9	1.4	0.6	2.1	2.4	4.8	17.4

**Source: Ramaswami and Gereffi (1998, 127)**

As can be seen, in terms of market shares, China and Hong Kong appear to pose the strongest competition and together they have a higher market share in the US than India in thirteen out of the seventeen product categories listed in the table. In fact, China alone has a higher market share than India in ten of the product categories. Further, in quite a few categories, other countries like Indonesia, Pakistan, Sri Lanka and Bangladesh too have higher market shares than India. However, by and large, there seems to be a specialisation among the competing countries with each holding higher market shares in a few specific categories. On the other hand, we also observe that China has penetrated significantly in most of the product categories. This leads us to infer that a region-wise specialisation in specific niches may enable the countries to expand their shares without undermining that of other countries. However, the market shares may also be influenced by the quota restrictions that prevent countries from expanding their exports beyond a point. Hence, we examine the unit values of these product categories exported across these countries (Table 14).

**Table 14**

**US Imports from Selected Countries by MFA categories, 1996 (unit values)**

Category Description	Average	India < /sp an >	Bangladesh	Pakistan	Indonesia < /b>	Hong Kong	China
Cotton men's knit shirts	8.35	10.35 < /p >	8.92	9.65	16.00 < /p>	20.83 < /p>	16.42 < /p>
Cotton men's non-knit shirts	4.13	4.35	3.05	2.73	4.75	5.67	4.69
Cotton women's non-knit shirts	5.57	4.42	3.86	3.74	5.63	7.71	7.85
Cotton other	0.75	0.57	0.42	0.52	0.57	1.29	1.07
Manufacturers							
Cotton men's trousers	5.19	4.16	4.21	3.76	5.59	6.70	5.99
Cotton women's trousers	4.82	4.76	3.81	2.76	5.77	6.40	6.13

**Note:** Average for all countries

**Source:** Ramaswami and Gereffi (1998, 127)

Table 14 indicates that unit values of garments exported from Hong Kong are higher than that of most other countries indicating that they compete in a different, relatively upmarket segment as compared to the other countries. Thus, unit values may not indicate the level of competitiveness too accurately as even at the four digit level, garments are a highly differentiated category, in terms of design and quality and hence, price. However, we do obtain a measure of competitiveness when we relate appears to offer the biggest source of competition to **India** in the **India's** unit values to that of the average for all competing countries. It appears that **India** has an above

average unit value in two of the six product categories though Indonesia has a higher unit value in both these categories and China in all of them. Thus, China post-MFA era.

As a step towards further refining the measures of competitiveness, we next calculate the revealed comparative advantage (RCA) in some of the product categories of Indian garment exports and compare them with that of China and Indonesia. It is well known that the comparative advantage of a country is influenced by a number of factors, which may be broadly classified as price and non price factors. It is however, difficult to obtain information on these factors across products and countries. For example, sufficient information to make inter-country cost comparisons is not available. Thus Balassa (1965) suggested that it is sufficient to provide information on Revealed Comparative Advantage. The RCA, a well known measure, is simply a ratio of the industry A's export share to total merchandise export from that country to the export share of the world exports of A to total world exports. The RCA is thus a ratio of two shares and is expressed as:

$$RCA = \frac{\text{India's export of product A} / \text{India's total merchandise export}}{\text{World export of product A} / \text{World's total merchandise exports}}$$

It has definite advantages over use of **market** share as an indicator. The simple **market** share is very sensitive to the size of the country. To illustrate, China obviously will have larger share in the world exports as compared to say, Nepal. Such a large **market** share need not be related to comparative advantage per se as the larger share may be reflecting the larger size of China. But, RCA is a standardised measure and using this measure it is possible to find that Nepal records a comparative advantage despite its low share in the world **market**. To be explicit, one cannot say anything about comparative advantage on the basis of simple shares. But, if RCA is greater than 1, one can make a definite statement that the country has a comparative advantage. Similarly, if the RCA is less than 1, one can make a definite statement that the country has a comparative disadvantage.

To add, unit values are generally not used as a measure of comparative advantage. Rather, it is used as a measure of quality of the product. This measure as an indicator of quality also is not free from flaws. It is very sensitive to the level of aggregation used. At higher levels of aggregation, it is not an accurate measure as the units of measurement may vary at specific product level. Thus, differences in unit value need not capture quality. Rather, it may arise as a result of the particular aggregation followed.

The use of 'revealed comparative advantage' offers other advantages as well. Its basic thrust is to 'measure' the patterns of comparative advantage as are revealed by the observed trade flows. The Heckscher-Ohlin-Samuelson theory, tries to explain trade flows in terms of factor intensities and factor endowments. In other theories of comparative advantage, there are propositions about the relationship between some other determinants of trade flows and the actual trade flows. For example, such determinants include technology gap (as in technology gap theory), economies of scale (Dreze, 1960), and domestic demand (Linder, 1961) etc. In the approach of RCA,

Earlier studies like that by Chatterji and Mohan (1993) and Ramaswamy and Gereffi (1998) too use the UN data. They are however, based on SITC Rev-2, wherein SITC 84 represents garments. As per an understanding with the UN, all individual countries are now supposed to adopt a new commodity classification system called Harmonised Commodity Description and Coding System. In fact, decision in this regard was taken long back, but many countries are yet to adopt the new commodity classification system. Thus, the UN in its published sources has been reporting the data on the basis of the earlier classification system (SITC-Rev 2). However, the data in India Trades is based on the Harmonised System, wherein 61 and 62 represent garments<sup>16[17]</sup>. One limitation of the world trade data in India Trades is that it

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