**Objectives of Compensation Management:**

The basic objective of compensation management can be briefly termed as meeting the needs of both employees and the organization. Since both these needs emerge from different sources, often, there is a conflict between the two.

This conflict can be understood by agency theory which explains relationship between employees and employers. The theory suggests that employers and employees are two main stakeholders in a business unit, the former assuming the role of principals and the latter assuming the role of agents. The compensation paid to employees is agency consideration. Each party to agency tries to fix this consideration in its own favour. The employers want to pay as little as possible to keep their costs low. Employees want to get as high as possible. The compensation management tries to strike a balance between these two with following specific objectives:

**Attracting and Retaining Personnel:**

From organisation’s point of view, the compensation management aims at attracting and retaining right personnel in the organization. In the Indian corporate scene, there is no dirth of personnel at operative levels but the problems come at the managerial and technical levels particularly for growing companies. Not only they require persons who are well qualified but they are also retained in the organization. In the present day context, managerial turnover is a big problem particularly in high knowledge based organizations.

**Motivating Personnel:**

Compensation management aims at motivating personnel for higher productivity. Monetary compensation has its own limitations in motivating people for superior performance. Alfie Kohn has gone to the extent of arguing that corporate incentive plans not only fail to work as intended but also undermine the objectives they intend to achieve. He argues that this is due to inadequate psychological assumptions on which reward systems are based. His conclusions are as follows:

 Rewards punish people-their use confirms that someone else is in control of the employee.

 Rewards rupture relationships-they create competition where teamwork and collaboration are desired.

 Rewards ignore reasons-they relieve managers from the urgent need to explore why an employee is effective or

ineffective.

 Rewards discourage risk taking-employees tend to do exactly what is required to earn the reward, and not any

more.

 Rewards undermine interest-they distract both manager and the employee from consideration of intrinsic

motivation.

Notwithstanding these arguments, compensation management can be designed to motivate people through monetary compensation to some extent.

**Optimizing Cost of Compensation:**

Compensation management aims at optimizing cost of compensation by establishing some kind of linkage with performance and compensation. It is not necessary that higher level of wages and salaries will bring higher performance automatically but depends on the kind of linkage that is established between performance and wages and salaries. Compensation management tries to attempt at this.

**Consistency in Compensation:**

Compensation management tries to achieve consistency-both internal and external-in compensating employees.

Internal consistency involves payment on the basis of criticality of jobs and employees' performance on jobs. Thus, higher compensation is attached to higher-level jobs. Similarly, higher compensation is attached to higher performers in the same job. Level of jobs within an organization is determined by job evaluation which will be discussed little later in this chapter. External consistency involves similar compensation for a job in all organizations. Though there are many factors involved in the determination of wage and salary structure for a job in an organization which may result into some kind of disparity in the compensation of a particular job as compared to other organizations, compensation management tries to reduce this disparity.

Compensation Management Process:

In order to achieve the objectives of compensation management, it should proceed as a process.

This process has various sequential steps as shown:

 Organisation’s strategy

 Compensation policy

 Job analysis and evaluation

 Analysis of contingent factors

 Design and implementation of compensation plan  Evaluation and review

**Organisation’s Strategy:**

Organisation’s overall strategy though not a step of compensation management is the starting point in the total human resource management process including compensation management. Companies operating in different types of market/product having varying level of maturity, adopt different strategies and matching compensation strategy and blend of different compensation methods. Thus, it can be seen that organizations follow different strategies in different market situations and align their compensation strategy and contents with these strategies. In a growing market, an organization can expand its business through internal expansion or takeover and merger of other organizations in the same line of business or a combination of both. In such a growing market, the inputs, particularly human resources, do

not grow in the same proportion as the business expands. Therefore, in order to make the growth strategy successful, the organization has to pay high cash to attract talents. For example, information technology is a fast growing business presently and we find maximum merger and higher managerial compensation in this industry. In mature market, the organization does not grow through additional investment but stabilizes and the growth comes through making the present investment more effective, known as learning curve growth. In such a situation, average cash and moderate incentives may work. The benefits which have been standardized have to be maintained. In the declining market, the organization has to harvest profit through cash generation and cost cutting and if this cannot be sustained over the long run, the possible retrenchment of business to invest somewhere else. In such a case, compensation strategy involves cost control with below average cash and incentive payments. Cascio has observed that in viewing the compensation from strategic point of view, the companies do the following:

 They recognize remuneration as a pivotal control and incentive mechanism that can be used flexibly by the management to attain business objectives.

 They make the pay system an integral part of strategy formulation.

 They integrate pay considerations into strategic decision-making processes, such as those that involve planning

and control.

 They view the company's performance as the ultimate criterion of the success of the strategic pay decisions and

operational remuneration programmes.

**Compensation Policy:**

Compensation policy is derived from organizational strategy and its policy on overall human resource management. In order to make compensation management to work effectively, the organization should clearly specify its compensation policy, which must include the basis for determining base compensation, incentives and benefits and various types of perquisites to various levels of employees. The policy should be linked with the organizational philosophy on human resources and strategy. Besides, many external factors which impinge on the policy must also be taken care of Job Analysis and Evaluation. Job analysis provides basis for defining job description and job specification with the former dealing with various characteristics and responsibilities involved in a job and the latter dealing with qualities and skills required in job performer. Job analysis also provides base for job evaluation which determines the relative worth of various jobs in the organization. The relative worth of various jobs determines the compensation package attached with each job.

**Analysis of Contingent Factors:**

Compensation plan is always formulated in the light of various factors, both external and internal, which affect the operation of human resource management system. Various external factors are conditions of human resource market, cost of living, level of economic development, social factors, pressure of trade unions and various labor laws dealing with compensation management. Various internal factors are organisation’s ability to pay and employees' related factors such as work performance, seniority, skills, etc. These factors may be analyzed through wage/salary survey. The impact of these factors will be discussed later.

**Design and Implementation of Compensation Plan:**

After going through the above steps, the organization may be able to design its compensation plan incorporating base compensation with provision of wage/salary increase over the period of time, various incentive plans, benefits and perquisites. Sometimes, these are determined by external party, for example, pay commissions for Government employees as well as for public sector enterprises. After designing the compensation plan, it is implemented. Implementation of compensation plan requires its communication to employees and putting this into practice.

**Evaluation and Review:**

A compensation plan is not a rigid and fixed one but is dynamic since it is affected by a variety of factors which are dynamic.

Therefore, compensation management should have a provision for evaluating and reviewing the compensation plan. After implementation of the plan, it will generate results either in terms of intervening variables like employee satisfaction and morale or in terms of end-result variable like increase of productivity. However, this latter variable is more important. The evaluation of compensation plan must be done in this light. If it does not work as intended, there should be review of the plan necessitating a fresh look.

**Designing and Developing the Compensation Plan:**

Develop a program outline:

 Set an objective for the program.

 Establish target dates for implementation and completion.  Determine a budget.

Designate an individual to oversee designing the compensation program:

 Determine whether this position will be permanent or temporary.  Determine who will oversee the program once it is established.

 Determine the cost of going outside versus looking inside.

 Determine the cost of a consultant's review.

**Develop a compensation philosophy:**

 Form a compensation committee (presumably consisting of officers or at least including one officer of the company).

 Decide what, if any, differences should exist in pay structures for executives, professional employees, sales employees, and so on (e.g., hourly versus salaried rates, incentive-based versus non-contingent pay).

 Determine whether the company should set salaries at, above, or below market.

 Decide the extent to which employee benefits should replace or supplement cash compensation.

Conduct a job analysis of all positions:

 Conduct a general task analysis by major departments. What tasks must be accomplished by whom?

 Get input from senior vice presidents of marketing, finance, sales, administration, production, and other

appropriate departments to determine the organizational structure and primary functions of each.

 Interview department managers and key employees, as necessary, to determine their specific job functions.

 Decide which job classifications should be exempt and which should be nonexempt.

 Develop model job descriptions for exempt and nonexempt positions and distribute the models to incumbents for

review and comment; adjust job descriptions if necessary.

 Develop a final draft of job descriptions.

 Meet with department managers, as necessary, to review job descriptions.

 Finalize and document all job descriptions.

**Evaluate jobs:**

 Rank the jobs within each senior vice president's and manager's department, and then rank jobs between and among departments.

 Verify ranking by comparing it to industry market data concerning the ranking, and adjust if necessary.

 Prepare a matrix organizational review.

 On the basis of required tasks and forecasted business plans, develop a matrix of jobs crossing lines and departments.

 Compare the matrix with data from both the company structure and the industry wide market.

 Prepare flow charts of all ranks for each department for ease of interpretation and assessment.

 Present data and charts to the compensation committee for review and adjustment.

Determine grades:

 Establish the number of levels - senior, junior, intermediate, and beginner - for each job family and assign a grade to each level.

 Determine the number of pay grades, or monetary range of a position at a particular level, within each department.

**Establish grade pricing and salary range:**

 Establish benchmark (key) jobs.

 Review the market price of benchmark jobs within the industry.

 Establish a trend line in accordance with company philosophy (i.e., where the company wants to be in relation to

salary ranges in the industry).

**Determine an appropriate salary structure:**

 Determine the difference between each salary step.

 Determine a minimum and a maximum percent spread.

 Slot the remaining jobs.

 Review job descriptions.

 Verify the purpose, necessity, or other reasons for maintaining a position.

 Meet with the compensation committee for review, adjustments, and approval.

**Develop a salary administration policy:**

 Develop and document the general company policy.

 Develop and document specific policies for selected groups.

 Develop and document a strategy for merit raises and other pay increases, such as cost-of-living adjustments,bonuses, annual reviews, and promotions.

 Develop and document procedures to justify the policy (e.g., performance appraisal forms, a merit raise schedule).

 Meet with the compensation committee for review, adjustments, and approval.

**Obtain top executives' approval of the basic salary program:**

 Develop and present cost impact studies that project the expense of bringing the present staff up to the proposed levels.

 Present data to the compensation committee for review, adjustment, and approval.

 Present data to the executive operating committee (senior managers and officers) for review and approval.

**Communicate the final program to employees and managers:**

 Present the plan to the compensation committee for feedback, adjustments, review, and approval.

 Make a presentation to executive staff managers for approval or change, and incorporate necessary changes.

 Develop a plan for communicating the new program to employees, using slide shows or movies, literature,

handouts, etc.

 Make presentations to managers and employees. Implement the program.

 Design and develop detailed systems, procedures, and forms.

 Work with HR information systems staff to establish effective implementation procedures, to develop appropriate data input forms, and to create effective monitoring reports for senior managers.

 Have the necessary forms printed.

 Develop and determine format specifications for all reports.

 Execute test runs on the human resources information system.

 Execute the program.

**Monitor the program:**

 Monitor feedback from managers.

 Make changes where necessary.

 Find flaws or problems in the program and adjust or modify where necessary.