
UNIT 13 COMPENSATION AND SALARY ADMINISTRATION

Structure

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13.0 OBJECTIVES

After reading this Unit, you should be able to define and understand the :

- aims of salary administration,
- principles of salary formulation,
- design of salary structures, and
- steps involved in salary progression and the procedures of administering salary systems.

13.1 INTRODUCTION

It is extremely important to have a well-designed compensation system. Employee compensation is an extremely important issue for every manager, and over the years compensation has become a complicated issue. Not only are the issues of internal equity and justice important, but also the larger issues of the wider economy and society impinge immediately on the problem of compensation. A properly planned and administered salary system is one of the most important aspects of modern management. Deciding how and what people should be paid is what is covered under salary administration. In this Unit we shall attempt to unravel the complexities of employee compensation and understand the basic factors affecting salary administration. We shall pay special attention to the process of fixing salary levels and designing salary structures. More dynamic aspects such as salary progression policies and procedures will also be examined.

Because of its vastness and in most cases unorganised nature, the tourism organisations in India offer wages lower to the job requirements. This not only restricts the entry of talent but also leads to constant job hopping and adoption of under hand measures like shopping commissions, etc. At many destinations the host population develops a feeling of exploitation because of low wages. Few organisations realise that **the ultimate sufferer in such situations is the destination and along with it the organisation is bound to suffer in the long run.** Hence, this Unit is vital for tourism managers.

13.2 AIMS OF SALARY ADMINISTRATION

The aim of salary administration is to develop and maintain a salary system of policies and procedures. A well-developed salary system will enable your organisation to attract, retain and motivate people of the required calibre and qualifications. Such a system should also be able to control your payroll costs. These aims and objectives have to be seen in greater depth from the point of view of the organisation, its individual staff, and collectively for both.

- i) **Organisational Aims** : The salary system should be tailored to meet the organisation's special needs and should be easily capable of modification in response to change. In particular the aim of the system should be to:
- ensure that the organisation can recruit the quantity and quality of staff it requires,
 - encourage suitable staff to remain with the organisation,
 - provide rewards for good performance and incentives for further improvements in performance,
 - achieve equity in pay for similar jobs,
 - create appropriate differentials between different levels of jobs in accordance with their relative value,
 - operate flexibly enough to accommodate organisational changes and relations in the relative market rates for different skills,
 - be simple to explain, understand, operate and control, and
 - be cost-effective in the sense that the benefits of the system are obtained without undue expense.
- ii) **Individual Aims** : The individual wants to feel that he or she is being treated fairly and expects to be paid according to his or her own evolution of self worth. This assessment will be based on comparisons with market rates for similar jobs elsewhere and with the pay received by other staff in the organisation.
- iii) **Collective Aims** : The objective of trade unions and staff associations must be to obtain the maximum benefits for their members. They will want their members' pay to keep ahead of inflation, to match or exceed market rates and to reflect any increase in the prosperity of the company. Moreover, they will also want an equitable system and may object to merit review schemes based on management discretion, because they are thought to be arbitrary and unfair.

13.3 PRINCIPLES OF SALARY FORMULATION

The main factors affecting salary levels within an organisation are:

- 1) **External relativities**: market rates as affected by supply and demand and general movements in pay levels,
- 2) **Internal relativities**: salary relativities between jobs within the organisation depending on the values attached to different jobs, and
- 3) **Individual worth**: the value of the individual's performance to the organisation.

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, 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 or her salary should be influenced by his or her 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.

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 or her philosophy, capacity to pay, competitive position and 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 organised 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 to often 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.

13.4 COMPONENTS OF SALARY ADMINISTRATION AND PAY STRUCTURE

The starting point of salary administration is the determination of salary levels. Salary levels are determined by the process of job evaluation. Job evaluation, as we have seen in an earlier Unit, is a systematic method of appraising the value of each job in relation to other jobs in the organisation. This is done by identifying the key tasks and the various dimensions of the jobs and thereby enabling you to arrange them in a hierarchy of grading.

Once you have arrived at the salary levels with the help of job evaluation, you should be concerned with:

- the design and maintenance of salary structures,
- the operation of salary progression systems,
- the administration and control of salary reviews, and
- the design and operation of other allowances.

13.4.1 Components of Pay Structures

An industrial pay packet in India, for example, consists of several elements: basic wage, dearness allowance, house rent allowance, city compensatory allowance, annual statutory bonus, and incentive bonus. The basic wage, dearness allowance and the annual bonus make up the bulk of average worker compensation. A wide

range of statutory and non-statutory institutions influence the determination of basic wage, dearness allowance and the annual bonus. Therefore, an understanding of the pay structure itself is necessary:

a) **Basic Wage** : Basic pay is a stable wage paid over a period of time. This could be on a monthly, weekly or daily basis. This pay is the normal rate for a given level of output. It is the price to be paid to get a given job done. It usually progresses over time.

Basic wage is built upon the statutory minimum wage, which states that the wage should provide not merely for the bare sustenance of life but for the preservation of the efficiency of the worker by providing some measure of education, medical requirements and amenities.

Basic wage of an industrial worker based on a “standard budget” concept for a family of four, should include food, clothing, housing and fuel. An underlying assumption behind the basic wage legislation is that the industry does not have the right to exist unless the minimum needs of the worker are met.

b) **Dearness Allowance**: The system of dearness allowance (DA) was instituted to protect the wage earners' real income by neutralising the increased cost of living. The DA, therefore, was to give relief to the worker in inflationary conditions, by trying to offset the cost of living with an additional allowance.

In general, there are two systems of DA payment: one is a flat rate system of neutralisation, and the other linking the payment of DA to the consumer price index. The flat rate system provides a lump-sum payment to the employees over a period of time to adjust for the growth in inflation. The system is simple and easy to administer.

The consumer price-linked system on the other hand, attempts to neutralise the actual increase in the cost of living. This method, as you can see, is more realistic because it regulates the payment of allowance on the basis of actual price movement in a given region. There are two variations of DA tied to the consumer price index. First, a specified rate of DA is fixed for every point rise in the price index, regardless of the income groups. In this system all employees receive the same amount of allowance, but the lower paid would then get a higher proportion of their basic as DA.

The second form is based on income groups and cost of living brackets or “Slabs”. In this method the absolute amount of allowance increases with each higher income group related to changes in the brackets of price index as opposed to each point; at the same time, the magnitude of relief as a proportion of basic pay is steadily reduced with each higher income group. The advantage of the DA-income slabs is that it introduces an element of stability, because the allowance does not change with every point in the cost of living index.

DA is also influenced by:

i) **Employer’s Ability to Pay**

An important issue of dispute between workforce, management and industrial tribunals has been whether the employer's ability is relevant to the payment of DA. Industrial tribunals have consistently held the view that the employer's paying ability is a major factor in the payment of DA and thus the Indian adjudicators of the DA question have favoured the position of the employer.

ii) **The Problem of Neutralisation**

How much of the price increase should be neutralised has been a matter of controversy in India. Industrial tribunals have supported full neutralisation in principle for low-wage workers; but the range of recommended neutralisation has

been 50-90 per cent of the price increase. The tribunals have been governed by the following considerations:

- 1) The recognition that the industry's paying capacity does not permit full neutralisation.
- 2) Full neutralisation is feared to lead to more inflation.
- 3) Employees, like other groups in society, should share in the hardships caused by inflation.

iii) Profit-sharing Bonus

Payment of bonus is an annual issue which every employee eagerly looks forward to. The payment of annual bonus is a constant source of friction every year in India. It has some unique features. From an ex-gratia payment, it has become obligatory. There are statutory minimum and maximum limits on the amount of bonuses to be paid to the employees.

13.4.2 Other Components of Pay Packet

By virtue of being the member of an organisation, an employee receives a number of other benefits, some in cash and some in kind. These are generally referred to as perquisites or fringe benefits. Many of these have no direct link to the work or output of a worker. Over the years, some of these have become statutory. These include:

- compensatory city allowance
- house rent allowance
- leave travel concession
- provident fund
- gratuity
- group-linked insurance scheme
- pension fund
- medical benefits
- ESIS
- accident and death compensation while on duty in addition to other schemes through the company's own insurance plan
- leave with pay
- educational allowances, etc.

These prerequisites are provided to enhance the employees' motivation and loyalty to their organisation. In many cases these may be the result of a collective agreement at the initiative of trade unions. We shall deal with these benefits in greater detail in **Unit 14 on "Laws and Rules Governing Employee Benefits and Welfare"**.

13.5 SALARY STRUCTURES

The salary structure consists of your company's salary grades or ranges and its salary levels for single jobs or groups of jobs. One of the major aims of a job evaluation exercise, as seen earlier, is to design a salary structure into which jobs can be correctly graded on the basis of an assessment of their relative value to the organisation. It is, of course, imperative to ensure that salaries are in line with market rates. While, designing a salary structure you are attempting to provide for internal equity in grading and paying staff and to maintain competitive rates of pay. This, naturally, cannot be achieved if a chaotic set of rates and systems of payment exist in your organisation. You can evolve a salary structure which may be any one of the following or a combination of them:

- i) Graded salary structures
- ii) Salary progression curves

i) **Graded Salary Structures:** A typical salary structure is one with a sequence of salary ranges or grades, each of which has a defined minimum and maximum. In this process you are assuming that all the jobs allocated into a grade are broadly of the

same value. However, you must ensure that actual salaries earned by the individuals are based on their performance or length of service. You may cover all the jobs in your organisation by the same structure of salary ranges or you may design different structures for different levels or categories of jobs. A properly designed salary structure should have the following features:

- All jobs are allocated into a salary grade within the structure. This allocation, of course, has to be done on the basis of assessment of their internal and external value to your organisation.
- Each salary grade should consist of a salary range or grade. No one holding a job in the grade can go beyond the maximum of the salary grade unless he/she is promoted.
- Jobs can be regarded within the structure when it is decided that their value has altered. This may be due to a change in responsibilities or a pronounced movement in market rates.
- General increases in the cost of living or in market rates are taken care of by proportionate increases in the minimum and maximum salary levels.
- The salary grades should be wide enough to provide room to recognise that people graded at the same level can perform differently and should therefore be rewarded according to their performance.
- A differential should be maintained between the mid-points of each salary grade. This is to provide adequate scope for rewarding increased responsibility on promotion to the next higher grade. At the same time the gap between adjacent grades should not be too wide as to reduce the amount of flexibility available for grading jobs.
- The mid-point of each grade is the target salary for the grade. You must assume that if there is a fairly steady movement of staff through the grade, the average salary of the staff in the grade will correspond with the target salary.
- There can be an overlap between salary grades which acknowledge that an experienced person doing a good job can be of greater value to the organisation than a newcomer to a job in the grade above.
- All jobs allocated into a salary grade should be broadly of the same level. Therefore, they normally have the same minimum and maximum rates which correspond with the grade boundaries.
- Progression within a grade depends on the performance of the individual. It would generally be assumed that all fully competent individuals in any jobs in a grade would eventually reach the normal maximum for a grade, if they are not promoted out of it. In some circumstances, you may make provisions for exceptional individuals to receive more than the grade maximum. This is desirable when there are no immediate opportunities for promotion, and your organisation wishes to retain their services without damaging their motivation.
- The number of salary grades or ranges will depend on, (i) the number of distinct levels of jobs in the hierarchy, (ii) the width of each salary grade, (iii) the extent of the overlap, if any, between grades, and (iv) the salary levels appropriate for the most senior and most junior jobs. This will give you the overall range of salaries within which you may fit the individual salary grades.

Make-up of a salary grade: A basic principle of a salary structure is that individuals should advance through the structure either by progressing within the salary grade for the job as they improve their performance, or by promotion. In the simplest structure, people should move more or less steadily from the entry point of the grade to the upper limit, unless they move to a higher grade. However, we can distinguish three stages into which this progression is divided. It would help us if we can divide the grade into three zones which correspond to these three stages:

- 1) **The learning zone:** This covers the period when a person is on his or her learning curve, familiarising himself or herself with the knowledge and skills required for becoming fully competent. Of course, the length of time to go through this zone will vary according to the individual's experience, competence and ability to learn.
- 2) **The qualified zone:** This covers the period when the job holder continues to increase his or her capacity to do the work and to improve performance. The minimum salary in this zone should be the market rate for the job in so far as this can be determined. Here, we are assuming that the market rate is the required salary level which will be able to attract a competent person from another job to join your organisation. The mid-point of the grade, is the salary level which all competent employees would be expected to achieve. This has to be above the market rate in order that you are able to retain these individuals.
- 3) **The premium zone:** This is reserved for those employees who achieve exceptional results but suitable promotion opportunities do not exist for them. This enables you to reward and encourage outstanding employees.

Designing the Salary Structure

The simplest way for you to design a salary structure would be to follow the following steps:

- Step 1 :** Establish by market rate surveys and studies of existing structures and differentials of the most senior and most junior jobs to be covered by the structure.
- Step 2 :** Draw up salary grade structure between the upper and lower limits, as established in **Step 1**, according to policies for differentials, the width of salary grades and the size of overlap between grades.
- Step 3 :** Conduct a job evaluation exercise, preferably by means of a simple ranking scheme, although this could be refined by using paired comparisons.
- Step 4 :** Obtain market rate data, bearing in mind that there is likely to be a range of market rates rather than a precise figure.
- Step 5 :** Slot the jobs into the grade structure in accordance with the results of both the job evaluations and the market rate surveys. It is here that judgment is required. While some decisions on grades will be obvious, others will be more difficult. If in doubt, re-evaluate the borderline cases to help make the final marginal decision. One advantage of an overlapping structure is that such decisions are less critical.

ii) Salary Progression Curves : Salary progression curves are also known as maturity curves or career curves. They aim to link increases in salary over a fairly long period to increased maturity or experience. They are best used for professional, scientific or other highly qualified staff. Their contribution is almost entirely related to their professional capacity rather than to a more or less fixed set of duties that enable their job to be firmly placed in a rigid hierarchy.

Progression curves are mostly used for professional/scientific staff whose starting salary is linked to the market rate for their degree or to a professional qualification. This system assumes that they will develop within their discipline at some standard rate as a result of their experience.

You may provide more than one rate of progression where you feel that there should be some scope for rewarding and encouraging individuals according to their performance and potential. The aim of the progression curve system is to allow plenty of scope for advancing people according to their contribution.

1) Discuss the organisational aims of salary administration.

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2) How is DA fixed?

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3) What are the steps involved in designing a salary structure?

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13.6 SALARY PROGRESSION

Salary progression procedures relate increases in salary to merit. It should be aimed at relating salary compensation to performance consistently and equitably while retaining an adequate degree of control over salary costs. The essential features of a systematic procedure for salary progression should be:

- The salary ranges are divided into defined areas or zones, as discussed earlier. The individual will pass through these zones as he or she progresses.
- There should be incremental systems which will indicate the rates at which individuals can progress according to merit or experience.

There must be guidelines for determining merit increments and planning salary progression.

Incremental Systems

There are different kinds of incremental systems which vary in their rigidity and flexibility. At one end you have extremely rigid procedures with fixed and predetermined movements through a scale related to age and service in the organisation or experience in the job, while at the other end there are flexible systems in which management exercises complete discretion over the award and size of increments without any guidelines. Between the two extremes there are middle-ranged, semi-flexible systems.

The choice of approach will naturally depend on the organisational climate and managerial style of the organisation. A bureaucratic organisation is likely to believe in strict control over managerial judgments by using a rigid system of salary administration, while a less autocratic organisation which allows the managers to exercise discretion would adopt a more flexible system. While there is no doubt about the advantages of a flexible system, we must at the same time be aware of the need to exercise control over the salary system.

It is extremely important to ensure that individuals are correctly placed in their range in relation to their performance and also that they move through and between salary grades at a rate appropriate to their progress and potential. Most salary planning decisions are short-term ones which are concerned with deciding on the next increment to be paid because of merit or promotion. Long term salary plans are closely linked with career planning procedures.

Short-term salary planning can be carried out by means of a variable incremental system with guidelines which will indicate the various rates at which people can progress through a zoned salary range.

13.7 SALARY ADMINISTRATION PROCEDURES

In this Section we will be concerned with the implementation and control of salary policies and with the control of salary costs against budgets. Control is an essential element of salary administration. We will also examine the following procedures:

- salary budgets,
- cost of living or general reviews of salary levels,
- individual salary reviews, and
- fixing salary levels on joining or on promotion.

Salary Control

In order to have effective control the salary administration procedure should have the following features:

- i) Defined ranges with the minimum and the maximum to which all jobs are allocated on the basis of their value. All employees are paid within the ranges for the jobs performed.
- ii) Defined methods of progress within the range based on specific criteria.
- iii) A detailed salary budget based on the number of staff required to carry out the forecast volume of work; forecast salary and levels taking into account the effects of general and incremental increases; forecasts of promotions and promotional increases and numbers joining and leaving the organisation; and forecasts of the likely effect on salary costs of changes in the numbers employed and of differences between the salary levels of those joining or leaving.
- iv) Clear statements of the degree of authority at each management level to award or to confirm increments with arrangement for authorising proposed salary changes and checking their consistency with policy.
- v) Clear salary review guidelines defining the limit to which the pay-roll costs of each department can increase as result of merit awards. Together with this it should contain other instructions on the maximum awards that can be given and the distribution of awards according to performance and salary grades.
- vi) Procedures for auditing increases and salary levels to ensure that they are in accordance with salary policies, and for monitoring actual salary costs against budgeted costs.

Salary Budget

A salary budget is a statement in quantitative/financial terms of the planned allocation and use of resources to meet the operational needs of the company. In a salary budget, you should forecast the levels of activity which will indicate the number of different categories of staff that are needed for the budget period. When you prepare the salary budget you must take account of the financial resources available to the company. This will, as you can see, affect the ability to pay general or individual merit increases, or the numbers employed, or both.

Salary Reviews

There are two types of salary reviews:

- a) **General salary reviews:** These reviews take place when it is necessary to increase all or most salaries as a result of an increase in the cost of living or in

market rates, or as a result of settlements. It is equally important to keep individuals informed of how they stand in the salary structure and the rewards they are getting or can obtain.

- b) **Individual salary reviews:** The purpose of an individual salary review is to decide on the merit increments that should be given to staff. You can have one annual review for all staff or you may phase increases through the year on the anniversary of the staff joining the organisation. The later enables you to give more individual attention to the staff and removes the emotional atmosphere that surrounds the annual review.

Fixing Salaries on Appointment or Promotion

Control over starting salaries should be exercised by providing guidelines on the policies to be followed and by defining who has the authority to approve salaries. Promotions should be dealt with as they arise rather than being left to the annual review. The increase should be meaningful and the starting point in the new grade should provide adequate scope to reward performance in the new job.

13.8 OTHER ALLOWANCES

Employees are given various forms of additional cash remuneration to encourage commitment to and participation in the success of the organisation. Payment other than the basic salary is also meant to compensate the employees for the special demands imposed on them by working for the organisation.

Incentive Schemes: While wage incentives increase the earnings of workers, they can at the same time improve the efficiency of your organisation. Improving efficiency will naturally lower your costs. It is recommended that wage incentives should be used for effective utilisation of manpower, which is the cheapest, quickest and surest means of increasing productivity. The only practicable and self-sustaining means of improving manpower utilisation is to introduce incentive schemes and stimulate human effort in order to provide a positive motivation to greater output.

Wage incentives are extra-financial motivation. A wage incentive scheme, is the payment for work of an acceptable quality produced over and above a specified quantity or standard. You can apply an incentive scheme to an individual, a group or to all employees in your organisation.

It is important, to remember that you are paying your employees an incentive for a better standard of performance. Therefore, in all incentive schemes you must fix a standard. And, of course, you must use your discretion in introducing an incentive scheme and fixing the standards of performance. But while doing this you must also ensure the acceptability of your scheme by the employees.

Bonus Schemes: You can devise various bonus schemes usually in the form of a lump-sum payment. This is of course in addition to the basic salary and should be related in some way to the performance of the individual or group of individuals receiving the bonus. The principal aim of a bonus scheme should be to provide an incentive and a reward for effort and achievement. You may use the following criteria as a base while designing a bonus scheme:

- The amount of reward received should be sufficiently high to encourage staff to accept existing targets and standards of performance.
- The incentive should be related to quantitative criteria over which the individual has a substantial measure of control.
- The scheme should be sensitive enough to ensure that rewards are proportionate to achievements.

- The individual should be able to calculate the reward he or she can get for a given level of achievement.
- The formula for calculating the bonus and the conditions under which it is paid should be clearly defined.
- Constraints should be built into the scheme to ensure that the staff cannot receive inflated bonus which may not reflect their own efforts.
- The scheme should contain provisions for a regular review which could result in its being changed or discontinued.
- The scheme should be easy to administer and understand, and it should be tailored to meet the requirements of your organisation.

Apart from the bonus, there are various other benefits like holidays, sick pay, travel allowance, pensions, housing and medical benefits, etc., which ultimately supplement the salary of your staff.

Another incentive in tourism organisations like travel agencies and tour operations is offering the employees a certain percentage of profits as commission if they sell more than the given targets. Besides, certain other perks are offered by the companies like, membership of clubs, credit cards, etc.

Check Your Progress-2

- 1) What do you understand by salary control?
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- 2) Besides salary what other allowances can be given.
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13.9 LET US SUM UP

This Unit has attempted to familiarise you with the systems and procedures of salary administration and the rationale of wage policy. Salary administration should be approached as a management tool to attract, retain and develop the required quantity and quality of human resources within your own organisation. A well-designed and properly administered salary system should be one that will not only reward your employees with the material remuneration they think they deserve, but will also act as a motivating factor.

This Unit has also tried to familiarise you with the various statutory requirements of the pay fixation and help you in developing your skills in formulating and designing salary structures. It has explained the rationale of salary administration, the need for salary reviews and the steps to ensure control over salary administration.

13.10 KEY WORDS

Job Evaluation : The process by which the relative worth/value of a job is determined.

- Living Wage** : Wage sufficient for an employee to support himself or herself and his or her family by providing the basic necessities of life.
- Minimum Wage** : Wage sufficient to sustain and preserve the efficiency of the worker and to provide him or her the basic amenities such as education, medical care and other needs.
- Salary Administration** : Systems and procedures designed for purposes of efficiently managing the compensation of organisational members.
- Salary Progression** : Procedures and guidelines which will help to relate increase in salary to the performance of the employee.
- Salary Structure** : Consists of the various salary grades and their different levels of single jobs or groups of jobs.

13.11 CLUES TO ANSWERS

Check Your Progress-1

- 1) See point (1) of Sec. 13.2.
- 2) Read point (b) of Sub-sec. 13.4.1.
- 3) Mention the five steps discussed in Sec. 13.5.

Check Your Progress-2

- 1) See Sec. 13.7.
- 2) Many, like housing, conveyance, bonus, etc. See Sec. 13.8.