

Direct and indirect compensation managing human capital



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Compensation policies are one of the most significant topics that are discussed within the HR systems. There are many variables to a good compensation package. However, it is important to analyze what sort of package would be beneficial to both the employee and the employer. It is in this race that the HR people find it difficult to balance a compensation policy that meets the expectations of both the parties. To balance this position, HR people use a mix of Direct and indirect means of compensation. Within this space, it is generally observed that there are many benefits of offering indirect compensation to the employees that can be gained by the employers. On the flipside, it is also observed that employees generally want more of direct compensation to be offered in their packages. This paper thus confronts this issue and tries to find a justification for both the parties. While justifying the choice of compensation, the paper also analyzes at the best possible option from the point of view of both the parties. At first, it will look at the major differences between direct and indirect means of compensation. This shall be followed by the literature surrounding compensation practices. Based on this, the paper shall advise on the most significant type of compensation practice.

Literature Review

Compensation is pecuniary value provided to the employees for the work done by them. Its known as a great motivation for employees and may help in satisfaction of the job, performance of the job and the recruitment process. The most common name for Compensation management is: remuneration management, or wage and salary administration. It's mostly involved with the building and implementing of the full compensation

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package. The reward management pressurize only on financial part (related to the compensation package) of the organization. Anyhow, with the changing conditions of the market and new traditions, this system is also changed and new and innovative ideas and schemes are accepted.

Components of Compensation

There are two categories of compensation direct and indirect:

“ Compensation includes direct cash payments, indirect payments in the form of employee benefits and incentives to motivate employees to strive for higher levels of productivity”

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In respect of the above explanation, we can classify there components as follows:-

Wage and Salary:

Wage and salary are the most important in the organization as it is decided on the size and the structure of the organization. Wage refers to be paid to the employees on hourly basis such as in UK minimum wages are paid at £5.93 per hour. Therefore Salary is referring to as recompense paid to the white collar employees within an organization. Wage and salary are paid on fixed period of time and it's not related to the production.

Incentives

Wage and salaries are not the only compensation paid by the employer to the employee there is some additional pay which employee gets in contrast

of their better performance. These incentives are basically given on individual basis or a group as a whole.

Fringe benefits

There are some long term benefits which the employees used to get such as like provident fund, gratuity and pension. Some benefits are given on the happening of particular events like medical benefits, accident relief, health and life insurance and also few facilities uniform, canteens and recreation, etc these benefits are usually fringe benefits.

Perquisites

Sometime it is very important for the manager to retain their employee and also pushing up their job performance by giving them special benefits like pick and drop service or company car, holiday pay and club membership etc.

Classification of Compensation

Compensation can be classified into two categories:

Financial Compensation

Non-financial Compensation

Financial Compensation: Financial compensation is most popular and important compensation that is given in form of money. It is the most important motivational factor that satisfies employee's basic needs like food, clothing, etc. It is further categorised in two parts:

Direct Compensation – Direct compensation means compensating employees by paying them money in following forms:

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Wages- Wages means remuneration paid in cash for the work performed by an employee.

Bonus- Bonus means extra cash paid to an employee for exceeding his performance or on completion of specified project or target.

Other financial incentives that are directly given to employees in form of cash

Indirect Compensation - Indirect compensation means compensating employees in form of indirect cash benefits that are mentioned below:

Travelling allowance- Travelling allowance means reimbursement of expenses incurred by an employee on travelling for company's work.

House Rent allowance- HRA is paid to employee when he stayed in rented accommodation.

Medical expenses- Medical expenses means reimbursement of expenses incurred by an employee on his ill health.

Accident relief- It refers to reimbursement of expenses on happening of some uncertain event.

Health and life insurance- It is given by the company to secure the health and life of employee.

Non-Financial Compensation: Non-financial compensation refers to compensating employee not in form of money but in some other forms that

stimulate employees' morale and also improved his performance. It can be in following form:

Job security

Recognition

Participation

Pride in job

Delegation of responsibility

Other incentives

According to Fredrick Herzberg's theory of factors (1966), all the factors in an organization fall into two categories:

Factors that lead to job dissatisfaction,(hygiene fators)

And

Factors that lead to motivation.(motivators)

All factors fall into one of these classifications but the outcome is different. While some of them appears in both the categories but they hold strong position in one of the category.

Example National Business Awards chose " Tesco" as the employer of the year. Tesco was chosen for this because its solutions were seen to be more holistic." Tesco provided solutions pointing out the significance of loyal and

motivated employees to the performance of the company. To work accordingly, Tesco invested £12m recent year to train employees according to Herzberg's motivation theory alone. For example:

Improved and direct communication between the managers and the staff.

a scheme where customers and employees give ideas and recommendations to the senior supervisors and the directors

a scheme where talent is given a promotion, known by the name of "talent spotting" scheme

Improved perception about environment and situation of the employees.

These changes resulted in growth of sales and profits in Tesco.

In the above diagram the four factors of the motivation can be seen which are: responsibility, recognition, nature of the work and the achievement. And the factors that can give rise to job dissatisfaction are at the bottom: work conditions, how the business is run, pay and supervision.

The bars are in ascending order of the level of effectiveness on the work of the employees and its width shows how much it can affect the work of the employees. This can be explained as following: as we can see that "how the business is run is the highest cause of dissatisfaction for employees if the business is not running good, which can be a point of concern leading to bad working environment. Most people think pay is the highest cause of dissatisfaction and so its bar should be wider but according to this theory

people would not accept the job at the first place if the pay is not good enough.

Say for example from an employee's point of view when he feels there is lack of personal responsibility, the job wont dissatisfy him but when he gets some responsibility on him, it's a huge motivational factor for him. And therefore the long extensions of bars are greater on the motivational side.

Explanation to given statement

“ If employees undervalue the cost of benefits, why should a company not drop benefits and simply add more direct compensation”

Yes we totally agree to this statement as if employees undervalue the cost of benefits, then the company must drop those benefits and simply add more direct compensation.

For example people who do not enjoy sales work still go for it as they desire to earn more or above an average salary. This is how people get extrinsic motivation with the help of good salary package. It will be clearer by going through following reasons.

High output: the employer can motive their employee to work efficiently and giving higher performance by offering them healthy incentives. This helps the employer to get higher output.

Greater profits: It is quite obvious that the reason behind the higher profit for the organization is higher and also quality output. It can be maintain when the cost per unit will fall down or by keeping the selling price low.

No problem of idle time: the organisation where the incentives are limited the employee have no motivation to work efficient. In contrast when there are suitable incentives available in the organization the employee tend to become time conscious and start giving the importance to time so problem of idle time gets solved too much extent.

Supervision does not pose any problem: If the employees get the ideal incentives they tend to become conscious to their work and comply with their responsibilities and duties. By doing this the role of supervisor become minimal.

Efficient workers are able to earn more: The employees who perform better are capable of earning high wages, bonus and commission etc.

For example for consistent high levels of performance, an excellent attendance record and going beyond her stated duties, HSBC Bank (Cayman) Limited named Theresa Ebanks as it's ' Employee of the Year' for 2008

Possible to identify inefficient and dull workers: If the incentives are not available most of the worker perform ordinary and get normal wages which gives the employer hardly any chance to identify between the dull and highly efficient worker. So proper incentive plan give the employer the opportunity to know who is performing better and who is dull in the organization. This give the chance to the employer to decide either retain the in the organization or less provide them training.

Rate of labour turnover is bound to be low: In order to suppress the artisan rate the employers have to provide sufficient incentive to the worker so that

they won't feel dissatisfaction or low morale in the organization and tend to be committed with the organization.

Reduction in complaints and grievances: The result of appropriate and suitable incentives cut the chances of complains from the employee as they are getting according to their performance. This reduces the chances of complaints and grievances and better work culture in an organisation.

Another point to support the statement would be that, Now-a-days there is lots of competition in market and also the market is getting expensive. So to attract new and skilful employees it is necessary to pay at competitive price i. e. good salary package. For example Citi Bank pays salaries to its employees that ranges between 900 K INR to 170 K INR per annum whereas HDFC bank pays direct compensation as salary between 150 K INR to 200 K INR per annum to its employees and bonus is paid some percentage annually. So the new employees will be attracted to HDFC bank because it has better pay package.

Example : According to Aon Employee Survey (n = 4, 100, June 2003) states that the employees are undervaluing the cost and value of benefits, there are many occasion when some employees are unaware of the benefits and even don't know that benefits they are getting. 32% of the employees thought that they did not have any long-term disability cover, and 24% thought they do not have any life cover.

Example: According to Oval Insurance Reward Employee Benefits Survey, YouGov Employee Benefits (18 July 2007) there is 76% of employees who do not even understand their benefits package. For me this area should be <https://assignbuster.com/direct-and-indirect-compensation-managing-human-capital/>

taken in to consideration and the company need to introduce some policy with an objective of educating their employees about the benefits they are getting in detail.

Example: Quoted in Workspan (November 2006) as “ Right Answer, Wrong Question”. 78 % of the non-cash group undervalue the cost of benefits and wanted to get more direct compensation but the study shows that performance improved 38. 6% due to Non-Cash award in compression to just 14. 6% Cash-Award.

Example : The payroll of almost 40% of the employer’s reflects the cost of employee benefits, reveals by the Society for Human Resource Management’s (SHRM) (2007, Benefits Survey Report. It has been stated that the employee consistently rate benefits have very essential role in job satisfaction. But the employee most employee’s have a wrong perception on it. In this situation the role of the HR professional’s has been consistently increasing by helping the employees to fully understand the exact value of their benefits packages. A very good example that the HR professionals can introduce so their benefits value can be use and valued by the employees are Total compensation statements, Employee meetings and workshops.

Following are some organisational examples in support of the given statement that we have already discussed. All examples are based on entry level employees.

Oracles compensate their entry level employees by paying them between 180 K INR to 4 K INR per annum in form of direct compensation excluding bonus.

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In contrast HCL pay-outs in form of direct compensation ranges between 200 K INR to 250 K INR per annum in form of salary.

Mind Tree consulting provides direct compensation between 310 K INR to 330 K INR per annum whereas bonus is paid separately.

Infosys flows their direct compensation ranging between 280 K INR to 290 K INR per annum in form of salary.

Wipro's direct compensation system offers 250 K INR to 280 K INR per annum to its entry level employees and bonus is paid on occasions.

In contrast TCS pays direct compensation between 280 K INR to 330 K INR per annum to its employees, whereas bonus is paid separately.

LIC (Life Insurance Corporation) offers direct compensation between 150 K INR to 200 K INR per annum to its employees.

ICICI prudential offers merely 900 K INR to 200 K INR per annum to its employees where its other benefits are negligible.

New York Life Insurance compensate its employees by paying them between 60 K INR to 260 K INR per annum in form of salary.

Met Life Insurance pay-outs ranges between 50 K INR to 125 K INR per annum in form of salary.

Birla Insurance pays salary to its employees that ranges between 50 K INR to 150 K INR per annum.

Convergys pay-outs in form of salary ranges from 180 K INR to 280 K INR per annum whereas bonus is paid extra.

IBM Daksha pays direct compensation in form of salary between 150 K INR to 250 K INR per annum and 10% bonus is paid annually.

WNS pays salary to its employees between 180 K INR to 260 K INR per annum whereas bonus is paid as performance annually.

Reliance Communication flows its pay-outs in form of salary ranging between 60 K INR to 240 K INR per annum whereas bonus is paid on occasions.

Tata Communication compensates its employees between 50 K INR to 250 K INR per annum including bonus.

Hutch pays direct compensation in form of salary between 75 K INR to 240 K INR per annum to its employees where bonus is paid 10% annually.

Idea Cellular pays salaries to its employees ranging between 50 K INR to 210 K INR per annum excluding bonus.

Axis Bank outflows their cash in form of salary that ranges between 60 K INR to 150 K INR per annum and bonus is paid on occasions.

ABN Amro compensates its employees in form of salary ranging between 100 K INR to 200 K INR per annum.

Standard Chartered pays salary to its employees between 100 K INR to 150 K INR per annum at entry level.

Kotak Mahindra Bank pays salary between 100 K INR to 200 K INR per annum to its employees and bonus is paid 10 per cent annually.

Bajaj Capital pay direct compensation in form of salary to its employees between 100 K INR to 125 K INR per annum.

ITC hotels compensate its employees between 150 K INR to 200 K INR per annum and bonus is paid annually as per performance.

Leela Hotels pays salary between 150 K INR to 250 K INR per annum to its employees and bonus is paid after 6 months.

Hyatt regency pay- out its salaries between 180 K INR to 240 K INR per annum where bonus is paid lucrative.

ITC hotels have its own policy that compensates its employees in form of salary between 190 K INR to 300 K INR per annum and bonus is paid annually.

Shipping Corporation of India Ltd pays its employees between 280 K INR to 290 K INR per annum and bonus is paid annually.

Bharti communications pays salaries to its employees between 60 K INR to 200 K INR per annum excluding bonus.

DLF limited offers its own packages between 150 K INR to 240 K INR per annum to its employees.

CONCLUSION

From the above discussion we may conclude that where employees don't feel any worth of extra benefits that are given to them, the company must drop down those benefits and add more money to their compensation as it gives satisfaction and many benefits like more output, higher productivity, less absenteeism, high motivation and much more. The companies giving more direct compensation and less indirect compensation are growing more these days as they have more power to retain good, powerful and strong employees in their organisation. For example HP is a worldwide known brand. Even they believe in direct compensation would attract new comers as compared to the indirect. They compensate their entry level employees by paying them between 180 K INR to 330 K INR per annum in form of salary whereas other benefits paid to them are less. People enjoy working here for good salary package and the prestige of the company.

RECOMMENDATIONS

As per the discussion we strongly recommend that if employees don't give weight age to perquisites and extra benefits, even then company should not drop down all these benefits as somewhere it also demotivates employees. No doubt that employees always want more direct compensation in form of cash but at the same time they also need some perquisites and extra benefits or we can say indirect compensation like travel allowance, HRA, insurance, medical facilities as it add more benefits to their current living scenario. And somewhere it also act as status symbol now a days as gifts and allowances attract more employees and improves their social status too in society.

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