1

HUMAN RESOURCES PHILOSOPHY AND APPROACH FOR AN ORGANIZATION

Unit Structure

1.0 OBJECTIVES

After studying this module, you should be able to:

- Understand the nature and relevance of HRM
- Importance of HRM
- Changing Philosophies of HRM
- Various Approaches to HRM
- Relevance of these Philosophies and Approaches for an Organization

1.1 HUMAN RESOURCE MANAGEMENT

1.1.1 Introduction:

Human resource management deals with the overall functions of procuring, hiring, training, motivating and maintaining the human resources of the organization. The operative functions of HRM includes procurement, development, compensation, motivation, maintenance and integration and emerging trends. The management functions of human resource management includes planning, organizing, directing and controlling.

Human resource management also deals with the management of change. Though, management of change is a pure management concept. When a manager plans for change, communicate the need of change to the people, assure them about the positive aspects of change and implement the same with the support of the people. This process is called change management. It is like managing those things which are inevitable, consistent and create fear in the mind of the people. The concept of change management plays a vital role in any organization. The task of managing change is not an easy task.

Manpower planning is also an integral part of human resource management. It deals with the difference between acquired people and required people. Effective manpower planning helps an organization to achieve goals and objectives. No product or service can be produced without manpower.

Out of the resources of management, man is the living and the most important resource of the organization. The main objective of human resource management is to manage the people at the workplace. From their acquisition to their exit, the subject matter of human resource management deals with the overall functions related to the people of the organization.

1.1.2 Definition:

The concept of Human Resource Management is concerned with hiring, promoting, maintaining and controlling the human resource of the organization. Different authors have given different definitions of the term -Human Resource Management‖. Some of the important definitions are given below -

According to Edwin B. Flippo, "The personnel function is concerned with the procurement, development, compensation, integration and maintenance of the personnel of an organization for the purpose of contributing toward the accomplishment of that organization's major goals or objectives."

According to the American Society for Personnel Administration, "Personnel administration is the art of acquiring, developing and maintaining a component work force in such a manner as to accomplish maximum efficiency and economy in the functions and objectives of the organization."

In the words of Dale Yoder, "Manpower management effectively describes the process of planning and directing the application, development and utilization of human resources in employment."

According to the Indian Institute of Personnel Management, "Personnel Management is the part of the management function which is primarily concerned with human relationships within an organization. Its objective is the maintenance of those relationships on a basis which, by considering the well-being of Human Resource Management."

According to Pigors and Myres, "Personnel administration is a method of developing the potentialities of employees so that they get maximum satisfaction out of the work and give their best effort to the organization."

From the above definitions, it can be defined that human resource management is concerned with managing people at work. It effectively describes the process of planning and directing the application, development and utilization of human resources.

1.1.3 Conceptual Framework:

With the help of the following diagram, we can better understand the concept of human resource management -

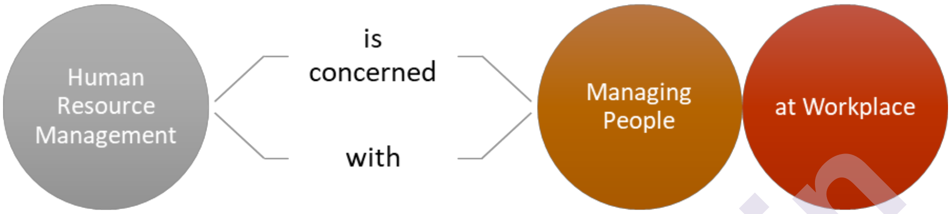

Fig. 1.1: Human Resource Management

Fig. 1.2: Conceptual Framework of Human Resource Management

1.1.4 Nature of Human Resource Management:

Human Resource Management is concerned with managing and controlling people at work place. The following points reveals the nature of human resource management -

Fig. 1.3: Nature of Human Resource Management

1. Based on Principles and Policies:

The field of human resource management is based on certain principles and policies. The philosophy of being focused on the people helps the organization to achieve its objectives.

2. Pervasive Function:

The human resource management function is present everywhere. It is pervasive in nature. It includes all the levels of the organization. The function is not associated with a single department. It manages employees from top to bottom.

3. Management Functions and Principles:

Human resource management is based on management functions and principles. Managing people at the workplace is an important part of human resource management. Management functions hiring, training, development, compensation; motivation, communication, and administration etc. of employees are taken care of by human resource management.

4. Concerned with People:

The subject matter of human resource management is concerned with people. The philosophies and approaches work with and for people. The people are motivated, influenced and maintained at the workplace. The center theme of this subject is people.

5. Integrating Function:

The function of human resource management deals with the integration of all the personnel related functions. In the best possible manner, the human resources of the organization are managed and integrated.

6. Action Oriented:

The focus of human resource management is not theoretical rather it is practical and actionable in nature. The approach of human resource management is action oriented. The problems and issues of employees are solved promptly.

1.2 HUMAN RESOURCES PHILOSOPHIES

1.2.1 Overview:

The human resource philosophies play a vital role in determining the overall policies of the organization related to the human resources. It is related to the strategic approach related to human resources. For competitive advantage and growth and development of the organization, the human resources policies involve a set of interrelated policies with ideological and philosophical approach.

The starting point of human resource management is to define the philosophical approach which helps in defining the vision and mission related to the human resources of the organization. The long term goal of any organization is to grow and develop through the development of human resources. Philosophies define the integrated set of beliefs and assumptions about the way things are and should be. In the field of management, there is a separation of ownership and management.

The people who create an organization are owners and the people who manage are managers. The former one is responsible for the formation of policies and procedures while the latter one is responsible for the execution function. In the minds of the decision makers, these policies and philosophies are sometimes explicit, sometimes implicit. The human resources policies revolve around the needs, values and approach of people towards the work of the organization.

The growth and development of the human resources philosophies is a long term process. The stakeholders should be considered first while preparing the policies and philosophies of the organization. Their values and opinions should be respected and considered. Human resources get influenced and the human resource leader influences the philosophies significantly.

1.2.2 Approaches to Human Resource Philosophies:

"Polices define how the company will deal with stakeholders. Employees, Customers, suppliers, distributors, and other important group employees act consistently on important issues"

\- Philip Kotler

The assumptions and beliefs determined by the human resources policies are based on how people are treated and should be treated. There are three approaches to treating people in an organization.

- Machine Approach
- Commodity Approach
- Humanistic Approach

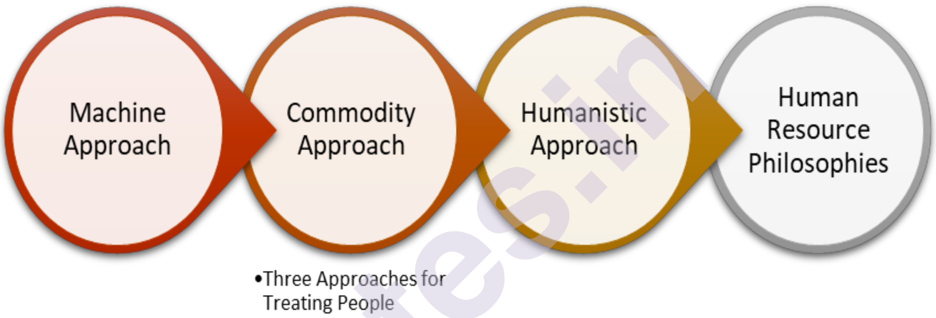

Fig. 1.4: HR Philosophies

1. Machine Approach:

In this approach, a person is treated as a machine. The human resources are treated as a part of the machine who can be fitted like any other part. As machines require maintenance, human resources also need to be maintained and preserved.

2. Commodity Approach:

The commodity approach is a very old approach of human resources philosophies. The human resources under this approach are treated like a commodity. Human resources can be bought and sold at a price . This approach can be traced back to old slavery system.

3. Humanistic Approach:

This is the most humane and accepted approach of human resources philosophies. In this approach, the human resources are treated as human beings having physiology. This approach puts emphasis on treating employees as human beings first.

1.2.3 Factors Influencing HR Philosophies:

The main factor which influences the human resources philosophies are:

Fig. 1.5: Factors Influencing HR Philosophies

1. Corporate Culture:

The corporate culture is an integral part of human resources philosophies. The philosophies and policies are influenced because of corporate culture. The corporate culture defines the boundaries for the policies. The culture defines how the people should behave commonly and the work of the organization should be done.

2. Style of Leadership:

Leadership is an activity of influencing people to get the work done. The leadership style is extremely important. The act of influencing is an art. Managers always try to act as a leader. The manager usually acts as a leader to start the change or re-design the human resources philosophies.

3. Corporate Values:

The corporate values also act as an influencing factor. The human resources philosophies in the context of management takes into consideration the values of the corporate as well. The philosophy revolves around the vision. Mission and goals of the organization. These factors help to set the values of the organization.

4. Market Competition:

Market competition also has an influence on human resources philosophies. The competition in the form of direct and indirect has a great influence on the philosophies. The companies have to change their working style while taking into consideration the level of competition.

5. Corporate Strategy:

Human resource strategy deals with the long term practices of the organization. The corporate strategy greatly influences the philosophies of human resources. They have a major impact when it comes to dealing with people. If the strategy mainly focuses on humans, the philosophies will have a major impact because of this strategy.

1.3 HUMAN RESOURCE APPROACHES

The following are the various approaches to human resources:

Fig. 1.6: Approaches to Human Resources

1. Commodity Approach:

The commodity approach is a very old approach of human resources philosophies. The human resources under this approach are treated like a commodity. Human resources can be bought and sold at a price . This approach can be traced back to old slavery system. The people can be hired and fired through money.

2. Management Approach:

In management approach, the PODC stands for:

- P - Planning
- - Organizing

- D - Directing
- C - Controlling

The management approach of human resources deals with managing people at work. Managers at all levels are responsible for managing their people in a group.

3. System Approach:

Organization works as a system to achieve the common goals of the organization. The system approach deals with the set of interrelated but separate elements or parts for a common goal.

Fig. 1.7: System Approach

4. Strategic Approach:

The strategic approach to human resources can be defined as the strategy to develop proper planning to hire & manage employees for fulfilling the long-term goals of the company. This strategy deals with the long term needs of the organization. The way of tackling problems for a long term is also included in this approach.

5. Reactive Approach:

Reactive approach is based on the response to the current situation. It occurs when the response is given after the problem arises. In this approach, the problems may be compounded. Organizations may suffer losses due to missed opportunities. If an organization takes a reactive approach, they may lose money and time.

This approach is opposite to the proactive approach. Experts from the management field strongly recommend avoiding this approach.

6. Proactive Approach:

This approach is based on the philosophy that prevention is better than cure. It is advocated that the HR managers should identify the challenges and problems before they start. It will save the considerable time and money of the companies in the long run and short run.

1.4 SUMMARY

- Human resource management deals with the overall functions of procuring, hiring, training, motivating and maintaining the human resources of the organization. The operative functions of HRM includes Procurement, development, compensation, motivation, maintenance and integration and emerging trends. The management functions of human resource management includes planning, organizing, directing and controlling.

- The concept of Human Resource Management is concerned with hiring, promoting, maintaining and controlling the human resource of the organization. Different authors have given different definitions of the term ―Human Resource Management‖.
- The human resource philosophies play a vital role in determining the overall policies of the organization related to the human resources. It is related to the strategic approach related to human resources. For competitive advantage and growth and development of the organization, the human resources policies involve a set of interrelated policies with ideological and philosophical approach.
- The assumptions and beliefs determined by the human resources policies are based on how people are treated and should be treated. There are three approaches to treating people in an organization - Machine Approach, Commodity Approach and Humanistic Approach.
- There are various approaches to human resources like commodity approach, reactive approach, proactive approach, strategic approach etc.

1.5 SELF ASSESSMENT TEST

1. Classify the various HR functions in an organization.
2. Write a note on Personnel Management Versus Human Resource Management.
3. Explain the nature and scope of human resource management.
4. Explain the various approaches to the philosophies of HRM.
5. Explain the various approaches of human resource management.
6. Describe the system approach in detail.
7. Highlights the various factors which influence the approaches of human resource management.

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2

REWARD STRATEGIES

Unit Structure

2.0 OBJECTIVES

After studying this module, you should be able to:

- Understand the nature and relevance of reward
- Importance of reward strategy
- How to develop and implement the reward strategy
- How to articulate and understand business context for reward strategies
- Relevance of reward strategies for an Organization

2.1 OVERVIEW

2.1.1 Introduction:

The concept of reward strategies comes under the subject matter of reward management. The subject matter of reward management deals with the strategies, policies and processes required to ensure that the contribution of people to the organization is recognized by both financial and non-financial means. The reward systems of the organization are designed, maintained and implemented.

The main objective of reward strategy is to motivate the people by fairly, equitable distributing the reward to them. The scope of reward management not only deals with the pay but also it covers employees benefits and non-financial rewards. The term 'Non-financial' covers -

- Recognition
- Learning
- Growth and development
- Career planning discussion
- Increased job opportunity
- Training

The reward strategy helps an organization to achieve its objectives for the long term. It ensures that the proper system is designed and implemented to reward policies and practices that support the organization's objectives, delivering a motivated and effective workforce. There are few important points to be considered while designing and implementing a total rewards strategy requires a large-scale approach that drives organizational change.

2.1.2 Conceptual Framework:

The following pictures depict the conceptual framework of the concept of reward strategy:

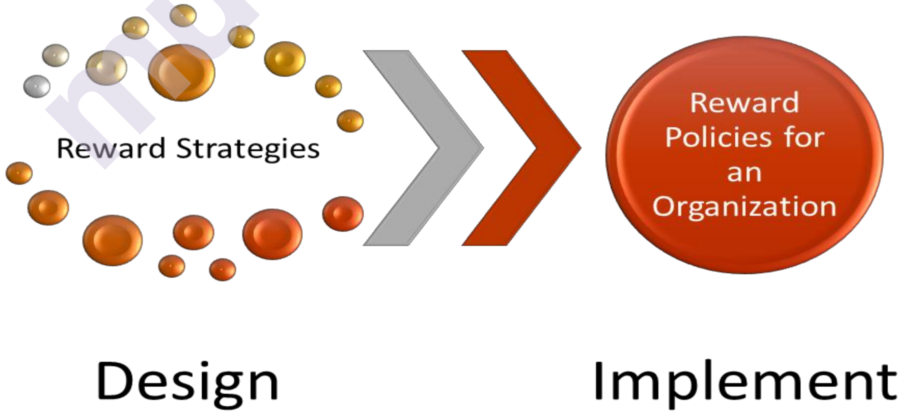

Fig. 2.1: Designing and Implementing the Reward Policies for an Organization

Fig. 2.2 Aspects of Reward Strategy

2.2 REWARD STRATEGY

2.2.1 Introduction:

Reward strategy can be defined as the strategy of an organization designing and implementing reward policies and practices that support the objectives. Reward strategy is an important aspect of reward management. It sets out what the organization intends to do in the long term to develop and implement the reward policies, practices and processes. This will help the organization to achieve the organizational goals.

The term "Reward Strategy" is a comprehensive term and deals with the long term strategy of the organization. The strategy provides monetary, beneficial and developmental rewards to employees. The reward strategy is a performance based strategy. It includes those employees who help organizations to achieve business goals. Reward is a positive term and it deals with combining the compensation and benefits for an employee.

It requires a large-scale approach that drives organizational change and development. For the success of reward strategy, the involvement of top executives and management is required. The approach of the reward strategy should be well rounded.

2.2.2 Definition:

Reward strategy can be defined as setting out what the organization intends to do in the longer term to develop and implement reward policies, practices and processes which will further the achievement of its business goals.

2.2.3 Features of Reward Strategy:

The following are the important features of reward strategy:

Fig. 2.3: Features of Reward Strategy

1. Deals with Long Term:

The reward strategy deals with the long term business achievements and goals of the organization. Reward strategy is a comprehensive term and deals with the long term strategy of the organization. The long term goals of the organization should be taken into consideration.

2. Developing the strategy:

The reward strategy deals with developing the strategy for the long term in an organization. It requires a large-scale approach that drives organizational change and development. The large scale approach involves the process of designing and implementing the strategy.

3. Implementing the Strategy:

Designing and developing the strategy plays a vital role for the long term benefits and survival of the employees of the organization. The implementation of strategy is more important. The process includes the development and implementation of strategy. The reward strategy is a performance based strategy.

4. Reward Policies, Practices and Processes:

Reward strategy is an important aspect of reward management. It sets out what the organization intends to do in the long term to develop and implement the reward policies, practices and processes. This will help the organization to achieve the organizational goals.

5. Important Part of Reward Management:

The concept of reward strategies comes under the subject matter of reward management. The subject matter of reward management deals with the strategies, policies and processes required to ensure that the contribution of people to the organization is recognized by both financial and non-financial means. The reward systems of the organization are designed, maintained and implemented.

2.2.4 Components of Reward Strategy:

The following are the important components of reward strategy:

Fig. 1.3: Components of Reward Strategy

1. Reward Policy:

Reward policy refers to the policy of the organization related to the employees benefits of the organization. The policy of the organization differs. The reward policy covers the following issues:

- Shaping employees behavior
- Promotion of work ethics
- Comparison between market rate and internal rate
- Achieving equal pay
- Contingent rewards related to performance, competence, contribution or skill
- The role of managers

2. Reward Practice:

The reward practice comes under the concept of reward system. The reward practices involves the following components:

- Monetary benefits like bonus, stock options, profit sharing plans, reimbursement etc.

- Non-monetary benefits like work from home, recognition, opportunity to leave work early, flexible working hours etc.
- Assistance
- Recognition of the work

3. Reward Process:

The reward process of the organization deals with the procedure of giving rewards to the employees in a systematic way. The following are the important aspects of the reward process:

- Analysis
- Strategy
- Activity
- Reward

2.3 DEVELOPING AND IMPLEMENTING THE REWARD STRATEGY

Reward strategy is an important aspect of reward management. It sets out what the organization intends to do in the long term to develop and implement the reward policies, practices and processes. This helps the organization to achieve the organizational goals. Development and implementation of reward strategy is an important aspect because it requires a large-scale approach that drives organizational change.

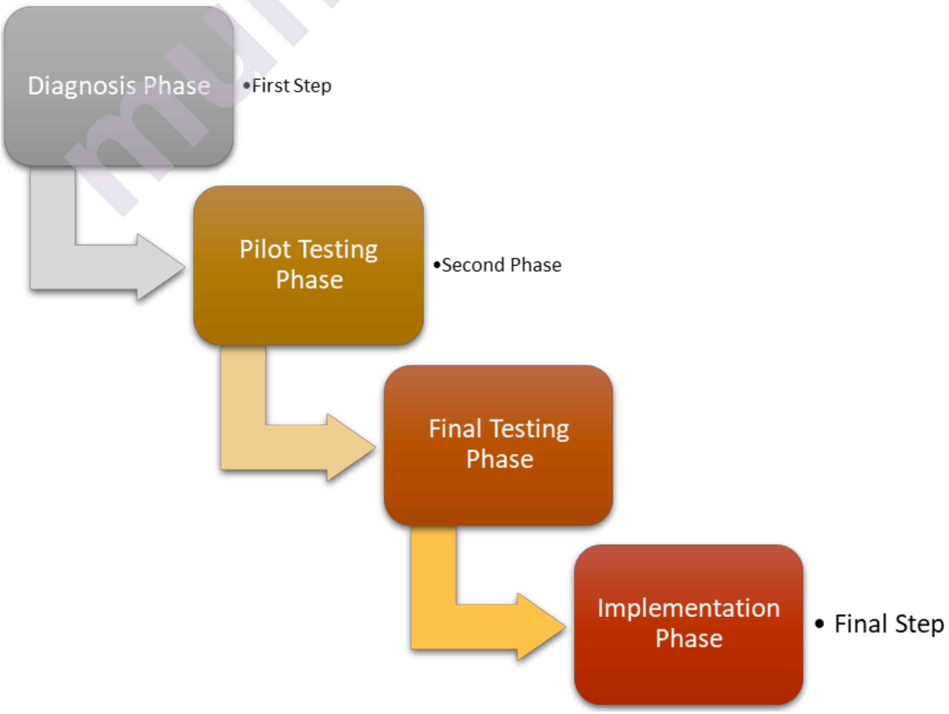

Fig. 1.4: Developing and Implementing the Reward Strategy

1. Diagnosis Phase:

The first step is the diagnosis step. In this step, a team diagnoses current benefits and compensation systems and determines the effectiveness of those systems in helping companies to reach their goals. In this step, the reward goals are diagnosed and assessed properly.

The current policies and practices assessed against them. The options for improvements are considered. If any changes are required, the team agrees upon them.

2. Pilot Testing Phase:

The second step deals with the design phase. In this stage, the design in detail is analyzed. The improvements and changes required in the current strategy are analyzed thoroughly. The team identifies and analyzes various reward strategies to determine what would work best in their workplace. The team will also determine the additional benefits that can be given to employees under the section of reward strategy:

- Flexible Work Schedule
- Additional Time Off
- Developmental Opportunities
- Training

3. Final Testing Phase:

This is the third stage of developing and implementing strategy for an organization. In this stage, the preparation phase before the implementation of the strategy will take place. This stage will determine whether the strategists responded to changes in organizational requirements or not?

4. Implementation Phase:

In this stage, the reward strategy's implementation takes place. The HR department implements the new reward strategy for the organization. The HR department will be responsible for communicating the new strategy to the employees of the organization by keeping in view the current changes and needs of the business enterprise. The implementation phase will be followed by ongoing review and modification.

2.4 ARTICULATING AND UNDERSTANDING BUSINESS CONTEXT FOR REWARD STRATEGIES

2.4.1 Overview:

The term "Reward Strategy" is a comprehensive term and deals with the long term strategy of the organization. The strategy provides monetary, beneficial and developmental rewards to employees. The reward strategy is a performance based strategy. It includes those employees who help organizations to achieve business goals. Reward is a positive term and it deals with combining the compensation and benefits for an employee.

It requires a large-scale approach that drives organizational change and development. For the success of reward strategy, the involvement of top executives and management is required. The approach of the reward strategy should be well rounded. It is important to articulate and understand the business context for reward strategies. By keeping in view the needs and importance of reward strategy in the context of business, it is important to consider the internal and external factors of the business.

Defining the context of business is needed to prepare and implement the plans strategically related to the reward management. It also defines the circumstances in which the exceptions for the business can be set. Managers are required to understand what works in an organization as far as the context of business is concerned. Some literature was reviewed while developing and implementing the reward strategy. Many contributors think that the reward strategy should deal with the organization perspective, not with the big things that may not work for the organization.

The business context involves the study of:

- **Internal Context:** It is within the organization and controllable in nature.

- **External Context:** It is outside the organization and uncontrollable in nature.

2.4.2 Articulating the Business Context:

It is very important to understand the business context in order to survive and develop in this competitive world. Articulating the business context is all about understanding it before it can go into effect. The team working under this head will identify what are the goals and how the success will be measured. In terms of doable and action, the employees can take part in this practice.

The goals of the organization must be communicated, clear and attainable for the employees. The focus on the business context is important, not the unrealistic things can be done for an organization. The things are not about the revolution, but about the evolution.

The following are the simple guidelines that can be followed:

1. Articulate the business strategy in terms of actions.

2. Give employees clear and measurable goals.

3. Measure the progress.

4. Keep it simple.

5. Manage the balance between policies and implementation

6. Think about the implementation

2.4.3 Understanding the Business Context for Reward Strategies:

Context is everything for modern business. The Greek philosopher Socrates said "In the world of knowledge the idea of the good appears last of all, and is seen only with effort". It is important to understand the context in every possible way. For reward strategies, understanding the business context is important.

The following steps can be followed to understand this topic thoroughly:

Fig. 1.5: Process of Understanding Business Context and Developing Strategy

1. Analyze the Business Context:

Analyzing business context is the first step in understanding the whole process. It is very important to understand the business context in order to survive and develop in this competitive world. Articulating the business context is all about understanding it before it can go into effect. The team working under this head will identify what are the goals and how the success will be measured.

2. Develop Strategy:

This is the preparation stage of developing the strategy by keeping in view the business context. Reward is a positive term and it deals with combining the compensation and benefits for an employee. Managers are required to understand what works in an organization as far as the context of business is concerned. Developing strategy on the basis of guiding principles is important in this stage. This is a preparation stage of developing strategy for reward management.

3. Develop and Justify the Reward Strategy:

Business context guides the strategy. In this stage, the team develops and justify the reward strategy. In this stage, the design in detail is analyzed. The improvements and changes required in the current strategy are analyzed thoroughly.

The team identifies and analyzes various reward strategies to determine what would work best in their workplace. The team will also determine the additional benefits that can be given to employees under the section of reward strategy like Flexible Work Schedule, Additional Time Off, Developmental Opportunities etc.

4. Test Plan:

In this stage, the pilot testing can be done by the team. This is the stage of developing and implementing strategy for an organization. In this stage, the preparation phase before the implementation of the strategy will take place. This stage will determine whether the strategists responded to changes in organizational requirements or not?

5. Implementation:

In this stage, the team will implement the new reward strategy for the organization. The team will be responsible for communicating the new strategy to the employees of the organization by keeping in view the current changes and needs of the business enterprise. The implementation phase will be followed by ongoing review and modification.

6. Review and Modify:

A top manager with his team is responsible for developing the reward strategy for the organization. In this stage, after reviewing the whole process and implementation part the things can be taken into consideration again for modification if needed.

2.5 SUMMARY

- The concept of reward strategies comes under the subject matter of reward management. The subject matter of reward management deals with the strategies, policies and processes required to ensure that the contribution of people to the organization is recognized by both financial and non-financial means. The reward systems of the organization are designed, maintained and implemented.

- The reward strategy helps an organization to achieve its objectives for the long term. It ensures that the proper system is designed and implemented to reward policies and practices that support the organization's objectives, delivering a motivated and effective workforce. There are few important points to be considered while designing and implementing a total rewards strategy requires a large-scale approach that drives organizational change.

- The term "Reward Strategy" is a comprehensive term and deals with the long term strategy of the organization. The strategy provides monetary, beneficial and developmental rewards to employees. The reward strategy is a performance based strategy. It includes those employees who help organizations to achieve business goals. Reward is a positive term and it deals with combining the compensation and benefits for an employee.

- Reward policy, reward practice and reward process are the important components of reward strategy.

- Reward strategy is an important aspect of reward management. It sets out what the organization intends to do in the long term to develop and implement the reward policies, practices and processes. This helps the organization to achieve the organizational goals. Development and implementation of reward strategy is an important aspect because it requires a large-scale approach that drives organizational change.

- Context is everything for modern business. The Greek philosopher Socrates said "In the world of knowledge the idea of the good appears last of all, and is seen only with effort". It is important to understand the context in every possible way. For reward strategies, understanding the business context is important.

2.6 SELF ASSESSMENT TEST

1. What are the key areas in which reward policies need to be formulated? Illustrate your answer with examples from your own organization.

2. What is a reward strategy? Explain the various components of reward strategy.

3. Explain the concept of reward strategy as an important aspect of reward management.

4. Describe the procedure of developing and implementing the reward strategy.

5. Why is business context vitally important?

6. Write a note on articulating and understanding business context for reward strategies.

7. Explain the components of understanding business context for reward strategies.

8. Elaborate the important features and components of a reward system.

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3

ELEMENTS OF REWARD STRATEGY

Unit Structure

3.0 OBJECTIVES

After studying this module, you should be able to:

- Understand the nature and relevance of reward management
- Importance of reward strategy
- Elements of reward strategy
- Understand the Elements of Reward Management
- Relevance of reward strategies for an Organization

3.1 OVERVIEW

The term "Reward Strategy" is a comprehensive term and deals with the long term strategy of the organization. The strategy provides monetary, beneficial and developmental rewards to employees. The reward strategy is a performance based strategy. It includes those employees who help organizations to achieve business goals. Reward is a positive term and it deals with combining the compensation and benefits for an employee.

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The concept of reward strategies comes under the subject matter of reward management. The subject matter of reward management deals with the strategies, policies and processes required to ensure that the contribution of people to the organization is recognized by both financial and non-financial means. The reward systems of the organization are designed, maintained and implemented. The main objective of reward strategy is to motivate the people by fairly, equitable distributing the reward to them. The scope of reward management not only deals with the pay but also it covers employees benefits and non-financial rewards.

The concept of reward management is concerned with analyzing and controlling worker remuneration, benefits, reimbursement and all the different advantages for the employees. The following elements are required to keep the value of the organization -

- Fairness
- Equity
- Consistent

The factors like compensation, benefits, work life, performance, recognition, development, growth and career opportunities are the key elements of reward management. The financial and non-financial rewards can have a significant impact on the performance and productivity of the workforce.

3.2 REWARD MANAGEMENT

3.2.1 Overview:

Reward management emphasizes the importance of considering all aspects of reward. It is designed to achieve the motivation, commitment, engagement and development of employees through monetary and non-monetary initiatives. The concept of reward management is based on a well defined philosophy. It is based on this aim to reward employees according to what the organization values and wants to pay for. The working of reward management is strategic in nature.

It deals with rewarding people who truly work well for the organization. It covers the aspect that the people should be rewarded for the value they create for the organization. They should be respected for their right behavior and work outcomes. The main essence is to convey the right message that organizations believe in rewarding the right people for the right things. Developing a performance culture is a key ingredient for the success and survival of any organization. It can be achieved with the help of a proper system of reward management.

The aim of reward management in the field of human resource management is to attract and retain the high quality people for the organization. These people help organizations to achieve common goals. The people who are treated fairly provide value through their work to the organization. Reward management deals with the inclusion, implementation and adaptation of various strategies, procedures and policies in an organization related to providing the incentives and benefits to the employees for their work towards the enterprise.

The term "Reward" can be described as an incentive or appreciation in the form of monetary or non-monetary value to the people for their contribution in an organization. According to **Dessler,** "Reward is an award as employee compensation for all types of salary employees receive and arises from their employment". According to **Bratton and Gold,** "Rewards are all forms of financial returns, and tangible service and benefits employees receive as part of an employment relationship".

3.2.2 Definition:

According to **Perkinson and White,** "Reward management is the combined action an employer may take to specify what levels of employee rewards will be offered based on what criteria and data available and how the offer will be regulated over time."

The concept of reward management helps employees to attract and retain the new and existing employees in an organization. It also helps organizations to avoid the cost of hiring and training. Developing a good organizational culture also comes under the objectives of reward management. In an organization, the reward management may include -

Fig. 3.1: Aspects of Reward Management

3.2.3 Conceptual Framework:

With the help of the following diagram, we can better understand the concept of reward management:

Fig. 3.2: Concept of Reward Management

Fig. 3.3: Aspects of a Good Reward Management System

3.2.4 Objectives of Reward Management:

The following are the main objectives of reward management:

1. To attract and retain the high performing employees.
2. To motivate the employees to perform better in an organization.
3. To enhance the organization’s corporate reputation.
4. To ensure the fairness for the contributions that people make to the organization.
5. To stimulate and implement change management.

6. To support the organization's strategy.
7. To avoid the cost of hiring and training the new employees.
8. To encourage the positive attitude and behavior among employees.
9. To give reward to the people for the value they create for the organization.
10. To channelize the efficient and productive administration.

3.2.5 Different Types of Rewards:

There are two types of rewards- extrinsic rewards and intrinsic rewards:

Fig. 3.4: Types of Reward Management

1. Intrinsic Rewards:

These rewards are internal to the organization. It helps employees to feel good and better in an organization. These are the rewards that deal with monetary and non-monetary nature and form a soft nature of motivation. The intrinsic rewards includes:

- Recognition
- Personal attention
- Bonuses
- Pay raise
- Gifts
- Promotion

2. Extrinsic Rewards:

Extrinsic rewards are those rewards which are given to employees to offer personal satisfaction to the employees. They are aimed at satisfying fundamental needs of recognition. The extrinsic rewards focus on improving the behavior of the employees. The extrinsic rewards are in the form of:

- Base pay for performance
- Feedback
- Information
- Putting Trust
- Empowerment

3.3 ELEMENTS OF REWARD STRATEGY

As mentioned earlier, reward strategy can be defined as the strategy of an organization designing and implementing reward policies and practices that support the objectives. Reward strategy is an important aspect of reward management. It sets out what the organization intends to do in the long term to develop and implement the reward policies, practices and processes. This will help the organization to achieve the organizational goals.

The term "Reward Strategy" is a comprehensive term and deals with the long term strategy of the organization. The strategy provides monetary, beneficial and developmental rewards to employees. The reward strategy is a performance based strategy. It includes those employees who help organizations to achieve business goals. Reward is a positive term and it deals with combining the compensation and benefits for an employee.

Reward strategy can be defined as setting out what the organization intends to do in the longer term to develop and implement reward policies, practices and processes which will further the achievement of its business goals.

The reward strategy helps an organization to achieve its objectives for the long term. It ensures that the proper system is designed and implemented to reward policies and practices that support the organization's objectives, delivering a motivated and effective workforce. There are few important points to be considered while designing and implementing a total rewards strategy requires a large-scale approach that drives organizational change.

The reward strategy deals with the long term business achievements and goals of the organization. The large scale approach involves the process of designing and implementing the strategy. It sets out what the organization intends to do in the long term to develop and implement the reward policies, practices and processes.

The following are the important elements of reward strategy:

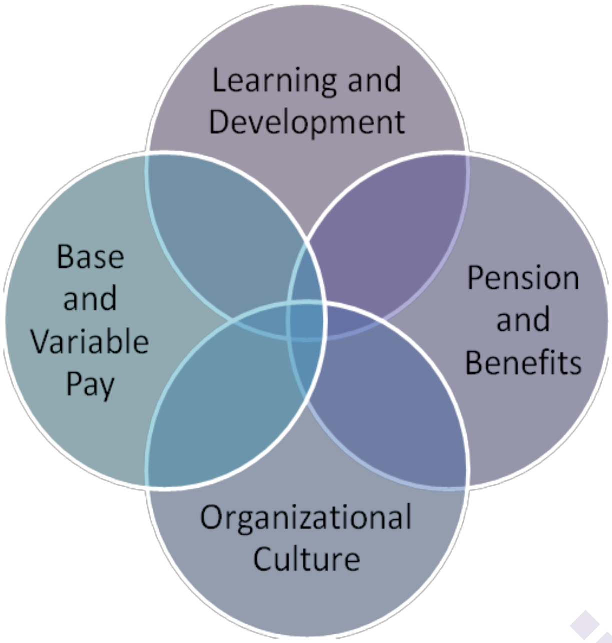

Fig. 3.4: Elements of Reward Strategy

Learning and Development:

The first element of reward strategy focuses on people' aspirations and achievements. Once an individual meets his/her monetary expectations, he/she will turn their focus on personal growth and development opportunities. They think about their career choices and advancement.

The term "Learning and Development" enables organizations to constantly work towards the growth and development of employees. An organization at their level prepare a strategy for -

- Training courses
- Development programs
- Online programs
- Development courses
- Learning culture

Pension and Benefits:

A pension is a type of monetary plan offered to an employee after he/she retires from his/her job. A pension is a type of retirement plan that provides monthly income after a person retires from a job position. This element adds additional triggers for people to work in an organization. Safety after retirement is a need of an individual. The company offers various types of benefits to attract and retain the new and present respectively.

Organizational Culture:

Organizational Culture is an important element of a reward strategy. In common parlance, organizational culture is generally understood as all of a company's beliefs, values and attitudes, and how these influence the behavior of its employees. It is a pervasive underline set of beliefs, assumptions, values shared and perceptions, the actions and decisions taken by the organization.

In an organization, people share culture. It denotes the morals, value systems, behavioral norms and ways of doing business that are unique to each operation. There are different perspectives of culture in organizations. People come into contact with organizations, Organisation transform their behavior and influences their thinking as per the organizational culture.

The organizational culture is a summation of a company's beliefs, policies, goals and objectives of the organization. It also covers the working style, way of communication and pattern described by the given group. It is expected from every new member to work in accordance with the culture of the organization.

There is a clear difference between the mission and vision of the organization and the organizational culture. The mission and vision of the organization clarify the road map to the people to work in that direction while organizational culture is a summation of a company's policies and beliefs which they expect to be transformed into the behavior of their employees.

Base and Variable Pay:

Base pay is a fixed amount while variable pay as the name suggests, is the portion of sales compensation determined by employee performance. When employees hit their goals, variable pay is provided as a type of bonus, incentive pay, or commission. The companies pay in line with the market. The element of fairness and just is required to keep this element effective as a part of reward strategy.

To remain the base and variable pay a hygiene factor, it needs to be in line with market expectations.

3.4 UNDERSTANDING THE ELEMENTS OF REWARD MANAGEMENT

As mentioned earlier, reward management emphasizes the importance of considering all aspects of reward. It is designed to achieve the motivation, commitment, engagement and development of employees through monetary and non-monetary initiatives. The concept of reward management is based on a well defined philosophy. It is based on this aim to reward employees according to what the organization values and wants to pay for. The working of reward management is strategic in nature.

The elements of reward management include programs, practices, elements that define an organization's strategy to attract and motivate employees. The following are the important elements of a reward management:

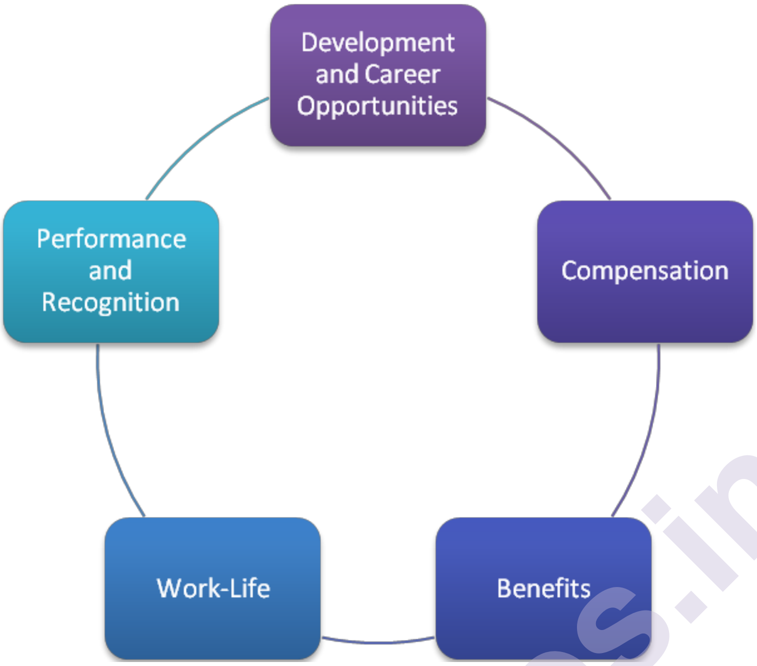

Fig. 3.5: Elements of Reward Management

1. Development and Career Opportunities:

The first most important element of reward management is development and career opportunities. Human resource is the most important resource of an organization. An organization succeeds best when it guides and motivates its employees in the best possible way. In a country like India, we have an extensive availability of manpower. It is up to the style of a manager, how he/she is able to take the best from his/her team.

When the organization provides development and career opportunities to the workforce, it ultimately becomes the best thing an organization can do for the people. People feel they can work for this organization for the long-term and they always try to give their best when they realize this.

2. Compensation:

Compensation is a systematic approach of providing monetary value to employees in exchange for the work or services they performed. The term compensation denotes all forms of financial returns and tangible benefits that an employee receives for the work performed in an organization. Compensation management is also known as salary and profits administration, remuneration control, or reward management.

The main objective of compensation management is to recruit and retain the qualified employees. A proper system of compensation and sure that the employer is willing to pay and the employees are going to perform in the best way. A good compensation system represents the most important element in the employment relationship between the employer and employee. It also helps to motivate employees for better performance and maintain morale.

3. Benefits

In attracting and retaining an employee, benefits are considered to be the major factor. Benefits are group membership rewards that provide security for employees and their family members. The employee receives all financial rewards indirectly if eligible. The benefits provide coverage for -

- Sickness
- Injury
- Old age
- Death
- Health insurance
- Life insurance
- Pensions
- Child care facilities

According to **Belcher,** "any wage cost which is not directly connected with employees' productivity, effort, performance, service or sacrifice."

According to **Cockman**, "those benefits which are supplied by an employer to or for the benefits of an employee, and which are not in the form of wages, salaries and time rated payments."

Benefits represent increased earnings to employees. Benefits help to reduce employed dissatisfaction, absenteeism and turnover. The benefits like vacations, family and medical leave, and sick leave helps the managers to effectively manage work schedules. benefits also help to improve the organizational image.

4. Work-life:

Maintaining a work-life is not an easy task. People overlap their work with their personal life. Work life balance is a term which denotes a condition where a person tries to establish an equilibrium between work life and personal life. Work life balance ensures that the employee is giving importance to his family life as well.

Increased responsibilities at work, working longer hours and increased responsibilities at home are some of the common reasons that lead to a poor work-life balance. Paying attention to the emotions is an important activity but as a human being we avoid and mix personal life and work life. When work life balance becomes an important aspect of a reward management system, it helps organizations to attract and retain new and existing talent.

The following benefits are found after studying the aspects of work-life balance for an organization:

- More engagement of employees
- Creates sense of belongingness among employees
- Reduces employees absenteeism and turnover
- More mindfulness
- Fewer health problems

The following ways can be adopted to improve work life:

- Prioritizing health
- Vacationing
- Unplugging
- Making time for oneself
- Asking employees about their problems
- Practicing

5. Performance and Recognition:

Recognizing someone's performance is the best way to boost the morale and motivation of an employee. Evaluating performance and recognizing is an important element of reward management. Exceptional performance can be rewarded to set an example for other employees as well. People who reach some specific goals can be offered recognition and a round of applause in front of everyone.

3.5 SUMMARY

- Reward management deals with rewarding people who truly work well for the organization. It covers the aspect that the people should be rewarded for the value they create for the organization. They should be respected for their right behavior and work outcomes. The main essence is to convey the right message that organizations believe in rewarding the right people for the right things. Developing a performance culture is a key ingredient for the success and survival of any organization. It can be achieved with the help of a proper system of reward management.

- The concept of reward management helps employees to attract and retain the new and existing employees in an organization. It also helps organizations to avoid the cost of hiring and training. Developing a good organizational culture also comes under the objectives of reward management. In an organization, the reward management may include pay practices, minimum wages, base pay etc.

- There are two types of rewards- extrinsic rewards and intrinsic rewards. These rewards are internal to the organization. It helps employees to feel good and better in an organization. These are the rewards that deal with monetary and non-monetary nature and form a soft nature of motivation. Extrinsic rewards are those rewards which are given to employees to offer personal satisfaction to the employees. They are aimed at satisfying fundamental needs of recognition. The extrinsic rewards focus on improving the behavior of the employees.
- Learning and development, base and variable pay, pensions and benefits, organizational culture are important elements of reward strategy.
- Performance and recognition, benefits, compensation, development and career opportunities, work life are important elements of reward management.

3.6 SELF ASSESSMENT TEST

1. What are the key areas in which reward policies need to be formulated? Illustrate your answer with examples from your own organization.
2. What is a reward strategy? Explain the various components of reward strategy.
3. Explain the concept of reward strategy as an important aspect of reward management.
4. What is reward management? Explain the various types of rewards.
5. What is a reward strategy? Describe the various elements of reward strategy.
6. Write a detailed on understanding the elements of reward management
7. Explain the important features of reward management. How the system works in an organization.

*****

4

COMPENSATION: AN INTRODUCTION

Unit Structure

4.0 OBJECTIVES

After studying this module, you should be able to:

- Understand the nature and relevance of compensation
- Importance of compensation
- Know about the objectives of compensation
- Know the role of Compensation / Remuneration place in Reward Strategy
- Study the factors which affects employee's compensation
- Relevance of reward strategies for an Organization

4.1 INTRODUCTION

4.1.1 Overview:

Compensation is one of the most important human resource functions of an organization. The concept of compensation represents the most important element in the employment relationship. For many organizations, the compensation factor is the biggest single cost of running a business. The 21st century economy is a knowledge based and performance driven economy. A businessman drives his business with the help of innovations and technology to transform it as per the customer expectations.

In a course of time, every business develops with complexities. Beyond a level, managing alone becomes a difficult task for a person. The need for management has increased tremendously. So is the need for organizational development. The compensation management helps organizations to develop and grow. In a changing business climate, it is important to understand the structural, cultural and strategic reality of work.

To facilitate organizational success, organizational development plays an important role. The existence and application of management is not only essential for growth and development but also it is essential for the survival of business organizations. There are several types of groups. Every human being has needs and desires. Organizations understand and work in this direction to provide better goods and services to the customers. These needs and wants can be satisfied by working and living together in an organized group of organizations.

A good compensation model can help to reinforce the key corporate values and facilitate the achievement of organizational objectives. In the globalization era, where the business environment has become increasingly challenging, an effective compensation system helps to attract the talent candidates for the organization. The concept of compensation can be divided into three types - direct compensation, indirect compensation and non-monetary compensation.

4.1.2 Meaning:

Compensation is a systematic approach of providing monetary value to employees in exchange for the work or services they performed. The term compensation denotes all forms of financial returns and tangible benefits that an employee receives for the work performed in an organization. Compensation management is also known as salary and profits administration, remuneration control, or reward management.

Compensation is a monetary payment given to an individual in exchange for their services. It may be defined as money received in performance of work and many kinds of services and benefits. An organization provides many kinds of services and benefits to their employees. This all comes under compensation management. In simple words, we can say that compensation is the remuneration received by an employee in return for their contribution to the organization.

The main objective of compensation management is to recruit and retain the qualified employees. A proper system of compensation ensure that the employer is willing to pay and the employees are going to perform in the best way. A good compensation system represents the most important element in the employment relationship between the employer and employee. It also helps to motivate employees for better performance and maintain morale.

4.1.3 Definition:

According to **Milkovitch and Newman,** "Compensation is all forms of financial returns, tangible services and benefits employees receive as part of an employment relationship." The phrase "financial returns" refers to an individual's base salary, as well as short- and long-term incentives. "Tangible services and benefits" are such things as insurance, paid vacation and sick days, pension plans, and employee discounts.

In the words of **Cascio,** "Compensation includes direct cash payments and indirect payments in form of employees benefits and incentives to motivate employees to strive for higher levels of productivity"

According to **Tapomoy Deb,** "Compensation management is a system compensating individuals for the work they perform in such a way that the organization is able to attract, retain, and motivate them to perform well keeping in view organizational and market factors".

According to **I. Kessler,** "Compensation management refers to payment systems which determine employee wages or salary, direct and indirect rewards".

From the above definitions, compensation may be defined as money received in performance of work and many kinds of services and benefits.

4.1.4 Conceptual Framework:

The following pictures depict the conceptual framework of the compensation -

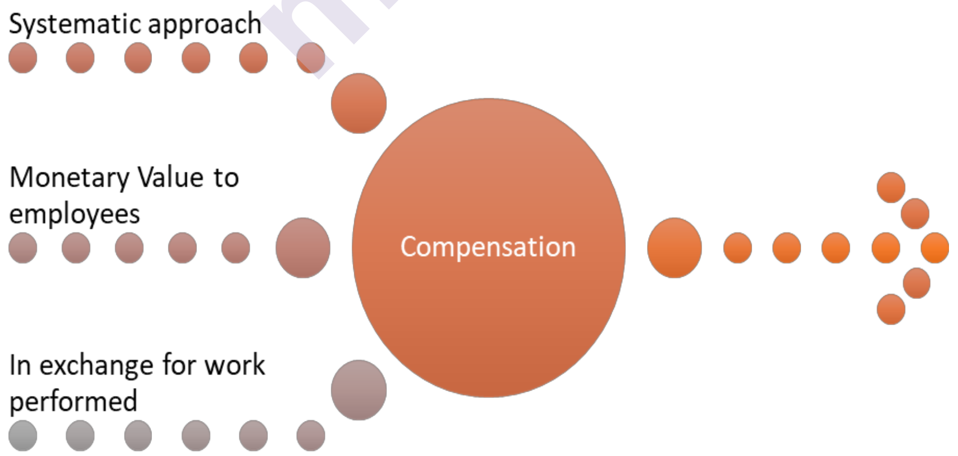

Fig. 4.1: Compensation: A Concept

4.1.5 Nature of Compensation:

The following point explains the nature of compensation:

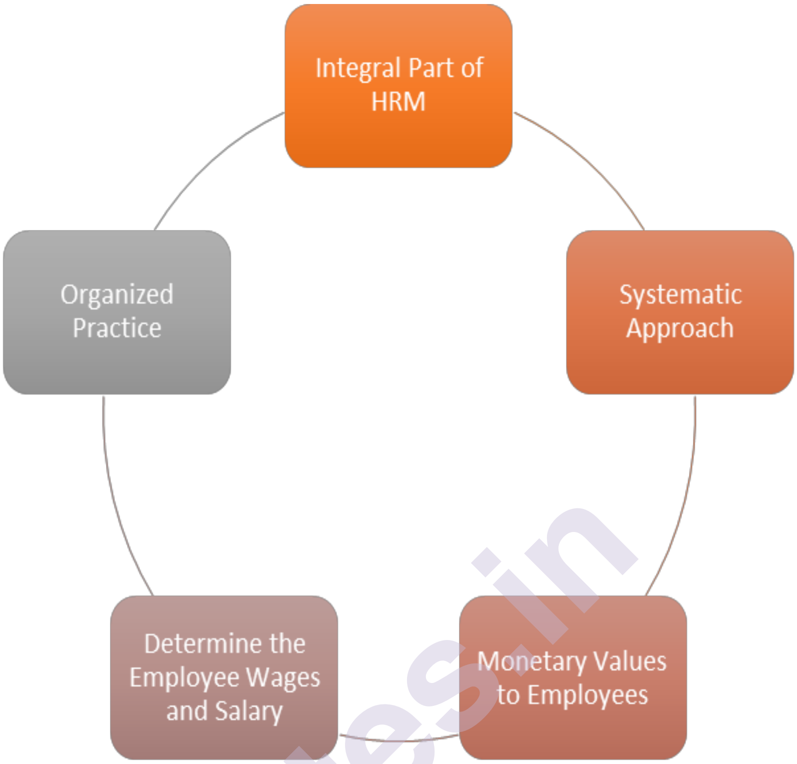

Fig. 4.2: Nature of Compensation

1. Integral Part of HRM:

Compensation management is an integral part of human resource management. It is a tool used by management for a variety of purposes to further the existence of the company. Compensation management consists of a number of activities pertaining to job evaluation, market rate analysis, job analysis, pay structure design and maintenance, etc. Compensation is one of the most important human resource functions of an organization.

2. Systematic Approach:

Compensation is a systematic approach of providing monetary value to employees in exchange for the work or services they performed. The term compensation denotes all forms of financial returns and tangible benefits that an employee receives for the work performed in an organization.

3. Monetary Values to Employees:

Compensation is a monetary payment given to an individual in exchange for their services. It may be defined as money received in performance of work and many kinds of services and benefits. An organization provides many kinds of services and benefits to their employees.

4. Determine the Employees Wages and Salary:

Compensation helps to determine the employees wages and salary. A good compensation model can help to reinforce the key corporate values and facilitate the achievement of organizational objectives. In the globalization era, where the business environment has become increasingly challenging, an effective compensation system helps to attract the talent candidates for the organization.

5. Organized Practice:

Compensation is an organized practice and it also represents the most important element in the employment relationship. The structure comprises a number of different elements that may be cash and non-cash payments.

4.2 OBJECTIVES OF COMPENSATION

The following are the main objectives of compensation management:

1. To attract and retain the high performing employees.
2. To motivate the employees to perform better in an organization.
3. To enhance the organization's corporate reputation.
4. To ensure the fairness for the contributions that people make to the organization.
5. To stimulate and implement change management.
6. To support the organization's strategy.
7. To avoid the cost of hiring and training the new employees.
8. To encourage the positive attitude and behavior among employees.
9. To give reward to the people for the value they create for the organization.
10. To channelize the efficient and productive administration.

4.3 IMPORTANCE OF COMPENSATION

The term compensation denotes all forms of financial returns and tangible benefits that an employee receives for the work performed in an organization. Compensation is one of the most important human resource functions of an organization. It is the most element of an organization and denotes the following points as importance of this topic:

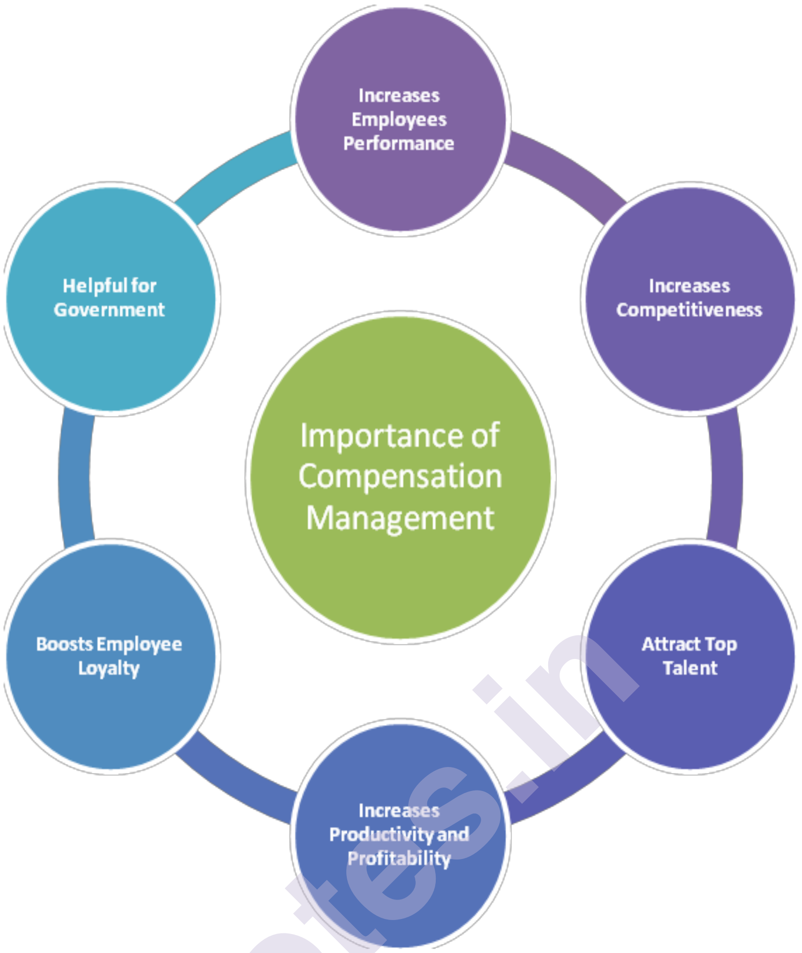

Fig. 4.3 Importance of Compensation

1. Increases Employees Performance:

Compensation is the most important element in the employment relationship. For the employees, a proper compensation system raises his standard of living. Compensation is a systematic approach of providing monetary value to employees in exchange for the work or services they performed. If they receive good remuneration, it increases their performance and productivity.

2. Increases Competitiveness:

From the employer's point of view, the compensation model represents a significant part of his cost. As mentioned earlier, a good compensation model increases the productivity and performance of an employee. Ultimately, their increased performance and productivity contributes to increasing the competitiveness of the organization.

3. Attract Top Talent:

A good compensation model helps organizations to attract and retain the new talent. It attracts the best candidates for the organization. People before joining any organization always give first preference to salary and goodwill of the company.

4. Increases Productivity and Profitability:

It is observed that the contented employees are the most productive employees. When the organization, through a good compensation model, pays a sufficient amount for the work of employees, they automatically feel motivated and perform well. Thus, it increases the overall productivity and performance of the organization.

5. Boosts Employee Loyalty:

When employees get good pay, they like to stay in an organization. The proper compensation model helps them to stay with the employer for the long term or may be forever. It boosts employee loyalty towards organization as they don’t leave and employers don't need to continue to spend time, money and energy on recruiting new candidates.

6. Helpful for Government:

Organizations stay in compliance with the Federal and State government agencies with the help of a legal compensation system. Many acts have been passed to ensure that the employees are getting sufficient payment to run their family and to fulfill their basic needs.

4.4 FACTORS AFFECTING EMPLOYEE’S COMPENSATION

Compensation is a tool used by management for a variety of purposes to further the existence of the company. Compensation management consists of a number of activities pertaining to job evaluation, market rate analysis, job analysis, pay structure design and maintenance, etc. Compensation in any organization is highly affected by numerous factors. The compensation at an organizational level can be classified into two categories - Internal factors and External factors.

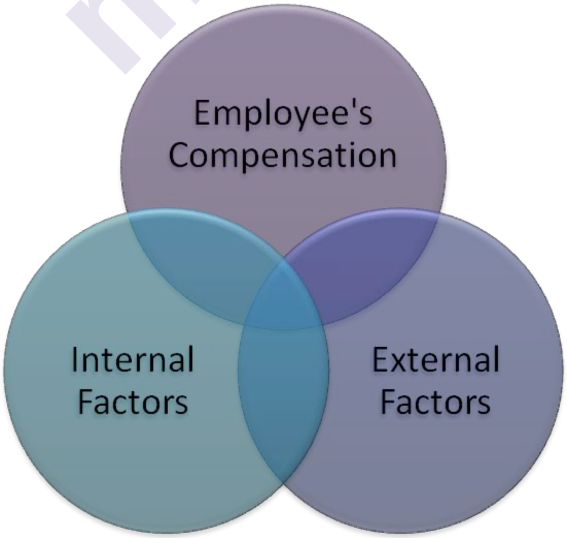

Fig. 4.4: Classification of Factors Affecting Employee’s Compensation

Further, the internal and external factors have various sub-factors affecting the employee's compensation at the workplace. The description of the same is given below:

1. Internal Factors:

Internal factors are also known as controllable factors. As the name suggests these factors are internal to an organization and controllable in nature. The impact of these factors affecting the compensation of the compensation is specific and direct. Internal factors have a great influence on the pay structure of the organization. The following are the internal factors which affect compensation at organizational level .

- Employer's Ability to Pay
- Job Status and Worth
- Compensation Policy of the Organization
- Performance and Productivity Level of an Employee
- Job Analysis
- Job Description
- Job Specification
- Employee Related Factors
- Business Strategy
- Experience of an Employee

Compensation is the most important element in the employment relationship. For the employees, a proper compensation system raises his standard of living. The factors which are mentioned above can affect the employee's performance and productivity. As these factors are internal to an organization, an employer can take care of these factors.

2. External Factors:

External factors are also known as uncontrollable factors. As the name suggests these factors are external to an organization and uncontrollable in nature. The impact of these factors affecting the compensation of the compensation is not specific and is indirect. External factors have a great influence on the pay structure of the organization. The following are the external factors which affect compensation at industry level -

- Demand and Supply of Labour
- Government Control
- Inflation Level
- Globalization

- Privatization Policy
- Cost of Living
- Economic Conditions
- Society
- Labour Unions
- Legislation
- Cross Sector Mobility
- Labor Laws and Legislation
- Ongoing Rate/Prevailing Wage Rate

4.5 COMPENSATION / REMUNERATION PLACE IN REWARD STRATEGY

4.5.1 What is Reward?

The term "Reward" can be described as an incentive or appreciation in the form of monetary or non-monetary value to the people for their contribution in an organization. Reward management deals with the inclusion, implementation and adaptation of various strategies, procedures and policies in an organization related to providing the incentives and benefits to the employees for their work towards the enterprise.

According to **Dessler,** "Reward is an award as employee compensation for all types of salary employees receive and arises from their employment."

According to **Bratton and Gold**, "Rewards are all forms of financial returns, and tangible service and benefits employees receive as part of an employment relationship."

The main objective of reward strategy is to motivate the people by fairly, equitable distributing the reward to them. The scope of reward management not only deals with the pay but also it covers employees benefits and non-financial rewards. The term 'Non-financial' covers:

- Recognition
- Learning
- Growth and development
- Career planning discussion
- Increased job opportunity
- Training

4.5.2 What is Compensation?

Compensation is a monetary payment given to an individual in exchange for their services. It may be defined as money received in performance of work and many kinds of services and benefits. An organization provides many kinds of services and benefits to their employees. This all comes under compensation management. In simple words, we can say that compensation is the remuneration received by an employee in returns of their contribution to the organization

A proper system of compensation and sure that the employer is willing to pay and the employees are going to perform in the best way. A good compensation system represents the most important element in the employment relationship between the employer and employee. It also helps to motivate employees for better performance and maintain morale.

In the words of **Cascio,** "Compensation includes direct cash payments and indirect payments in form of employees benefits and incentives to motivate employees to strive for higher levels of productivity"

According to **Tapomoy Deb,** "Compensation management is a system compensating individuals for the work they perform in such a way that the organization is able to attract, retain, and motivate them to perform well keeping in view organizational and market factors".

According to **Milkovitch and Newman,** "Compensation is all forms of financial returns, tangible services and benefits employees receive as part of an employment relationship."

Compensation is one of the most important human resource functions of an organization. The term compensation denotes all forms of financial returns and tangible benefits that an employee receives for the work performed in an organization.

4.5.3 Compensation Place in Reward Strategy:

The term "Compensation" is a vital part of human resource management. The present area of human resource management is of competitive nature. It is more important to manage and sustain the most important resource of the organization. Human resource management deals with the overall functions of procuring, hiring, training, motivating and maintaining the human resources of the organization.

The operative functions of HRM includes Procurement, development, compensation, motivation, maintenance and integration and emerging trends. The management functions of human resource management includes planning, organizing, directing and controlling.

Compensation in the high performance organization needs to reinforce the directions set by the leadership. Compensation strategy issued to guide the design of specific compensation decisions. Compensation strategy plays an important role in the strategic decision making of the organization.

Fig. 4.5: Concept of Compensation and Strategy in Human Resource Management

In reward strategy, compensation holds a significant place. Compensation is a key issue for the employees. It is significant to approach compensation strategically by developing a philosophy towards compensation along with a set of objectives. Methods of delivery and number of levels plays a vital role determining the compensation level of an organization.

An organization can include the following types of compensation in their strategy:

- Base pay
- Bonus
- Commission
- Overtime pay
- Paid time off
- Flexible schedules

4.6 SUMMARY

- In a course of time, every business develops with complexities. Beyond a level, managing alone becomes a difficult task for a person. The need for management has increased tremendously. So is the need for organizational development. The compensation management helps organizations to develop and grow. In a changing business climate, it is important to understand the structural, cultural and strategic reality of work.

- Compensation is a monetary payment given to an individual in exchange for their services. It may be defined as money received in performance of work and many kinds of services and benefits. An organization provides many kinds of services and benefits to their employees. This all comes under compensation management. In simple words, we can say that compensation is the remuneration received by an employee in return for their contribution to the organization.

- The main objective of compensation management is to recruit and retain the qualified employees. A proper system of compensation and sure that the employer is willing to pay and the employees are going to perform in the best way. A good compensation system represents the most important element in the employment relationship between the employer and employee. It also helps to motivate employees for better performance and maintain morale.

- Compensation is a tool used by management for a variety of purposes to further the existence of the company. Compensation management consists of a number of activities pertaining to job evaluation, market rate analysis, job analysis, pay structure design and maintenance, etc. Compensation in any organization is highly affected by numerous factors. The compensation at an organizational level can be classified into two categories - Internal factors and External factors.

- In reward strategy, compensation holds a significant place. Compensation is a key issue for the employees. It is significant to approach compensation strategically by developing a philosophy towards compensation along with a set of objectives. Methods of delivery and number of levels plays a vital role determining the compensation level of an organization.

4.7 SELF ASSESSMENT TEST

1. Define the term Compensation. Explain the various objectives of compensation management.

2. Identify the major components of compensation management.

3. Outline the various factors which affect employee compensation in an organization.

4. Explain the need and importance of compensation in an organization.

5. Bring out the difference between manager's remuneration and wages of workers.

6. Justify the high remuneration paid to executives. Also explain the role of compensation management in this area.

7. Write a detailed on place of compensation in reward strategy.

8. Explain the various components of reward strategy.

*****

5

UNDERSTANDING THE ELEMENTS OF COMPENSATION/STOCK OPTION

Unit Structure

5.0 OBJECTIVES

After studying this module, you should be able to:

- Understand the nature and relevance of compensation
- Study the importance of compensation programs
- Know about the Elements of compensation
- Understand the Concept of Stock Option
- Understand the Elements of Stock Option

5.1 INTRODUCTION

Compensation is a systematic approach of providing monetary value to employees in exchange for the work or services they performed. The term compensation denotes all forms of financial returns and tangible benefits that an employee receives for the work performed in an organization. Compensation management is also known as salary and profits administration, remuneration control, or reward management.

The main objective of compensation management is to recruit and retain the qualified employees. A proper system of compensation and sure that the employer is willing to pay and the employees are going to perform in the best way. A good compensation system represents the most important element in the employment relationship between the employer and employee. It also helps to motivate employees for better performance and maintain morale.

According to **Milkovitch and Newman,** "Compensation is all forms of financial returns, tangible services and benefits employees receive as part of an employment relationship."

The phrase "financial returns" refers to an individual's base salary, as well as short- and long-term incentives. "Tangible services and benefits" are such things as insurance, paid vacation and sick days, pension plans, and employee discounts.

Compensation helps to determine the employees wages and salary. A good compensation model can help to reinforce the key corporate values and facilitate the achievement of organizational objectives. In the globalization era, where the business environment has become increasingly challenging, an effective compensation system helps to attract the talent candidates for the organization. Compensation is an organized practice and it also represents the most important element in the employment relationship. The structure comprises a number of different elements that may be cash and non-cash payments.

5.2 IMPORTANCE OF COMPENSATION PROGRAMS

The term compensation denotes all forms of financial returns and tangible benefits that an employee receives for the work performed in an organization. **Compensation** is one of the most important part of **human resource functions** of an organization. It is the most element of an organization and denotes the following points as importance of this topic -

Compensation is the most important element in the employment relationship. For the employees, a proper compensation system raises his standard of living. Compensation is a systematic approach of providing monetary value to employees in exchange for the work or services they performed. If they receive good remuneration, it **increases their performance and productivity.**

From the employer's point of view, the compensation model represents a significant part of his cost. As mentioned earlier, a good compensation model **increases the productivity and performance of an employee.** Ultimately, their increased performance and productivity contributes to increasing the competitiveness of the organization.

A good compensation model helps organizations to **attract and retain the new talent.** It attracts the best candidates for the organization. People before joining any organization always give first preference to salary and goodwill of the company.

It is observed that the contented **employees** are the most productive employees. When the organization, through a good compensation model, pays a sufficient amount for the work of employees, they automatically **feel motivated and perform well.** Thus, it increases the overall productivity and performance of the organization.

When **employees get good pay, they like to stay in an organization.** The proper compensation model helps them to stay with the employer for the long term or may be forever. It boosts employee loyalty towards organization as they dont leave and employers don't need to continue to spend time, money and energy on recruiting new candidates.

Organizations stay in compliance with the Federal and State government agencies with the help of a legal compensation system. Many acts have been passed to ensure that the employees are getting sufficient payment to run their family and to fulfill their basic needs.

5.3 ELEMENTS OF COMPENSATION

As mentioned many times, compensation is the most important human resource function of an organization. There are various important elements of compensation. While designing a successful compensation package, one must consider the following elements:

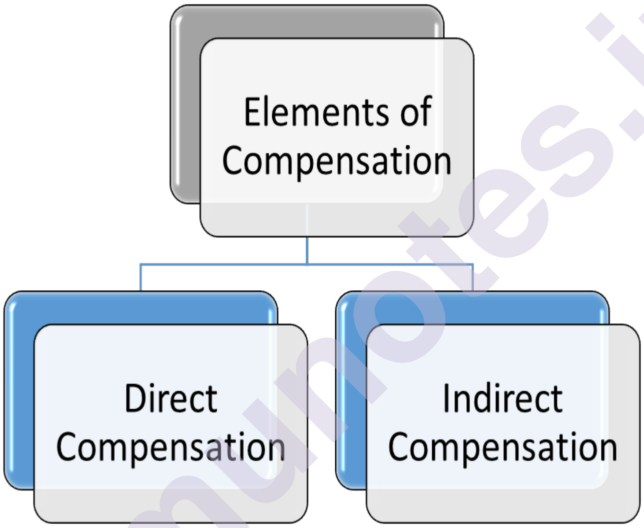

Fig. 5.1 Elements of a Successful Compensation Programs

1. Direct Compensation:

Direct compensation is a form of compensation an employer pays to his employee directly for his/her services rendered for the work in an organization. It can be paid in the form of wages, salaries, commissions and bonuses that an employer provides regularly and consistently. The following are the elements of direct compensation:

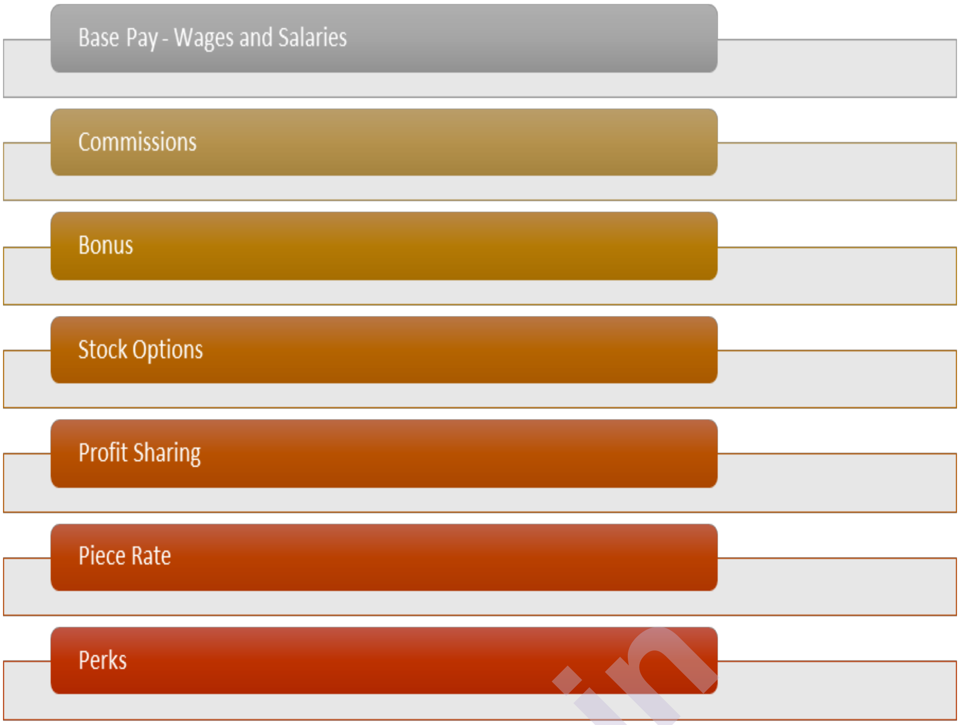

Fig. 5.2: Elements of Direct Compensation

1) Base Pay:

The first component of direct compensation is base pay. It is the first element of executive remuneration. The base pay is determined through the evaluation of the job. Job evaluation is a process through which the job of a person is evaluated through the level of skills,efforts and responsibility required to perform the jobs.

The subject matter of base pay includes:

Salary:

Salary is a term used to indicate a fixed amount of money or compensation paid to an employee by an employer in return for work performed.

Wages:

Wages is a term used to indicate an amount of money or compensation paid to a labor/worker by an employer in return for work performed.

2) Commissions:

Commissions form another important element of compensation management. Commissions are a sum of money paid to an employee upon completion of a task, usually selling a certain amount of goods or services. Commission along with salary or alone are often considered as an allowance paid to the employees for the sales target or the work which is commission based.

Direct compensation can be in the form of commissions that an employer provides regularly and consistently

3) Bonus:

Bonus is a gift paid to an employee occasionally to reward the exceptional performance or for some special occasions. The concept of bonus plays a vital role in today's competitive executive payment program. In the form of bonuses, an employer appreciated his/her employees. This type of incentive is special and occasionally given to the employees.

According to the definition of Cambridge Dictionary, "Bonus is an amount of money given to an employee in addition to their salary as a reward for working well.

The following are the types of bonuses namely,

a. Production Bonus

b. Profit Bonus

c. Customary Bonus

d. Implied Bonus (Bonus as an implied term)

4) Stock Options:

Stock options are popularly known as Employee Stock Option. Employee Stock Option is a contract between two parties that gives the buyer the right to buy or sell underlying stocks at a predetermined price and within a specified time period. There are two types of stock option -

- Call Option
- Put Option

5) Profit Sharing:

Profit sharing is a plan in which an employer gives the right to an employee to be a part of profit sharing of the organization. It is a type of pre-tax contribution plan for employees that gives workers a certain amount of a company's profits. The amount of profit sharing is up to the company how much they would like to share with the employees.

The profit sharing depends on the following elements:

- Amount set by the Employer
- Profitability of the Business
- Working Capital Needs of the Business
- Amount of Wages and Salaries

6) Piece Rate:

When the workers are paid by the units performed, this system is known as Piece rate. The Piece Rate is also known as Piece Work Pay. Understanding what Piece rate is important. Complying with the wages and overtime allowances is also a part of the Piece Rate system. The system to be effective must be transparent.

7) Perks:

Perks or Perquisites constitute a major source of income for the executives. The perks like vacations, club membership, well furnished accommodation, vehicle facilities are some direct form of compensation which comes under the category of perks.

The scope of direct compensation does not include:

- Benefits
- Retirement plans
- Leaves
- Employee services
- Education

2. Indirect Compensation:

As the name suggests, indirect compensation is a type of compensation an employer pays to his/her employees indirectly. It is important to pay indirect compensation because in a tight labor market, it has become increasingly significant to attract and retain the talent. Some of the indirect compensation alternatives are:

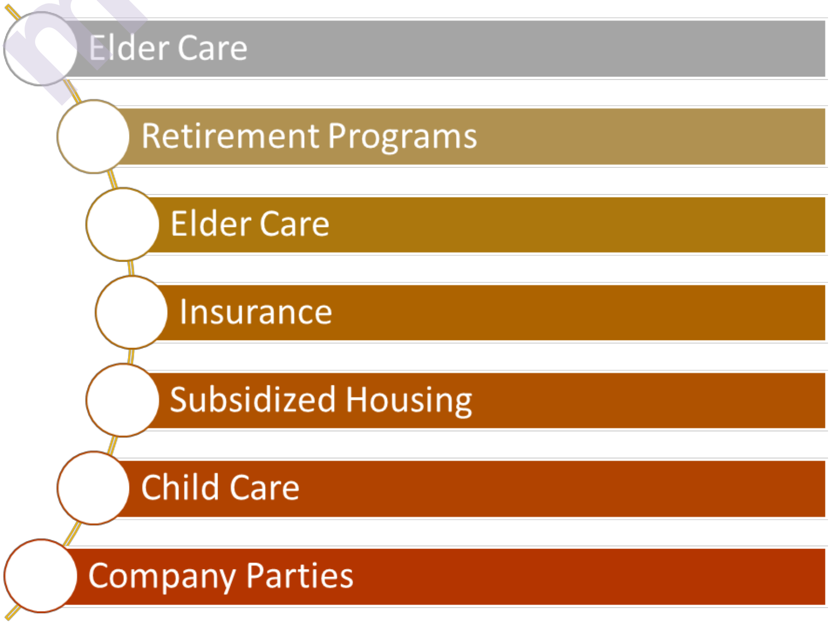

Fig. 5.3 Alternatives of Indirect Compensation

Apart from the alternatives mentioned in the diagram, an organization adopts the following types as an indirect compensation:

- Flexible working schedules
- Moving expenses
- Paid leaves
- Subsidized utilities
- Events tickets
- Magazines subscription
- Boots and clothing
- Laundry services
- Use of machineries
- Cellular phones etc.

5.4 CONCEPT OF STOCK OPTION

5.4.1 Meaning:

Stock options are popularly known as Employee Stock Option. Employee Stock Option is a contract between two parties that gives the buyer the right to buy or sell underlying stocks at a predetermined price and within a specified time period.

There are two types of stock option:

- Call Option
- Put Option

A seller is paid a premium from the contract purchased by the buyer and known as option writer. He is the one who sells the stock option to the employees. This practice of compensation is also known as equity option. Many companies are offering equity to their employees. As the name suggests, it is an option not an obligation on the part of the investor.

The employee stock option is a type of equity compensation. It is granted by the companies to their executives and employees. In this type of compensation rather than granting shares of stock directly, the company gives derivative options on the stock instead. The great benefit of this type of compensation can be determined when the stock prices of the company rises.

It also contributes in increasing the worth of the employees in terms of the stocks they have in their names. It provides an opportunity to employees to share directly in the company's success through stock holdings. As the employees own a stake in the company, they feel more productive and motivated. From the employer's point of view, it is understood that a productive employee produces more. The employee stock option boosts job satisfaction. It also helps them to boost their financial strength. It is a key tool to recruit the best and retain the best.

5.4.2 Conceptual Framework:

The following pictures depict the conceptual framework of the compensation:

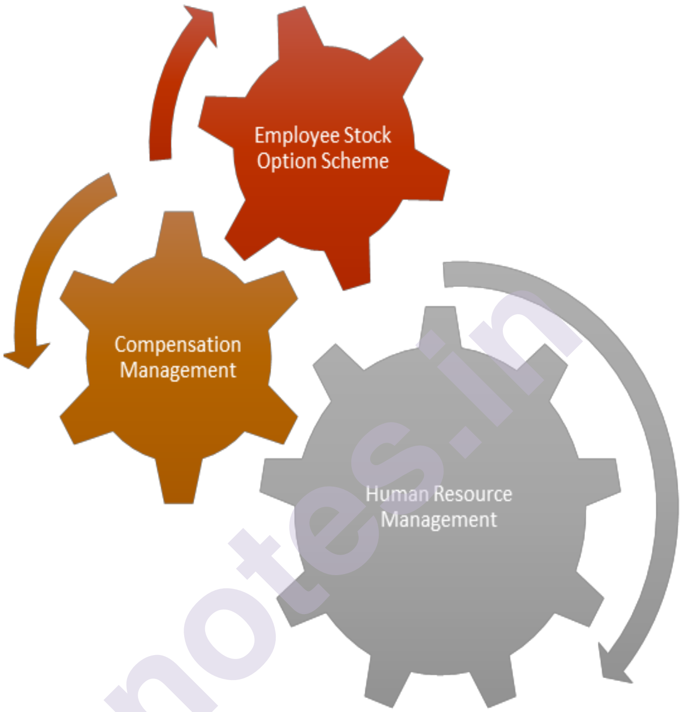

Fig.5.4: Interrelationship Between HRM, CM and ESOS

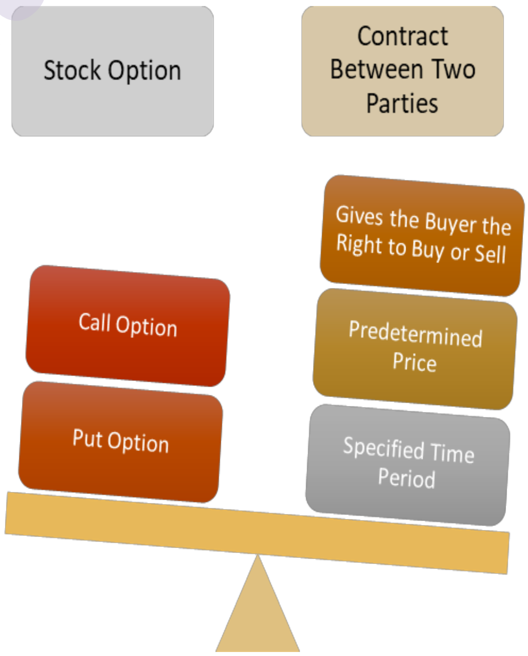

Fig. 5.5: Concept of Stock Option

5.5 UNDERSTANDING THE ELEMENTS OF STOCK OPTION

To understand the elements of the stock option, it is important to understand the following features of stock option:

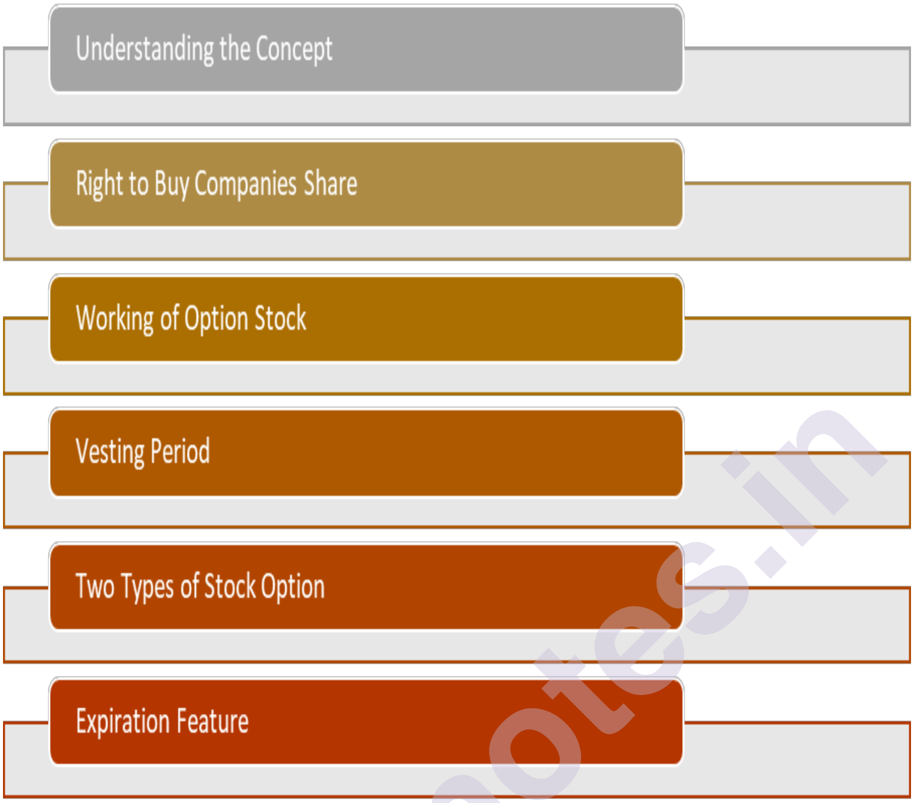

Fig. 5.6: The Key Features/Elements of Stock Option

1. Understanding the Concept:

Stock options are popularly known as Employee Stock Option. Employee Stock Option is a contract between two parties that gives the buyer the right to buy or sell underlying stocks at a predetermined price and within a specified time period. There are two types of stock options - Call Option and Put Option.

The employee stock option is a type of equity compensation. It is granted by the companies to their executives and employees. In this type of compensation rather than granting shares of stock directly, the company gives derivative options on the stock instead. The great benefit of this type of compensation can be determined when the stock prices of the company rises. It also contributes in increasing the worth of the employees in terms of the stocks they have in their names.

2. Right to Buy Companies Share:

The employees of the organization get rights to buy the companies share at a fixed price. A seller is paid a premium from the contract purchased by the buyer and known as option writer. He is the one who sells the stock option to the employees. This practice of compensation is also known as equity option. Many companies are offering equity to their employees. As the name suggests, it is an option not an obligation on the part of the investor.

3. Working of Stock Option:

The option value can go up and down. It is not easy to understand the working of a stock option. One must have some knowledge of finance when it comes to understanding this topic. The option can go up and down. The great benefit of this type of compensation can be determined when the stock prices of the company rises.

4. Vesting Period:

Vesting is a word which deals with acquiring the stock option of a company. It is a process by which an employee acquires a "vested interest" or "stock option" in their company. It is a process of earning like an asset.

5. Two Types of Stock Option:

Companies can offer or grant two types of stock option:

a. Non-qualified Stock Option

b. Incentives Stock Options

Non-qualified stock options do not qualify for special tax treatment. While, incentives stock options qualify for special tax treatment.

6. Expiration Feature:

The term of the stock option is limited. If it is not exercised within the time limit, it may expire. Stock options always have a limited term during which they can be exercised. The most common term is 10 years from the day of grant.

5.6 SUMMARY

- Compensation helps to determine the employees wages and salary. A good compensation model can help to reinforce the key corporate values and facilitate the achievement of organizational objectives. In the globalization era, where the business environment has become increasingly challenging, an effective compensation system helps to attract the talent candidates for the organization. Compensation is an organized practice and it also represents the most important element in the employment relationship. The structure comprises a number of different elements that may be cash and non-cash payments.

- As mentioned many times, compensation is the most important human resource function of an organization. There are various important elements of compensation. While designing a successful

compensation package, one must consider the following elements - Direct Compensation and Indirect Compensation.

- Direct compensation is a form of compensation an employer pays to his employee directly for his/her services rendered for the work in an organization. It can be paid in the form of wages, salaries, commissions and bonuses that an employer provides regularly and consistently.
- As the name suggests, indirect compensation is a type of compensation an employer pays to his/her employees indirectly. It is important to pay indirect compensation because in a tight labor market, it has become increasingly significant to attract and retain the talent.
- Stock options are popularly known as Employee Stock Option. Employee Stock Option is a contract between two parties that gives the buyer the right to buy or sell underlying stocks at a predetermined price and within a specified time period. There are two types of stock options - Call Option and Put Option.
- It is important to understand the elements of stock options.

5.7 SELF ASSESSMENT TESTS

1. Identify the major components of compensation management.
2. Explain the various types of Compensation. Describe the types in detail.
3. Distinguish between direct compensation and indirect compensation.
4. Explain the various important elements of direct compensation? How do they affect the employees performance and productivity?
5. Explain the various important elements of indirect compensation? How do they affect the employees performance and productivity?
6. Describe the concept of Stock Option. Explain the salient features of stock options.
7. Write a note on understanding the elements of stock options.

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6

COST TO COMPANY (CTC)

Unit Structure

6.0 OBJECTIVES

After studying this module, you should be able to :

- Understand the nature and relevance of compensation
- Know about the Elements of compensation
- Understand the Concept of CTC
- Know about the Compensation Structure
- Understand Costing the CTC of each element of Compensation Structure

6.1 INTRODUCTION

Compensation is the most important element in the employment relationship. For the employees, a proper compensation system raises his standard of living. Compensation is a systematic approach of providing monetary value to employees in exchange for the work or services they performed. If they receive good remuneration, it increases their performance and productivity.

The concept of Cost to Company is not a new term. In the field of human resource management, it plays a vital role. Cost to company is a term which denotes the total cost a company bears for an employee. The components of CTC are monetary and non-monetary. When a company bears any kind of cost on employees, it comes under the section of Cost to Company.

It is basically calculated yearly. Employees may not directly receive CTC in cash. Candidates often come across this term when they negotiate with the company about their salary. CTC and Take Home Salary are some basic terms which a candidate needs to understand before applying or joining any organization. If an organization is paying on any facility, it will come under CTC.

Every organization calculates CTC. It is also known as gross salary. Cost To Company is calculated by adding Basic Salary and other additional benefits that employees receive such as Gratuity, Employees Provident Fund, House Rent Allowance, Travel Allowance, Food coupons, and so on.

In the salary description of the organization. Many elements are listed in the salary package of an employee. Compared to the CTC, there is one term: Take Home Salary. Take Home Salary is the exact thing is the exact amount an employee takes home. It means it is the amount which gets deposited in the account of the employees after all the necessary deductions like:

- Tax Deducted at Source
- Provident Fund Etc.

6.2 ELEMENTS OF COMPENSATION

As mentioned many times, compensation is the most important human resource function of an organization. There are various important elements of compensation. While designing a successful compensation package, one must consider the following elements -

1. Direct Compensation
2. Indirect Compensation

1. Direct Compensation:

Direct compensation is a form of compensation an employer pays to his employee directly for his/her services rendered for the work in an organization. It can be paid in the form of wages, salaries, commissions and bonuses that an employer provides regularly and consistently. The following are the elements of direct compensation -

1) Base Pay:

The first component of direct compensation is base pay. It is the first element of executive remuneration. The base pay is determined through the evaluation of the job. Job evaluation is a process through which the job of a person is evaluated through the level of skills, efforts and responsibility required to perform the jobs.

The subject matter of base pay includes:

Salary:

Salary is a term used to indicate a fixed amount of money or compensation paid to an employee by an employer in return for work performed.

Wages:

Wages is a term used to indicate an amount of money or compensation paid to a labor/worker by an employer in return for work performed.

2) Commissions:

Commissions form another important element of compensation management. Commissions are a sum of money paid to an employee upon completion of a task, usually selling a certain amount of goods or services. Commission along with salary or alone are often considered as an allowance paid to the employees for the sales target or the work which is commission based.

Direct compensation can be in the form of commissions that an employer provides regularly and consistently.

3) Bonus:

Bonus is a gift paid to an employee occasionally to reward the exceptional performance or for some special occasions. The concept of bonus plays a vital role in today's competitive executive payment program. In the form of bonuses, an employer appreciated his/her employees. This type of incentive is special and occasionally given to the employees.

According to the definition of Cambridge Dictionary, "Bonus is an amount of money given to an employee in addition to their salary as a reward for working well.

The following are the types of bonuses namely,

a. Production Bonus

b. Profit Bonus

c. Customary Bonus

d. Implied Bonus (Bonus as an implied term)

4) Stock Options:

Stock options are popularly known as Employee Stock Option. Employee Stock Option is a contract between two parties that gives the buyer the right to buy or sell underlying stocks at a predetermined price and within a specified time period. There are two types of stock option -

- Call Option
- Put Option

5) Profit Sharing:

Profit sharing is a plan in which an employer gives the right to an employee to be a part of profit sharing of the organization. It is a type of pre-tax contribution plan for employees that gives workers a certain amount of a company's profits. The amount of profit sharing is up to the company how much they would like to share with the employees.

The profit sharing depends on the following elements:

- Amount set by the Employer
- Profitability of the Business
- Working Capital Needs of the Business
- Amount of Wages and Salaries

6) Piece Rate:

When the workers are paid by the units performed, this system is known as Piece rate. The Piece Rate is also known as Piece Work Pay. Understanding what Piece rate is important. Complying with the wages and overtime allowances is also a part of the Piece Rate system. The system to be effective must be transparent.

7) Perks:

Perks or Perquisites constitute a major source of income for the executives. The perks like vacations, club membership, well furnished accommodation, vehicle facilities are some direct form of compensation which comes under the category of perks.

The scope of direct compensation does not include:

- Benefits
- Retirement plans
- Leaves
- Employee services
- Education

2. Indirect Compensation:

As the name suggests, indirect compensation is a type of compensation an employer pays to his/her employees indirectly. It is important to pay indirect compensation because in a tight labor market, it has become increasingly significant to attract and retain the talent. Some of the indirect compensation alternatives are:

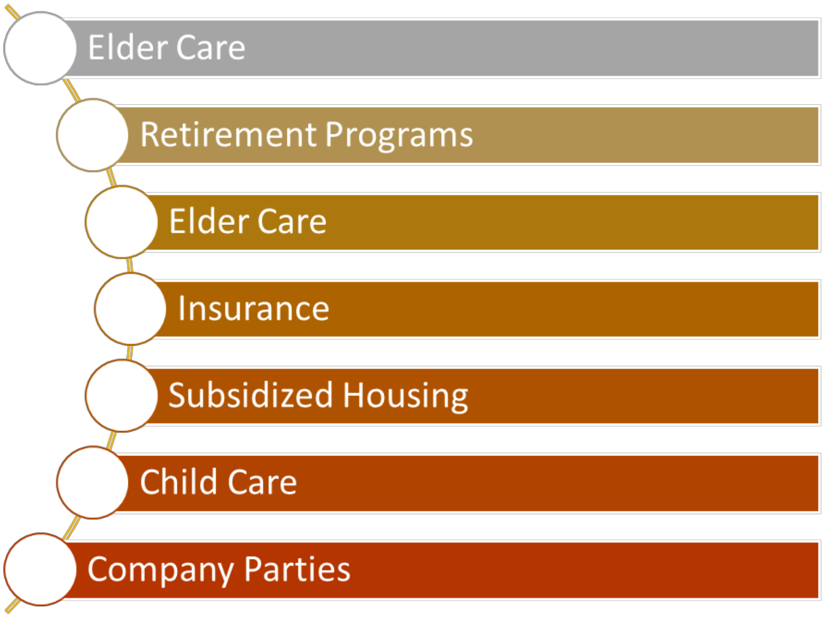

Fig. 6.1: Alternatives of Indirect Compensation

Apart from the alternatives mentioned in the diagram, an organization adopts the following types as an indirect compensation:

- Flexible working schedules
- Moving expenses
- Paid leaves
- Subsidized utilities
- Events tickets
- Magazines subscription
- Boots and clothing
- Laundry services
- Use of machineries
- Cellular phones etc.

6.3 COMPENSATION STRUCTURE

A compensation structure helps to determine the level of compensation an organization is ready to pay to employees. A compensation structure includes all the items which are the elements of compensation. Most people think the pay and compensation is the same, but the fact is compensation is a comprehensive term and covers all the monetary and non-monetary rewards provided by an employer to an employee.

While determining the compensation structure, the few points have to consider:

Cost to Company (CTC)

Fig. 6.2: Components of Salary Structure

1. The most important goal in designing a compensation structure is supporting the strategic objectives of the organization.

2. Determining the number of pay structures is another important component. Depending upon the market rate and the structure of the organization, many firms decide more than one pay structure.

3. Determining the internal pay equity is another component of a compensation structure. The internal pay equity determines the fairness within the organization.

4. Determining the external pay equity is another component of a compensation structure. The external pay equity is the perceived

fairness in pay relative to what other employees are paying for the same type of labor.

5. Determining a market pay line is another important component of compensation structure. Market pay line is a rate which the market offers and is considered as a prevailing pay rate in the market.

6. Designing pay grades and salary structure is another important part of compensation structure. Different pay for different level jobs is an important task to be determined under this section.

7. Computing the pay grades for each pay also constitutes the important element of a compensation structure.

8. Once all the homework is done, designing of salary structure takes place.

6.4 CONCEPT OF CTC

6.4.1 Overview:

Cost to company is a term which denotes the total cost a company bears for an employee. The components of CTC are monetary and non-monetary. When a company bears any kind of cost on employees, it comes under the section of Cost to Company.

It is basically calculated yearly. Employees may not directly receive CTC in cash. Candidates often come across this term when they negotiate with the company about their salary. CTC and Take Home Salary are some basic terms which a candidate needs to understand before applying or joining any organization. If an organization is paying on any facility, it will come under CTC.

Every organization calculates CTC. It is also known as gross salary. Cost To Company is calculated by adding Basic Salary and other additional benefits that employees receive such as Gratuity, Employees Provident Fund, House Rent Allowance, Travel Allowance, Food coupons, and so on.

In the salary description of the organization. Many elements are listed in the salary package of an employee. Compared to the CTC, there is one term: Take Home Salary. Take Home Salary is the exact thing is the exact amount an employee takes home. It means it is the amount which gets deposited in the account of the employees after all the necessary deductions like Tax Deducted at Source, Provident Fund Etc.

CTC is calculated as,

CTC = Gross salary + Allowances + Deductibles

1. Basic Salary:

Basic salary is the amount payable to the employees for the services they render to an organization. The basic salary is deducted under the head of income tax. It forms a part of their take home salary.

2. Allowances:

Allowances are all the perks and benefits (direct and indirect) that the company offers to the employee. The perks and benefits includes:

- Dearness Allowance
- Medical Allowance
- Entertainment Allowance
- Conveyance Allowance
- House Rent Allowance
- Other Allowances

3. Compulsory Deductibles:

The final component of CTC is compulsory deductibles. These deductions are Provident Fund, Professional Tax and Income Tax.

CTC is the cost an employer bears to hire and sustain its employees.

6.5 COSTING THE CTC OF EACH ELEMENT OF COMPENSATION STRUCTURE

The components of CTC are monetary and non-monetary. The following are the components of CTC:

- Basic Pay
- Dearness Allowance (DA)
- Incentives or bonuses
- Conveyance allowance
- House Rent Allowance (HRA)
- Medical allowance
- Leave Travel Allowance or Concession (LTA / LTC)
- Vehicle Allowance
- Telephone / Mobile Phone Allowance
- Special Allowance

1. Basic Pay:

Basic pay or basic salary is a fixed amount paid to employees by their employers in return for the work performed or performance of professional duties by the employee. It is the amount apart from surplus or additional factors, such as bonuses, benefits or compensation from an employer's end. Basic Pay includes:

Gross Pay: Total allowances (Medical Insurance, HRA, DA, Conveyance, etc.)

Or

Basic Salary = Percentage of the CTC or Gross Pay

2. Dearness Allowances:

Dearness allowance is a component of salary which is some fixed percentage of the basic salary, aimed at hedging the impact of inflation. It is paid by the government to its employees as well as pensioners to offset the impact of inflation. It is calculated as-

For the employees of Central Government

% of DA = {(Average of the All-India Consumer Price Index (Base year - 2001 =100) for the last 12 months -115.76)/115.76} x 100

For Central Public Sector Employees

% of DA = {(Average of the All-India Consumer Price Index (Base year - 2001 =100) for the last 3 months -126.33)/126.33} x 100

3. Incentives or Bonuses:

Incentives are rewards and benefits used to motivate positive behaviors in your workforce. Incentives in the form of compensation, reimbursement, recognition, and rewards are given to employees to motivate and boost their morale.

Bonus is a financial compensation an employer pays to his/her employees. Bonus is a gift paid to an employee occasionally to reward the exceptional performance or for some special occasions. The concept of bonus plays a vital role in today’s competitive executive payment program. In the form of bonuses, an employer appreciated his/her employees. This type of incentive is special and occasionally given to the employees.

According to the definition of Cambridge Dictionary, “ Bonus is an amount of money given to an employee in addition to their salary as a reward for working well.

The following are the types of bonuses namely, Production Bonus, Profit Bonus, Customary Bonus and Implied Bonus.

4. Conveyance Allowance:

As the name suggests, conveyance allowance is paid to an employee to compensate for the travel they have to undertake from their residence to the workplace. It is also called a transport allowance. Conveyance allowance is paid by an employer only if there is no transportation provided by the employer. In case an employer offers transport, conveyance allowance will not be provided to employees.

5. House Rent Allowance:

House Rent Allowance is popularly known as HRA. House Rent Allowance an amount that an employer pays an employee to compensate for rent paid to live in the place of employment. In Income Tax, HRA means house rent allowance which is paid by an employer to the employee.

6. Medical Allowance:

A medical allowance is a fixed payment that employers provide to employees to cover their medical expenses. The Owner provides this benefit to promote staff health and support medical expenses that workers incur in a financial year. As per the Income Tax rules, No tax is levied on medical reimbursement up to Rs. 15,000 if all bills are furnished by an employee to his or her employer as per clause (b) of Section 17 (2) of the IT Act, 1961.

7. Leave Travel Allowance or Concession (LTA / LTC):

Leave Travel Allowance is a form of stipend given by an employer to an employee who is on leave from work to fund his or her travel.

Leave Travel Concession (LTC) is granted to Central Government employees for travel to various parts of the country and home as well. Leave Travel Allowance is one of the best tax-saving tools that an employee can avail.

8. Vehicle Allowance:

Vehicle allowance is also a transport allowance. It is an allowance given to meet commuting expenses between place of residence and office or to meet personal expenditure of employees of transport business. Few companies pay car maintenance allowance to their employees.

9. Telephone/ Mobile Phone Allowance:

As the name suggests, Telephone/Mobile allowance is an allowance which The company pays monthly to employees as compensation for the use of mobiles or telephones for office or personal use.

10. Special Allowance:

Companies pay these allowances which are special and not general in nature. Special allowance is a sum of money that an organization pays its employees for various reasons. The examples are:

- Tuition fees allowance for children
- Children Education Allowance
- Hostel Allowance
- Underground Allowance

6.6 SUMMARY

- Compensation is the most important element in the employment relationship. For the employees, a proper compensation system raises his standard of living. Compensation is a systematic approach of providing monetary value to employees in exchange for the work or services they performed. If they receive good remuneration, it increases their performance and productivity.
- Every organization calculates CTC. It is also known as gross salary. Cost To Company is calculated by adding Basic Salary and other additional benefits that employees receive such as Gratuity, Employees Provident Fund, House Rent Allowance, Travel Allowance, Food coupons, and so on.
- Direct compensation is a form of compensation an employer pays to his employee directly for his/her services rendered for the work in an organization. It can be paid in the form of wages, salaries, commissions and bonuses that an employer provides regularly and consistently.
- As the name suggests, indirect compensation is a type of compensation an employer pays to his/her employees indirectly. It is important to pay indirect compensation because in a tight labor market, it has become increasingly significant to attract and retain the talent.
- A compensation structure helps to determine the level of compensation an organization is ready to pay to employees. A compensation structure includes all the items which are the elements of compensation. Most people think the pay and compensation is the same, but the fact is compensation is a comprehensive term and covers all the monetary and non-monetary rewards provided by an employer to an employee.
- Cost to company is a term which denotes the total cost a company bears for an employee. The components of CTC are monetary and non-monetary. When a company bears any kind of cost on employees, it comes under the section of Cost to Company.
- It is basically calculated yearly. Employees may not directly receive CTC in cash. Candidates often come across this term when they negotiate with the company about their salary. CTC and Take Home Salary are some basic terms which a candidate needs to understand

before applying or joining any organization. If an organization is paying on any facility, it will come under CTC.

- The components of CTC are monetary and non-monetary. The following are the components of CTC - Basic Pay, Dearness Allowance (DA), Incentives or bonuses, Conveyance allowance, House Rent Allowance (HRA), Medical allowance, Leave Travel Allowance or Concession (LTA / LTC), Vehicle Allowance, Telephone / Mobile Phone Allowance and Special Allowance.

6.7 SELF ASSESSMENT TESTS

1. Identify the major components of compensation management.
2. Explain the various types of Compensation. Describe the types in detail.
3. Distinguish between direct compensation and indirect compensation.
4. Explain the various important elements of direct compensation? How do they affect the employees performance and productivity?
5. Explain the various important elements of indirect compensation? How do they affect the employees performance and productivity?
6. Explain the concept of CTC. How is it calculated?
7. What is CTC? Explain the various elements which an employer considered while calculating CTC.
8. What comes under the scope of CTC? Explain the various components of CTC.

*****

7

UNDERSTANDING INFLATION

Unit Structure

7.0 OBJECTIVES

After studying this module, you should be able to:

- Understand the meaning and concept of inflation.
- Know about the causes of inflation.
- Understand the impact of inflation.
- Know the measures to control inflation.

7.1 INTRODUCTION

The term "Inflation" is associated with the excessive money supply. It is a monetary phenomenon which denotes a condition of an economy of rising prices with a reduction in the purchasing power of money. Inflation is the result of disequilibrium between demand and supply forces and is attributed to increase in the demand for goods and services and a decrease in the supply of goods in the economy.

In relation to the aggregate supply, the excess aggregate demand of goods and services is the essence of inflation. Many modern and old countries have suffered from inflation. The most famous and remarkable inflation was the hyperinflation of Germany, Zimbabwe and Sri Lanka. During the year of 1932, the people in Germany went to the market with wheelbarrows full of money to buy a few groceries.

The term ‘Inflation’ implies a reduction in the purchasing power of money with the increase in general price level. It reflects a loss of value in the medium of exchange. The situation denotes a condition where there is a sustained increase in the general price level of goods and services. It refers to a specific period of time. In inflation, the money supply exceeds in the market due to increasing general price levels.

With the decrease in purchasing power of money, people tend to buy fewer goods and services. The money chases the goods in more quantity as it denotes a situation where values of money also diminishes. It always denotes a upward trend in the general price level and downward trend in calculating the value of money. While measuring the level of inflation, a large number of goods and services used by the people of a country is taken into consideration while calculating the inflation rate.

Deflation is opposite to inflation. As inflation is a state of rising prices, deflation is a state of falling prices.

7.2 MEANING OF INFLATION

7.2.1 What Is Inflation?

In simple words, inflation is a phenomenon of rising prices with the falling value of money. It is a condition where the general price level increases with the fall in the value of money. When the people get the things more expensive compared to the normal level, this condition is said to be inflation. It is a state at which the purchasing power of people decreases. They remain in a situation to buy fewer goods in terms of more money.

The condition is inflation beyond the limit is not considered good for any economy. The hyperinflation of Germany is famous in this regard. A small or sudden rise in prices is not considered inflation. A general increase in prices with a reduction in the purchasing power of money is called inflation. The general price level tends to rise during inflation with a reduction in the purchasing power or value of money.

During inflation, the following aspects of economy tends to increase:

- Money supply
- Public expenditure
- Amount of black money
- Investment
- Profits of business class
- Factors prices

There are numerous reasons which contribute to increasing inflation in an economy. Due to increasing population, the demand for goods is higher than the growth rate of output in the country. This also causes the prices to rise.

7.2.2 Definition:

Let's have a look in understanding few definitions of inflation -

According to **Coulborn,** “Inflation is the stage of too much money chasing too few goods.”

G. Ackley defined inflation as “a persistent and appreciable rise in the general level or average of prices.”

In the words of **Johnson,** “Inflation is an increase in the quantity of money faster than real national output is expanding.”

According to **Sameulson,** “By inflation, we mean a time of generally rising prices.”

In the words of **Peterson,** “The word inflation in the broadest possible sense refers to any increase in the general price-level which is sustained and non-seasonal in character.”

According to **Keynes,** “True inflation is the one in which the elasticity of supply of output is zero in response to increase in supply of money.

From the above definitions, we can say that inflation means a general price rise against a standard level of purchasing power. When the people get the things more expensive compared to the normal level, this condition is said to be inflation. It is a state at which the purchasing power of people decreases.

7.2.3 Conceptual Framework:

The following pictures depict the conceptual framework of the compensation:

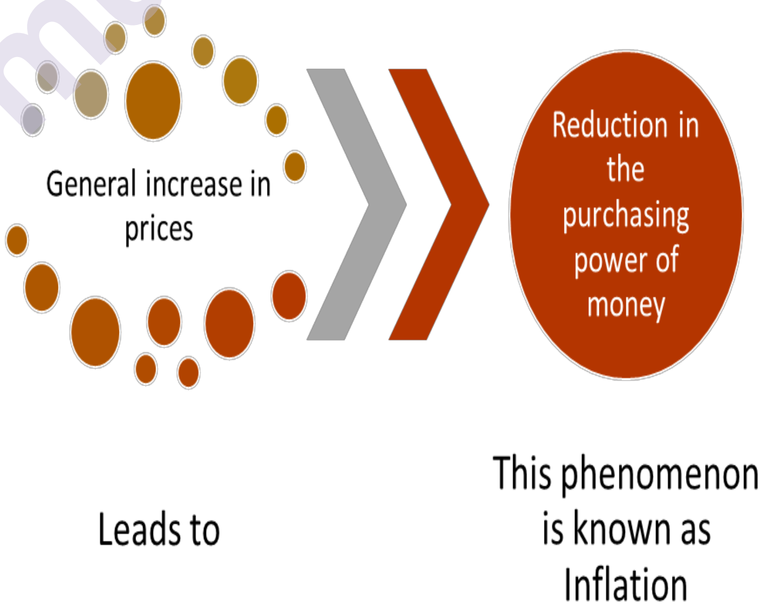

Fig. 7.1: Concept of Inflation

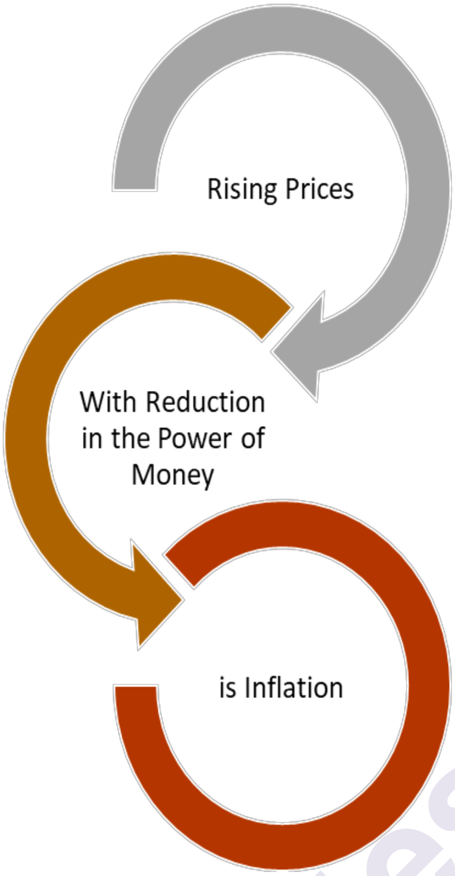

Fig. 7.2: Concept of Inflation

7.3 THEORIES OF INFLATION

There are two theories of Inflation:

1. Demand Pull Inflation
2. Cost Push Inflation

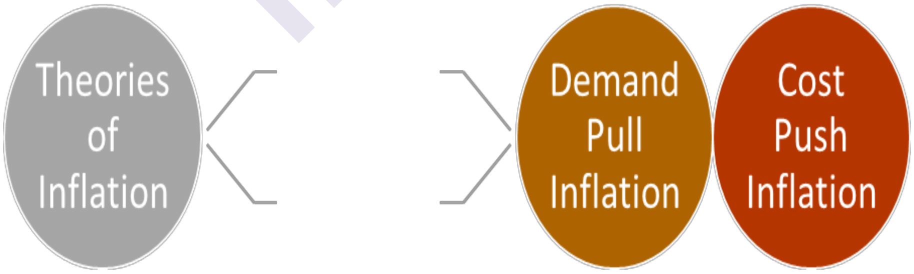

Fig. 7.3: Theories of Inflation

1. Demand Pull Inflation:

Demand pull inflation is considered as the oldest theory of price rise. It is a situation in which the aggregate demand exceeds the aggregate supply of goods and services. In this situation, the demand grows at an unstoppable rate. This theory is also known as excess demand inflation. This denotes a condition where too much money chases too few goods.

2. Cost Push Inflation:

Cost push inflation is a situation in which aggregate demand is falling but the cost of production is rising. The rise in cost of production leads to increase in price level. The rise in cost of production could be due to -

- Rise in the prices of raw material
- Labor
- Increase in profit
- Increase in the price of any other factor of production

7.4 CAUSES OF INFLATION

Inflation is the result of disequilibrium between demand and supply forces. The forces are attributed to:

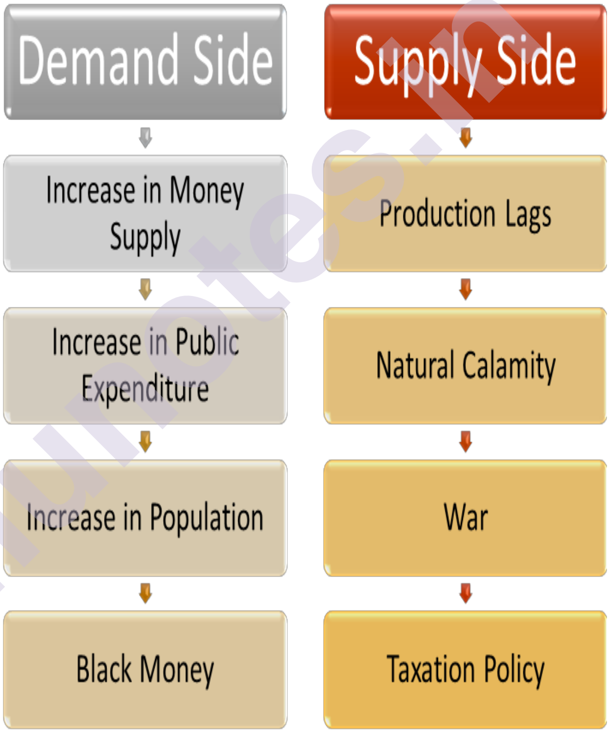

Fig. 7.4: Causes of Inflation

1. Demand Side:

An increase in the demand for goods and services in the country is one of the main causes of inflation. The demand is increasing due to following reasons:

i) Increase in Money Supply:

The first cause of increasing demand is an increase in money supply in an economy. An increase in the money supply leads to an increase in money income. More quantity of money raises the monetary value of goods and services and thus it reduces the value of money in terms of purchasing power.

ii) Increase in Public Expenditure:

One of the major causes of inflation is increase in public expenditure. Increase in public expenditure leads to an increase in the purchasing power. The increase in the purchasing power leads to more increase in demand for goods and services.

iii) Increase in Population:

Though the prices are rising, with the increasing population the demand for the products is also rising. The demand for goods is higher than the rate of output in the country. This is also one of the reasons that the demand for the goods is rising and due to increasing demand, this causes prices to rise.

iv) Black Money:

The money which is not authorized or accounted for is known as black money. It is not the color but the feature which calls the unaccounted money as black money. Black money is the outcome of tax evasion. Tax evasion money is flaunted and spended by people unconsciously.

2. Supply Side:

A decrease in the supply of goods in the economy is one of the main causes of inflation. The supply is decreasing due to following reasons -

i) Production Lags:

The delay or lag in production is one of the fundamental reasons from the supply side of inflation. When the production falls due to strikes, lockouts, scarcity of raw material etc. leads to the reduction in the supply of goods. Demand for the goods is increasing or the same but supply is not increasing due to multiple factors. This causes inflation to rise.

ii) Natural Calamity:

Due to natural calamities like flood, drought, earthquake, the production of agricultural goods get affected. Agricultural production occurs occasionally and it is affected by the multiple factors of nature. Sometimes, heavy rainfall destroys crops. Sometimes, no rainfall or low rainfall destroys crops.

iii) War:

During war, the production of consumer goods get affected. During wartime, the production of consumer goods falls heavily. The productive resources are diverted and become unproductive due to war. The scarcity of consumer goods leads to inflation.

iv) Taxation Policy:

The taxes like sales tax, excise duty, corporation tax discount\get the money flow of a businessman. It results in discouragement of production. This fall in production results in scarcity and price rise.

7.5 IMPACT OF INFLATION

The following are the effects of inflation on the various parameters:

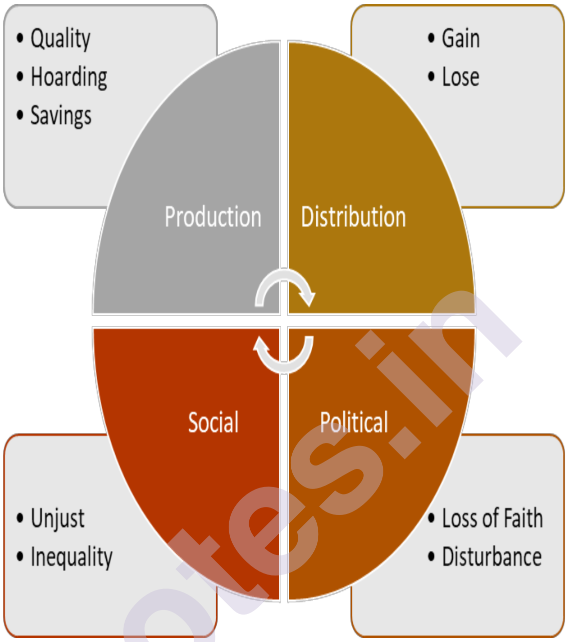

Fig. 7.5: Impact of Inflation

1. Effects on Production:

In the initial stages, the mild inflation has a favorable effect on production. When the level of inflation stimulates, it has an unfavorable effect on production such as:

- The quality of goods gets reduced.
- Businesses start hoarding goods to earn more profit by certain artificial scarcity.
- Savings and capital accumulation gets affected adversely.
- It discourages foreign capital.
- Businesses change their pattern of production

2. Effects on Distribution:

The effect of inflation is different on the different sections of the society. The effects of distribution in terms of losing and gaining are as follows:

- The creditors lose as they receive money when the purchasing power of money is low.

- The debtors gain because when they repay the purchasing power of money is low.
- The farmers gain because the prices of agricultural products increase.
- The business community gains as they earn more profit from the rising prices.
- The fixed income group is worst affected because expenses increase but the income stands the same.
- The impact on balance of payment is also adverse.
- The shareholders gain as companies earn profit.
- The debenture holder loses as the interest amount is fixed and the purchasing power of money is low.

3. Political Effects:

Inflation gives discontentment in the public. They lose their faith in the government. They feel the government is unable to control inflation. It results in social degradation as well.

4. Social Effects:

Socially, inflation is always considered unjust. It increases the inequalities between the rich and poor. The morality of businesses are affected. People do get involved in black marketing. It results in moral degradation. The activities like profiteering, adultering, hoarding increases.

7.6 MEASURES TO CONTROL INFLATION

The following are the measures to control inflation:

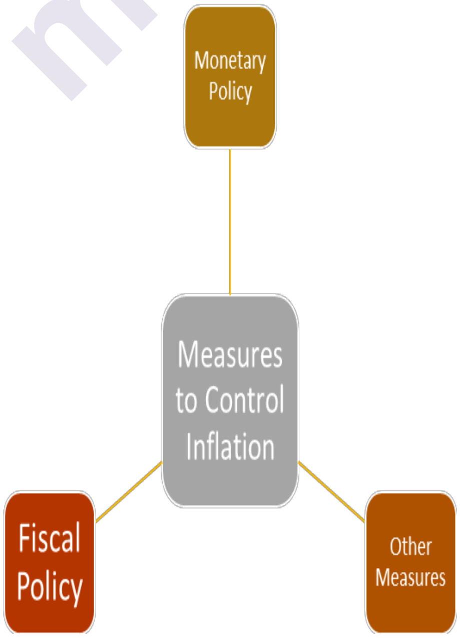

Fig. 7.6: Measures to Control Inflation

1. Monetary Policy:

Monetary policy is the policy of the central bank regarding the control and regulation of money supply in the economy. To control the inflation, the following measures are taken under this head:

- The Central Bank increases bank rate to raise the market rate of interest.
- Under the open market operations, the Central Bank sells the government securities.
- The Central bank increases the cash reserve ratio.

2. Fiscal Policy:

The policy of the government relating to taxation, public borrowings and public expenditure is known as fiscal policy. Under fiscal policy, the following methods are adopted:

- Government increase taxes
- Government reduces its expenditure
- Government incurs public debt
- Government repay the old debts

3. Other Measures:

Under this head, the following measures are adopted to control inflation:

- Production is regulated to avoid the situation of underproduction.
- Quotas are getting fixed.
- Price control
- Exports is reduced

7.7 SUMMARY

- The term 'Inflation' implies a reduction in the purchasing power of money with the increase in general price level. It reflects a loss of value in the medium of exchange. The situation denotes a condition where there is a sustained increase in the general price level of goods and services. It refers to a specific period of time. In inflation, the money supply exceeds in the market due to increasing general price levels.
- In simple words, inflation is a phenomenon of rising prices with the falling value of money. It is a condition where the general price level increases with the fall in the value of money. When the people get the things more expensive compared to the normal level, this condition is said to be inflation. It is a state at which the purchasing power of

people decreases. They remain in a situation to buy fewer goods in terms of more money.

- Demand pull inflation is considered as the oldest theory of price rise. It is a situation in which the aggregate demand exceeds the aggregate supply of goods and services. Cost push inflation is a situation in which aggregate demand is falling but the cost of production is rising.
- Inflation is the result of disequilibrium between demand and supply forces. The forces are attributed to demand side and supply side.
- The impact of inflation adversely affects the production, distribution, political conditions and the social status.
- With the help of monetary and fiscal policy, inflation can be controlled.

7.8 SELF ASSESSMENT TEST

1. Define inflation. Explain the theories of inflation.
2. What is inflation? What are the causes of inflation? Suggest measures to control it.
3. Give the remedies to control inflation.
4. Write the effects of inflation.
5. What is inflation and deflation? How does the economy get affected?
6. Explain the various causes of inflation.

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8

UNDERSTANDING VARIOUS ACTS

Unit Structure

8.0 OBJECTIVES

After studying this module, you should be able to:

- Understand the nature and relevance of social security legislations.
- Importance of social security legislations in India.
- Know the relevance of Gratuity Act 1972.

- Assess the objectives of Provident Fund Act and Miscellaneous Provisions Act.
- Understand the important provisions of the Workmen's Compensation Act 1923.

8.1 INTRODUCTION

The regulative laws of labor establish a legal system that facilitates productive individual and collective employment relationships and hence a productive economy. It helps to regulate the various aspects of the factory and industries. The Central and State Government is empowered to enact laws and regulation for the betterment of workers and employees. The Constitution of India has empowered the Central and the State Government to take care of and to protect the interest of the workers. The Ministry of Labor and Employment is responsible to protect and safeguard the interest of workers. They are also responsible for safeguarding the interest of poor, marginal and disadvantaged sections of the society.

Social security legislations are essential because it is the security that society furnishes, through appropriate organization, against certain risks to which its members are exposed. The concept of social security is essentially related to the higher ideals of human dignity and social justice. The term social security came into general use after the year 1935. In the same year, the US passed the social security act introducing the old age pension scheme. The scheme was administered by the Federal Government and paid for by employers and employees.

The International Labor Organization plays an important role in social security legislation. In 1919, the formation of the International Labour Organisation to promote the concept of Social Justice through International standards, by providing information, technical assistance and guidance and most important through cooperation with other international organizations was promoted to ensure this concept for laborers.

India was a founder member of the ILO. The Social Security (Minimum Standards) Convention No. 102, adopted by the International Labour Conference on 28th June, 1952, defines the nine branches of social security benefit. The benefits for the laborers are:

1. Medical Care
2. Sickness benefit
3. Unemployment Benefit
4. Old-age Benefit
5. Employment Injury Benefit
6. Family Benefit
7. Maternity Benefit

8. Invalidity Benefit

9. Survivors Benefit

The evolution of social security provisions, acts and measures in India had been rather slow. The state bears the primary responsibility for developing the correct system for providing protection and assistance to its workforce. In India, the schemes are designed to guarantee the long-term substance to families when the earning member retires and dies and suffers a disability. The social security system acts as a facilitator and helps the workers to plan their own future through insurance and assistance.

According to the International Labour Organisation, "social security is the security that society furnishes, through appropriate organization, against certain risks to which its members are exposed. These risks are essentially contingencies against which the individual of a small means cannot effectively provide by his own ability of foresight alone or even in private combination with his fellows."

Social security legislation in India in the industrial sector consists of the following important enactments:

1. The Workmen's Compensation Act 1923
2. The Employees State Insurance Act, 1948
3. The Gratuity Act, 1972
4. The Provident Fund Act and Miscellaneous Provisions Act, 1952
5. The Maternity Benefit Act, 1961

In a country like India the problem of poverty is commonly seen. Illiteracy and unemployment is another problem our country is facing. The problem of unemployment is in practice and the population is ever increasing. As of today, social security seems to be the need of the hour because the only resource that is available in ample in India is labor. The above acts Important provisions to provide the social security in terms of compensation, insurance, gratuity provident fund and maternity benefits to the labor.

The main objective of social security legislations are to protect the poor and the vulnerable and to ensure that they have an acceptable standard of living. The aim of the social security legislation is three fold. To provide compensation, to restore the sick and to prevent the loss of a labor.

8.2 THE EMPLOYEES' PROVIDENT FUNDS AND MISCELLANEOUS PROVISIONS ACT, 1952

8.2.1 Overview:

Employees provident fund is a welfare scheme for the benefits of employees. In this scheme, the contribution is made by employer and employee. Later on, the whole of the amount is contributed by the employer. The statutory rate of contribution is prescribed by the act. The employee share is deducted from the salary of the employee and it is deducted by the employer. The interest on this provident fund account is credited to the account of the employee.

If the certain conditions are satisfied, at the time of retirement the accumulated amount of provident fund is given to the employee. In India, the Employees' Provident Funds and Miscellaneous Provisions Act, 1952 came into effect from 1st March, 1971. The act was further amended in 1976. The Act was passed with a view to introducing the Employees Deposit Linked Insurance Scheme. The Employees Deposit Linked Insurance Scheme is a measure to provide an insurance cover to the members of the provident fund.

Further, the Act was enacted to provide a kind of social security to the industrial workers. This act is an important labor legislation which came into existence in 1952 to ensure compulsory provision of Provident Fund, Family Pension Fund and Deposit Linked Insurance in factories and other establishments for the benefits of employees.

8.2.2 Objectives of the Act:

1. To provide a kind of social security to the industrial workers.
2. To provide provident fund to the employees after their service.
3. To introduce the Employees Deposit Linked Insurance Scheme.
4. To cultivate the spirit of saving something for the future among employees.
5. To make provision for the future of the work man after his retirement or for his dependents in case of early death.

8.2.3 Scope and Applicability of the Act:

The act is applicable:

1. to every establishment which is a factory engaged in any industry specified in Schedule I and in which twenty or more persons are employed, and
2. to any other establishment employing twenty or more persons or class of such establishments which the Central Government may, by notification in the Official Gazette, specify in this behalf:
3. The Central Government may, after giving not less than two months' notice of its intention to do so, by notification in the Official Gazette, apply the provisions of this Act to any establishment employing such a number of persons less than twenty as may be specified in the notification.

8.2.4 Important Provisions of the Act:

1. **Section 2A** lays down the provisions related to an establishment to include all departments and branches under this scheme.

2. **Section 3** lays down the provisions related to the Power to apply Act to an establishment which has a common provident fund with another establishment.

3. **Section 4** empowers the Central Government to add any industry in Schedule I. The Central Government may, by notification in the Official Gazette, add to Schedule-I any other industry in respect of the employees whereof it is of opinion that a Provident Fund Scheme should be framed under this Act, and thereupon the industry so added shall be deemed to be an industry specified in Schedule-I for the purposes of this Act.

4. **Section 5** of the act lays down provisions related to Employees' Provident Fund scheme. The Central Government may, by notification in the Official Gazette, frame a Scheme to be called the Employees' Provident Fund Scheme for the establishment of provident funds under this Act for employees or for any class of employees and specify the establishments or class of establishments to which the said scheme shall apply 4[and there shall be established, as soon as may be after the framing of the scheme, a fund in accordance with the provisions of this Act and the Scheme.

5. **Section 6** lays down the provisions related to the Contribution and matters which may be provided for in Schemes. The statutory rate of provident fund by the employee and the employer as prescribed in the act is 10% of the pay/ wages of the employees.

6. **Section 7** lays down the provisions related to the modification of scheme. The Central Government may, by notification in the Official Gazette, add to amend or vary, either prospectively or retrospectively, the Scheme, the Pension Scheme, or the Insurance Scheme as the case may be. Some 7 of the act is very comprehensive and covers many provisions.

7. **Section 8** of the act lays down the provisions related to the mode of recovery of money due from employers.

Apart from these provisions, the Employees' Provident Funds and Miscellaneous Provisions Act, 1952 covers many other provisions related to withdrawals, offenses, obligations of employers etc.

8.3 ESIC

ESIC Stands for Employees' State Insurance Corporation. The Central Government may, by notification in the Official Gazette, appoint on this behalf, there shall be established for the administration of the scheme of employees' state insurance in accordance with the provisions of this Act a

Corporation to be known as the Employees' State Insurance Corporation. The Corporation shall be a body corporate by the name of Employees' State Insurance Corporation having perpetual succession and a common seal and shall by the said name sue and be sued.

The employees State Insurance Corporation shall consist of the following members, namely:

- The Director-General of the Corporation
- A Chairman, appointed by the Central Government
- A Vice-Chairman appointed by the Central Government.
- Not more than 5 persons nominated by the Central Government.
- 1 person to represent each state.
- 1 person representing the Union Territories.
- 10 persons representing employers.
- 10 persons representing employees.
- 2 persons representing the medical profession.
- 3 members of parliament (2: Lok Sabha and 1: Rajya Sabha).

The Director-General of the Corporation, the Chairman, the Vice-Chairman, the five people nominated by the Central Government, the members representing each State and the members representing each Union Territory shall hold the office for up to four years.

8.4 PAYMENT OF GRATUITY ACT

8.4.1 Overview:

Gratuity is an amount which is paid by the employer to the employee for the services rendered by him or her towards the organization. It refers to the additional retirement benefit to be secured to the laborers for the contribution of their services towards the organization. The amount paid by the employer is in lump sum in consideration of the past service of the laborer. The amount is given as a token of appreciation towards the years contributed by the laborer to the organization.

In India, this benefit is governed by the Payment of Gratuity Act, 1972. The Payment of Gratuity Act, 1972 came into force from 16th September 1972. The act provides for rewarding employees who have served a long career in the organization.

8.4.2 Objectives of the Act:

1. To provide for a scheme for the payment of gratuity to employees engaged in factories, mines, oilfields, plantations, ports, railway

companies, shops or other establishments and for matters connected therewith or incidental thereto.

2. To provide a reward to employees who have served a long career in the organization.

3. To provide the benefits to the employees as a token of appreciation for his/her services.

8.4.3 Scope and Applicability of the Act:

1. The act extends to the whole of India.

2. The act is applicable to every shop or establishment in which 10 or more persons are employed or were employed on any day of the preceding 12 months.

3. It shall apply to-

(a) every factory, mine, oilfield, plantation, port and railway company;

(b) every shop or establishment within the meaning of any law for the time being in force in relation to shops and establishments in a State, in which ten or more persons are employed, or were employed, on any day of the preceding twelve months;

(c) such other establishments or class of establishments, in which ten or more employees are employed, or were employed, on any day of the preceding twelve months, as the Central Government may, by notification, specify in this behalf.

4. It shall come into force on such date as the Central Government may, by notification, appoint.

8.4.4 Important Provisions of the Act:

Controlling Authority [Section 3]:

The appropriate Government may, by notification, appoint any officer to be a controlling authority. The officer shall be responsible for the administration of this act. The appropriate government may appoint different controlling authority for different areas.

Payment of Gratuity [Section 4]:

Gratuity shall be payable to an employee on the termination of his employment after he has rendered continuous service for not less than five years,:

(a) on his superannuation, or

(b) on his retirement or resignation, or

(c) on his death or disablement due to accident or disease:

Powers to Exempt [Section 5]:

The appropriate Government may, by notification, and subject to such conditions as may be specified in the notification, exempt any establishment, in receipt of gratuity or pensionary benefits not less favorable than the benefits conferred under this Act.

Nomination [Section 6]:

Section 6 of the act deals with the provisions relating to the nomination. An employee may in his nomination, distribute the amount of gratuity payable to him or may nominate one or more members of the family.

Determination of the Amount of Gratuity [Section 7]:

Section 7 of the act, lays down the rules for the determination of amount of gratuity. The person who is entitled to receive the gratuity is required to apply to an employer by writing an application. The employer shall calculate the amount of gratuity to be paid. He shall provide notice to the concerned employee and the controlling authority after calculating the amount to be payable. The payment of gratuity should be made within 30 days from the date it is due.

Inspectors [Section 7A]:

The appropriate Government may, by notification, appoint as many inspectors, as it deems fit, for the purposes of this act. While Section 7B deals with the Powers of Inspectors under this act.

Recovery of Gratuity [Section 8]:

If the amount of gratuity is not paid by the employer, the controlling authority should give the employer a reasonable opportunity to show the cause of such an Act. The amount of interest to be paid should not exceed the amount of gratuity under this Act

Penalties [Section 9]:

(1) Whoever, for the purpose of avoiding any payment to be made by himself under this Act or of enabling any other person to avoid such payment, knowingly makes or causes to be made any false statement or false representation shall be punishable with imprisonment for a term which may extend to six months, or with fine which may extend to ten thousand rupees or with both.

(2) An employer who contravenes, or makes default in complying with, any of the provisions of this Act or any rule or order made there under shall be punishable with imprisonment for a term which shall not be less than three months but which may extend to one year, or with fine which shall not be less than ten thousand rupees but which may extend to twenty thousand rupees, or with both:

Provided that where the offense relates to non-payment of any gratuity payable under this Act, the employer shall be punishable with imprisonment for a term which shall not be less than Six months but which may extend to two years unless the court trying the offense, for reasons to be recorded by it in writing, is of opinion that a lesser term of imprisonment or the imposition; a fine would meet the ends of justice.

8.5 CONCEPT OF SUPERANNUATION

The dictionary meaning of the word 'superannuation' or 'superannuate' is to become retired, to retire because of age or infirmity.

Superannuation benefit is a scheme designed for the welfare of the organization's workers in the form of a pension plan. Superannuation scheme is also known as pension plan. A superannuation benefit is a type of retirement pension that is provided by a company to its employees.

8.6 PAYMENT OF BONUS ACT

8.6.1 Overview:

The Payment of Bonus Act was passed in 1965. The act was passed to regulate the amount of bonus to be paid to the persons employed in establishments. The amount of bonus is calculated on the basis of employee's salary and profit of the establishments. The productivity of the employees largely depends on this factor. The term 'Bonus' means something given in addition to salary. The Payment of Bonus (Amendment) Bill, 2015 was introduced in Lok Sabha on December 7, 2015. The bill seeks to amend the Payment of Bonus Act, 1965.

8.6.2 Objectives of the Act:

1. To provide for the payment of bonus to the person employed in certain establishments on the basis of profit or productivity.
2. To regulate the amount of bonus to be paid,
3. To prescribe the minimum and maximum percentage of calculating bonus.
4. To share the prosperity of the establishment in terms of profit.

8.6.3 Scope and Applicability of the Act:

1. This act extends to the whole of India.
2. This act is applicable to every factory and every establishment in which twenty or more persons are employed on any day during an accounting period.
3. The act has laid down a detailed procedure for calculating the amount of bonus payable to employees.

8.6.4 Important Provisions of this Act:

1. **Section 4** deals with the computation of Gross profit derived by an employer from an establishment in **respect of any accounting year.**

2. **Section 5** deals with the provisions related to computation of available surplus in respect of any accounting year.

3. **Section 6** deals with the deduction part from the gross profit. Any amount by way of depreciation, development rebate, investment allowance and development allowance admissible in accordance with the Income Tax Act.

4. Subject to the provisions of **Section 7** and direct tax, the employer is liable to pay for the accounting year in respect of his income, profits and gains during that year.

5. **Section 8** deals with the provisions related to eligibility of bonus. A person is entitled to get the bonus if he/she has worked in the establishment for less than thirty working days in that year.

6. **Section 9** deals with the provisions related to disqualification of an employee for bonus. If a person due to fraud, riotous or violent behavior, theft, misappropriation or sabotage of any property is dismissed from service is disqualified to receive bonus.

7. **Section 10** deals with the minimum amount of bonus to be paid to the eligible person.

8. **Section 11** deals with the maximum amount of bonus to be paid to the eligible person.

9. **Section 15** deals with the set-on and set-off of allocable surplus.

10. **Section 19** deals with the provisions of time limit for the payment of bonus. The bonus shall be paid within a period of 8 months from the close of the accounting year.

8.7 WORKMEN'S COMPENSATION ACT 1923

8.7.1 Overview:

The work man compensation act is an important act of social security in India. The beginning of social security in India was made with the passing of this act 1923. Before the passing of this act, the government formulated some proposals for the grant of compensation. These proposals were circulated for opinion among them. The proposals for the grant of compensation received general support. Subsequently, the workmen's compensation Act was passed in March 1923. The act came into force on July 1st 1924.

The Workmen's Compensation Act is administered by the government. The extent of the act is very comprehensive as it covers the various types of disablement, employers liability for compensation, amount of compensation, compensation to be paid when due and penalty for default and appointment of Commissioner by the government. It helps the parties to get relief from a necessary litigation bring about the relations between employers and workmen.

8.7.2 Objectives of the Act:

1. To provide employment injury compensation to industrial workers.
2. To provide for the payment of certain classes of employers to their workmen compensation for injury by accident at the workplace.
3. To provide a simple and economical mechanism for the recovery of compensation in case of personal injury.
4. To provide a quick mechanism for the recovery of compensation in case of occupational diseases.
5. To protect workmen from uncertainty and emergency in the course of employment.
6. To impose an obligation upon employers to pay compensation to employees for accidents rising out of and in the course of employment.

8.7.3 Scope and Applicability of the Act:

1. The act extends to the whole of India.
2. The act is applicable to workmen employed in factories, mines, plantations, mechanically propelled vehicles, construction works and certain other hazardous occupations in any such a capacity as is specified in schedule II.
3. Under sub-section (3) of section 2 of the act, the state governments are empowered to extend the scope of the act to any class of persons whose occupations are considered hazardous after giving three months notice in the Official Gazette.
4. The act, however, does not apply to members serving in the armed forces of the Indian Union.
5. The compensation is related to the extent of the injury or death rising out of and in the course of employment.
6. The employer is not responsible if a workman sustains his injuries under the influence of drugs, drinks etc.

8.7.4 Important Provisions of the Act:

Employer's Liability for Compensation [Section 3]:

Under this section, the act imposes the liability to pay compensation to workmen if a personal injury is caused to him arising out of and in the course of employment. Workmen are entitled to receive compensation from the employer if the personal injury is caused to him or her by accident at the workplace or arising out of or in the course of his employment.

Amount of Compensation [Section 4]:

The Section 4 of the workmen's compensation act deals with the provisions relating to the amount of compensation to be paid to workmen if the personal injury is caused by accident or arising out of and in the course of his employment. Subject to the provisions of this Act, the amount of compensation shall be as follows, namely -

(a) where death results in from the injury : an amount equal to fifty per cent. of the monthly wages of the deceased employee multiplied by the relevant factor; or an amount of one lakh and twenty thousand rupees, whichever is more;

(b) where permanent total disablement results from the injury : an amount equal to sixty per cent. of the monthly wages of the injured employee multiplied by the relevant factor; one lakh and twenty thousand rupees, whichever is more;

Compensation to Be Paid When Due and Penalty for Default [Section 4A]:

Under this act, if the employer is under fault in paying the compensation due within one month from the date it fell due, The Commissioner shall direct that the employer in addition to the amount of areas pay simple interest of 12% per annum or on such higher rates. The Commissioner has the power to impose the penalty and the interest on the cleared amount it

Appointment of Commissioner [Section 20]:

The State Government may, by notification in the Official Gadget, appoint any person to be a Commissioner for workmen compensation for such areas as may be specified in the notification.

8.8 SUMMARY

- In India, the Employees' Provident Funds and Miscellaneous Provisions Act, 1952 came into effect from 1st March, 1971. The act was further amended in 1976. The Act was passed with a view to introducing the Employees Deposit Linked Insurance Scheme. The Employees Deposit Linked Insurance Scheme is a measure to provide an insurance cover to the members of the provident fund.

- In India, this benefit is governed by the Payment of Gratuity Act, 1972. The Payment of Gratuity Act, 1972 came into force from 16th September 1972. The act provides for rewarding employees who have served a long career in the organization.

- ESIC Stands for Employees' State Insurance Corporation. The Central Government may, by notification in the Official Gazette, appoint on this behalf, there shall be established for the administration of the scheme of employees' state insurance in accordance with the provisions of this Act a Corporation to be known as the Employees' State Insurance Corporation.

- In India, this benefit is governed by the Payment of Gratuity Act, 1972. The Payment of Gratuity Act, 1972 came into force from 16th September 1972. The act provides for rewarding employees who have served a long career in the organization.

- Superannuation benefit is a scheme designed for the welfare of the organization's workers in the form of a pension plan. Superannuation scheme is also known as pension plan. A superannuation benefit is a type of retirement pension that is provided by a company to its employees.

- The Workmen's Compensation Act is administered by the government. The extent of the act is very comprehensive as it covers the various types of disablement, employers liability for compensation, amount of compensation, compensation to be paid when due and penalty for default and appointment of Commissioner by the government. It helps the parties to get relief from a necessary litigation bring about the relations between employers and workmen.

8.9 SELF ASSESSMENT TESTS

1. Explain the scope and applicability of the Employees Provident Fund and Miscellaneous Provisions Act, 1952.

2. Discuss the important provisions of the Workmen's Compensation Act, 1923.

3. Discuss the important provisions of the Payment of Gratuity Act.

4. What are the applications of the employer under Payment of Gratuity Act?

5. What are the important provisions of the Employees Provident Fund and Miscellaneous Provisions Act, 1952.

6. Explain the concept of provident fund. How are the contributions drawn from the employer and employee?

7. What are the important provisions under the Payment of Bonus Act, 1965.

8. Who is eligible to get a bonus?

*****

9

VARIABLE PAY

Unit Structure

9.0 OBJECTIVES

After studying this module, you should be able to :

- Know the concept of variable pay
- Understand then various forms/types of variable pay
- Study the advantages of Variable Pay
- Know the disadvantages of Variable Pay

9.1 VARIABLE PAY

9.1.1 Introduction:

The concept of variable pay has its origin from western nations. In the last decade, this concept started gaining importance in the last decade. The variable pay concept migrated from the Multinational Companies. It came into Asia and other emerging markets. The variable pay is performance based pay. Indian companies are progressing at par with the West.

Along with Private Companies, many Public Sector Units are working in this direction. In the form of incentives and Commissions, the variable pay can take many forms for the employees. It covers paying commissions to sales representatives depending on the sales or paying annual bonuses to the managers for their performance.

The concept of variable pay is not confined to only top and middle level. It is spreading its wings to cover the lower level as well. Companies are using stock options throughout the organization. The typical incentives are changed with the stock option and other modern forms of variable pay.

Variable pay is linked to:

- Individual Performance
- Group Performance
- Organizational Performance

9.1.2 Meaning:

Variable pay is a performance based pay given to the employees by the organization in the form of bonuses, stock options, incentives etc. It is a form of compensation linked to individual or group performance. The organizational performance is another important parameter of variable pay. Variable pay is also known as incentives in many organizations.

Variable pay is based on employee's performance, group performance and organizational performance. When an employee achieves their goals, variable pay is provided as a type of bonus or incentives along with the basic salary. The basic pay is determined through the evaluation of the job. Job evaluation is a process through which the job of a person is evaluated through the level of skills, efforts and responsibility required to perform the jobs.

The subject matter of base pay includes:

Salary:

Salary is a term used to indicate a fixed amount of money or compensation paid to an employee by an employer in return for work performed.

Wages:

Wages is a term used to indicate an amount of money or compensation paid to a labor/worker by an employer in return for work performed.

Variable pay is also known as pa mix where along with the basic pay, an employee gets incentives, commission, bonuses for the work he performed for the organization. Variable Pay is basically employee compensation that changes.

9.1.3 Conceptual Framework:

The concept of variable pay can be understood with the help of the following figures:

Fig. 9.1 Concept of Variable Pay

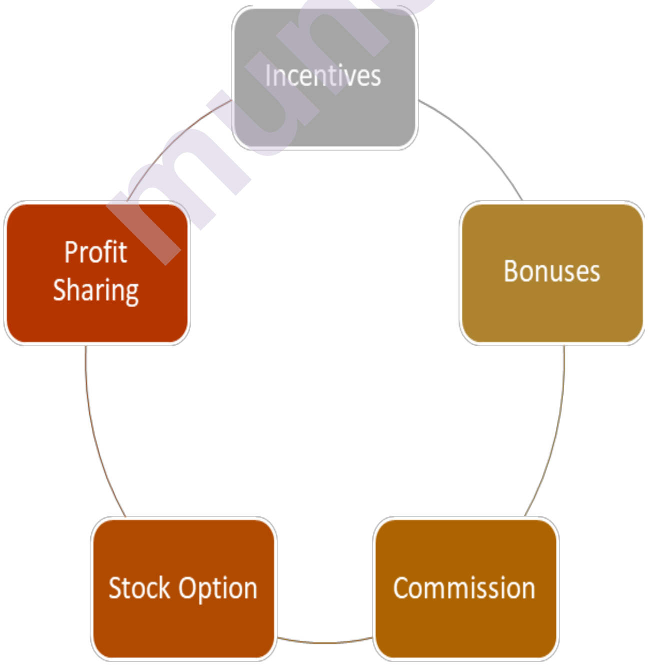

Fig. 9.2: Components of Variable Pay

9.1.4 Assumptions:

The working of variable pay in an organization relies on several basic assumptions:

1. Variable pay is a compensation linked to individual, team, and/or organization performance.
2. Some people perform better than others.
3. Some jobs and works of the organization contribute more to the organizational success.
4. Employees who perform better should receive more compensation.
5. Above satisfactory or outstanding performance should be encouraged and recorded.

9.2 TYPES OF VARIABLE PAY

Variable pay is based on employee's performance, group performance and organizational performance. When an employee achieves their goals, variable pay is provided as a type of bonus or incentives along with the basic salary. The basic pay is determined through the evaluation of the job. Job evaluation is a process through which the job of a person is evaluated through the level of skills, efforts and responsibility required to perform the jobs.

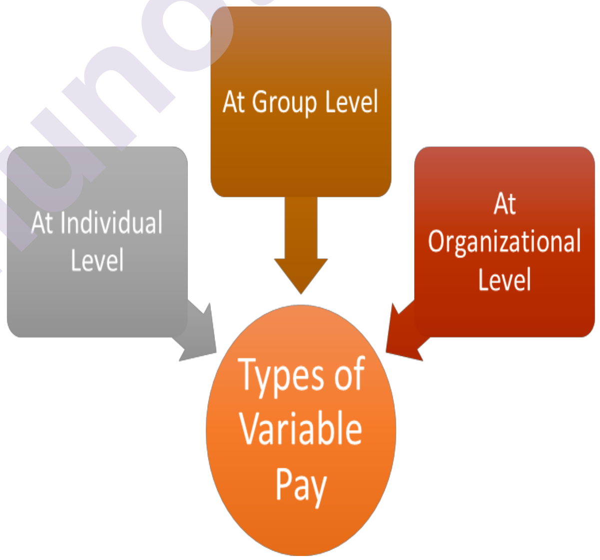

Fig. 9.3: Types of Variable Pay

1. At Individual Level:

At an individual level, an employee according to the performance gets many types of variable pay. Piece rate, sales commission, bonuses, special recognition, safety awards and attendance bonuses are some forms of variable pay paid to the employees as per their work performance and target achievement.

Fig. 9.4: Forms of Variable Pay at Individual Level

1) Piece Rate:

When the workers are paid by the units performed, this system is known as Piece rate. The Piece Rate is also known as Piece Work Pay. Understanding what Piece rate is important. Complying with the wages and overtime allowances is also a part of the Piece Rate system. The system to be effective must be transparent.

2) Bonuses:

Bonus is a gift paid to an employee occasionally to reward the exceptional performance or for some special occasions. The concept of bonus plays a vital role in today's competitive executive payment program. In the form of bonuses, an employer appreciated his/her employees. This type of incentive is special and occasionally given to the employees.

According to the definition of Cambridge Dictionary, "Bonus is an amount of money given to an employee in addition to their salary as a reward for working well.

The following are the types of bonuses namely,

a. Production Bonus

b. Profit Bonus

c. Customary Bonus

d. Implied Bonus (Bonus as an implied term)

3) Pay Commissions:

Commissions form another important element of compensation management. Commissions are a sum of money paid to an employee upon completion of a task, usually selling a certain amount of goods or services. Commission along with salary or alone are often considered as an allowance paid to the employees for the sales target or the work which is commission based.

Direct compensation can be in the form of commissions that an employer provides regularly and consistently

4) Safety Recognition:

Safety measures play a vital role in the performance of an employee. Safety recognition refers to the acknowledgment of safety as a priority within an organization. The idea of safety recognition lies on both employer and employees. A safety incentive program is formal workplace safety programs that center on acknowledging safety performance via rewards.

5) Safety Awards:

Safety awards are given to employees to promote competitive spirits among employees to boost and promote the safety measures in an organization. These awards are given to those employees who follow all safety norms and help others to promote safety at the workplace.

6) Attendance Bonuses:

Attendance bonuses are given to those employees as an incentive used to boost employee attendance rates by rewarding employees who have excellent attendance and are not frequently absent or were on leaves in an organization.

2. At Group Level:

At a group level, an employee in a group according to the performance gets many types of variable pay. Gain Sharing, quality improvement and labor cost reduction are some forms of variable pay paid to the employees as per their work performance and target achievement.

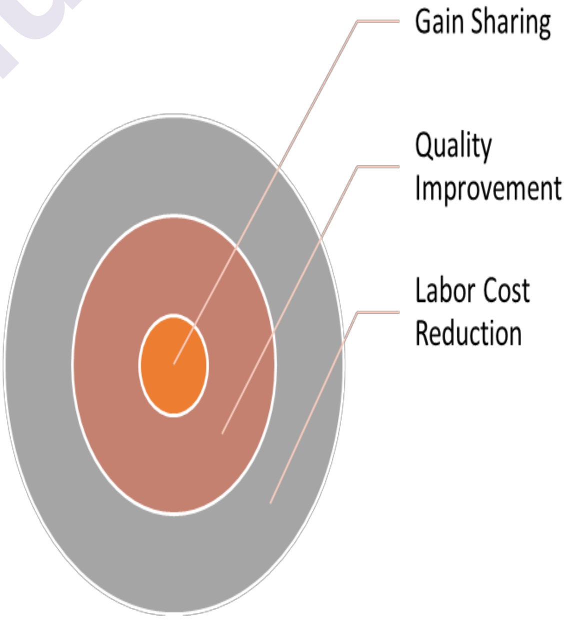

Fig. 9.5: Forms of Variable Pay at Group Level

1) Gain/Profit Sharing:

Gain/Profit sharing is a plan in which an employer gives the right to an employee to be a part of profit sharing of the organization. It is a type of pre-tax contribution plan for employees that gives workers a certain amount of a company's profits. The amount of profit sharing is up to the company how much they would like to share with the employees.

The profit sharing depends on the following elements:

- Amount set by the Employer
- Profitability of the Business
- Working Capital Needs of the Business
- Amount of Wages and Salaries

2) Quality Improvement:

This approach is based on a quality model. Establishing a culture of quality in a practice. Quality improvement (QI) is a systematic, formal approach to the analysis of practice performance and efforts to improve performance. It includes the following parameters:

- Establishing a culture
- Identifying key areas
- Communicating results
- Ongoing evaluation

3) Labor Cost Reduction:

Labor cost reduction is also a type of variable pay. Labor costs are often one of the largest line items on your company balance sheet. When it is reduced due to the efficient work of employees, it helps to control costs. The same benefit received by the organization can be distributed in the form of benefits to the group members.

3. At Organizational Level:

At an organizational level, an employee in a group according to the performance gets many types of variable pay. Profit Sharing, employees stock options, executive stock options and deferred compensation are some forms of variable pay paid to the employees as per their work performance and target achievement.

Fig. 9.6: Forms of Variable Pay at Organizational Level

1) Profit Sharing:

Profit sharing is a plan in which an employer gives the right to an employee to be a part of profit sharing of the organization. It is a type of pre-tax contribution plan for employees that gives workers a certain amount of a company's profits. The amount of profit sharing is up to the company how much they would like to share with the employees.

The profit sharing depends on the following elements:

- Amount set by the Employer
- Profitability of the Business
- Working Capital Needs of the Business
- Amount of Wages and Salaries

2) Employee Stock Options:

Stock options are popularly known as Employee Stock Option. Employee Stock Option is a contract between two parties that gives the buyer the right to buy or sell underlying stocks at a predetermined price and within a specified time period.

There are two types of stock option:

- Call Option
- Put Option

A seller is paid a premium from the contract purchased by the buyer and known as option writer. He is the one who sells the stock option to the employees. This practice of compensation is also known as equity option. Many companies are offering equity to their employees. As the name suggests, it is an option not an obligation on the part of the investor.

The employee stock option is a type of equity compensation. It is granted by the companies to their executives and employees. In this type of compensation rather than granting shares of stock directly, the company gives derivative options on the stock instead. The great benefit of this type of compensation can be determined when the stock prices of the company rises.

3) Executive Stock Options:

Executive Stock Option is a contract between two parties that gives the buyer the right to buy or sell underlying stocks at a predetermined price and within a specified time period. There are two types of stock options - Call Option and Put Option.

The executive stock option is a type of equity compensation. It is granted by the companies to their executives and employees. In this type of compensation rather than granting shares of stock directly, the company gives derivative options on the stock instead. The great benefit of this type of compensation can be determined when the stock prices of the company rises. It also contributes in increasing the worth of the employees in terms of the stocks they have in their names.

4) Deferred Compensation:

Deferred compensation refers to the part of one's contribution that is with held and paid at a future date. It is an arrangement in which a portion of an employee's income is paid out at a later date after which the income was earned. The deferred compensation includes -

- Insurance Schemes
- Contingency Plans
- Stock Option Plans

9.3 ADVANTAGES OF VARIABLE PAY

As mentioned earlier, the concept of variable pay is not confined to only top and middle level. It is spreading its wings to cover the lower level as well. Companies are using stock options throughout the organization. The typical incentives are changed with the stock option and other modern forms of variable pay.

The following advantages can be drawn from variable pay:

1. It helps to control costs.

2. It emphasizes the use of metrics to track performance.
3. It helps to engage and retain the key employees.
4. It helps to attract and retain valuable employees.
5. It helps to encourage managers to define success and communicate that to team members
6. It encourages productivity and helps employees to work more efficiently.

9.4 DISADVANTAGES OF VARIABLE PAY

The following are the disadvantages of variable pay:

1. If the parameters of variable pay are not defined clearly, it may result in the improper implementation of the pay structure.
2. An increase in the variable pay may increase the cost of running an organization.

9.5 SUMMARY

- Variable pay is a performance based pay given to the employees by the organization in the form of bonuses, stock options, incentives etc. It is a form of compensation linked to individual or group performance. The organizational performance is another important parameter of variable pay. Variable pay is also known as incentives in many organizations.

- Variable pay is based on employee's performance, group performance and organizational performance. When an employee achieves their goals, variable pay is provided as a type of bonus or incentives along with the basic salary. The basic pay is determined through the evaluation of the job. Job evaluation is a process through which the job of a person is evaluated through the level of skills, efforts and responsibility required to perform the jobs.

- At an individual level, an employee according to the performance gets many types of variable pay. Piece rate, sales commission, bonuses, special recognition, safety awards and attendance bonuses are some forms of variable pay paid to the employees as per their work performance and target achievement.

- At a group level, an employee in a group according to the performance gets many types of variable pay. Gain Sharing, quality improvement and labor cost reduction are some forms of variable pay paid to the employees as per their work performance and target achievement.

- At an organizational level, an employee in a group according to the performance gets many types of variable pay. Profit Sharing, employees stock options, executive stock options and deferred compensation are some forms of variable pay paid to the employees as per their work performance and target achievement.

9.6 SELF ASSESSMENT TESTS

1. Explain the concept of variable pay in detail.
2. Describe the concept of Stock Option. Explain the salient features of stock options.
3. Write a note on understanding the elements of stock options.
4. Explain the various forms of variable pay.
5. Explain the various types of variable pay. Also add examples in your answer.

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10

UNDERSTANDING INCOME TAX

Unit Structure

10.0 OBJECTIVES

After studying this module, you should be able to:

- Understand the nature and relevance of Income Tax
- Importance of Income Tax
- Know about the various sources of Income Tax
- Understand the basic concepts of Tax

10.1 INTRODUCTION

Public finance is the study of finance of the country's government. The public authority requires a huge amount of resources to finance its operations. The public authority raises revenue and meets expenditure. It refers to the revenue which can be fetched by the public authority in a given period, usually a year.

The concept of public finance deals with the public and management of the finance raised from the public in the name of revenue. Public finance is also known as Government's finance. The area of public finance covers the income and expenditure of public authorities in a manner in which one is adjusted with the other.

Fiscal policy plays an important role for the development of the economy by ensuring the proper money supply. The money is supplied to required sectors. Thus, the basic objective of finance is to promote the economic growth and development of the country by optimizing the use of finance for the welfare of the general public.

The main sources of public revenue are:

1. Fees
2. Taxation
3. Prices
4. Fines
5. Penalties
6. Special Assessment
7. Public Debts
8. Public Borrowings

Out of these public revenue sources, taxation is an important tool of raising finance in order to meet the expenses for the assessment year. The money through taxation is raised to meet expenditure on various public services. It is the legal duty of a citizen to pay taxes. The taxes can be levied on property, income, wealth or at the time of purchasing a commodity. It is the most important source of revenue for the government. Income tax is charged on the annual income of an individual.

10.2 BASIC CONCEPTS

10.2.1 What is Income Tax?

Income tax is a type of direct tax. Direct tax refers to that type of tax where the impact and incidence of tax fall on the same person. The burden of direct taxes cannot be shifted to other people. The domain of taxation system in India basically falls into two categories - direct tax and indirect tax. To understand the term 'Tax', let's have a look in some definitions given by the experts:

According to Tausing, "The essence of the test is distinguished from other charges by the government, is the absence of a direct quid-pro-quo between the taxpayer and the public authority.

According to Hugh Dalton, "A tax is the compulsory contribution imposed by the public authority irrespective of the exact amount of services rendered to the tax year in return and not imposed as a penalty for any legal offense."

Income tax is a compulsory payment that governments impose on income generated by businesses and individuals. It is the legal duty of a citizen to pay taxes. When the tax is levied on the income of a person and if his income falls under the preview of income tax, he/she is bound to pay taxes. Tax is not a voluntary contribution. It is a compulsory payment which is not considered a legal offense or penalty. No one has any right to challenge the tax levied by the government.

Many economists have propounded many principles regarding a good taxation system. The father of Economics, Adam Smith has mentioned four principles of taxation which must be considered while designing a system. The first principle talks about the certainty regarding taxation. The second principle states that people should pay taxes according to their capacity. The third principle states that the state should collect taxes with minimum expenditure and the Fourth principal deals with the convenience of the taxpayer.

10.2.2 Important Definitions:

In India, the tax system of our country is administered by the Income Tax, 1961. The Act came into force from 1st April 1962. The act extends to the whole of India. Income Tax Act, 1961 is an act to levy, administrate, collect & recover Income-tax in India. As per this act, some important terms are defined.-

Assessee:

According to **Section 2(7), Assessee** means a person by whom any tax or any other sum of money is payable under this Act, and includes

(a) every person in respect of whom any proceeding under this Act has been taken for the assessment of his income or assessment of fringe benefits or of the income of any other person in respect of which he is assessable, or of the loss sustained by him or by such other person, or of the amount of refund due to him or to such other person;

(b) every person who is deemed to be an assessee under any provision of this Act;

(c) every person who is deemed to be an assessee in default under any provision of this Act;

Assessment Year:

According to **Section 2(9), Assessment year** means the period of twelve months commencing on the 1st day of April every year;

Income:

According to **Section 2(24), Income** includes:

(i) profits and gains;

(ii) dividend;

(iia) voluntary contributions received by a trust created wholly or partly for charitable or religious purposes or by an institution established wholly or partly for such purposes or by an association or institution referred to in clause (21) or clause (23), or by a fund or trust or institution referred to in sub-clause (iv) or sub-clause (v) or by any university or other educational institution referred to in sub-clause (iiiad) or sub-clause (vi) or by any hospital or other institution referred to in sub-clause (iiiae) or sub-clause (via) of clause (23C), of section 10 or by an electoral trust.

Explanation. For the purposes of this sub-clause, trust includes any other legal obligation;

(iii) the value of any perquisite or profit in lieu of salary taxable under clauses (2) and (3) of section 17;

(iiia) any special allowance or benefit, other than perquisite included under sub-clause (iii), specifically granted to the assessee to meet expenses wholly, necessarily and exclusively for the performance of the duties of an office or employment of profit;

(iiib) any allowance granted to the assessee either to meet his personal expenses at the place where the duties of his office or employment of profit are ordinarily performed by him or at a place where he ordinarily resides or to compensate him for the increased cost of living;

(iv) the value of any benefit or perquisite, whether convertible into money or not, obtained from a company either by a director or by a person who has a substantial interest in the company, or by a relative of the director or such person, and any sum paid by any such company in respect of any obligation which, but for such payment, would have been payable by the director or other person aforesaid;

(iva) the value of any benefit or perquisite, whether convertible into money or not, obtained by any representative assessee mentioned in clause (iii) or clause (iv) of sub-section (1) of section 160 or by any person on whose behalf or for whose benefit any income is receivable by the representative assessee (such person being hereafter in this sub-clause referred to as the beneficiary) and any sum paid by the representative assessee in respect of any obligation which, but for such payment, would have been payable by the beneficiary;

(v) any sum chargeable to income-tax under clauses (ii) and (iii) of section 28 or section 41 or section 59;

(va) any sum chargeable to income-tax under clause (iiia) of section 28;

(vb) any sum chargeable to income-tax under clause (iiib) of section 28;

(vc) any sum chargeable to income-tax under clause (iiic) of section 28;

(vd) the value of any benefit or perquisite taxable under clause (iv) of section 28;

(ve) any sum chargeable to income-tax under clause (v) of section 28;

(vi) any capital gains chargeable under section 45;

(vii) the profits and gains of any business of insurance carried on by a mutual insurance company or by a co-operative society, computed in accordance with section 44 or any surplus taken to be such profits and gains by virtue of provisions contained in the First Schedule;

(viii) the profits and gains of any business of banking (including providing credit facilities) carried on by a co-operative society with its members;

(ix) any winnings from lotteries, crossword puzzles, races including horse races, card games and other games of any sort or from gambling or betting of any form or nature whatsoever.

Explanation. For the purposes of this sub-clause,

(i) lottery includes winnings from prizes awarded to any person by draw of lots or by chance or in any other manner whatsoever, under any scheme or arrangement by whatever name called;

(ii) card game and other game of any sort includes any game show, an entertainment programme on television or electronic mode, in which people compete to win prizes or any other similar game;

(x) any sum received by the assessee from his employees as contributions to any provident fund or superannuation fund or any fund set up under the provisions of the Employees State Insurance Act, 1948 (34 of 1948), or any other fund for the welfare of such employees;

(xi) any sum received under a Keyman insurance policy including the sum allocated by way of bonus on such policy.

Explanation. For the purposes of this clause, the expression Keyman insurance policy shall have the meaning assigned to it in the Explanation to clause (10D) of section 10;

(xii) any sum referred to in clause (va) of section 28;

(xiia) the fair market value of inventory referred to in clause (via) of section 28;

(xiii) any sum referred to in clause (v) of sub-section (2) of section 56;

(xiv) any sum referred to in clause (vi) of sub-section (2) of section 56;

(xv) any sum of money or value of property referred to in clause (vii) 114 or clause (viia) of sub-section (2) of section 56;

(xvi) any consideration received for issue of shares as exceeds the fair market value of the shares referred to in clause (viib) of sub-section (2) of section 56;

(xvii) any sum of money referred to in clause (ix) of sub-section (2) of section 56;

(xviia) any sum of money or value of property referred to in clause (x) of sub-section (2) section 56;

(xviib) any compensation or other payment referred to in clause (xi) of sub-section (2) of section 56;

(xviii) assistance in the form of a subsidy or grant or cash incentive or duty drawback or waiver or concession or reimbursement (by whatever name called) by the Central Government or a State Government or any authority or body or agency in cash or kind to the assessee 120 other than,

(a) the subsidy or grant or reimbursement which is taken into account for determination of the actual cost of the asset in accordance with the provisions of Explanation 10 to clause (1) of section 43; or

(b) the subsidy or grant by the Central Government for the purpose of the corpus of a trust or institution established by the Central Government or a State Government, as the case may be;

Previous Year:

According to Section 3 of the Act, "previous year" means the financial year immediately preceding the assessment year:

Provided that, in the case of a business or profession newly set up, or a source of income newly coming into existence, in the said financial year, the previous year shall be the period beginning with the date of setting up of the business or profession or, as the case may be, the date on which the source of income newly comes into existence and ending with the said financial year.

Resident:

According to Section 2(42), resident means a person who is resident in India within the meaning of section 6;

According to Section 6, For the purposes of this Act,-

(1) An individual is said to be resident in India in any previous year, if he-

(a) is in India in that year for a period or periods amounting in all to one hundred and eighty two days or more; or

*Sub-clause

(b) omitted by Act 14 of 1982

(c) having within the four years preceding that year been in India for a period or periods amounting in all to three hundred and sixty-five days or more, is in India for a period or periods amounting in all to sixty days or more in that year.

10.3 HEADS OF INCOME

The income of the individual can be traced from the various sources. As per the Income Tax Act, 1961, the income of the individuals can be classified under the various heads -

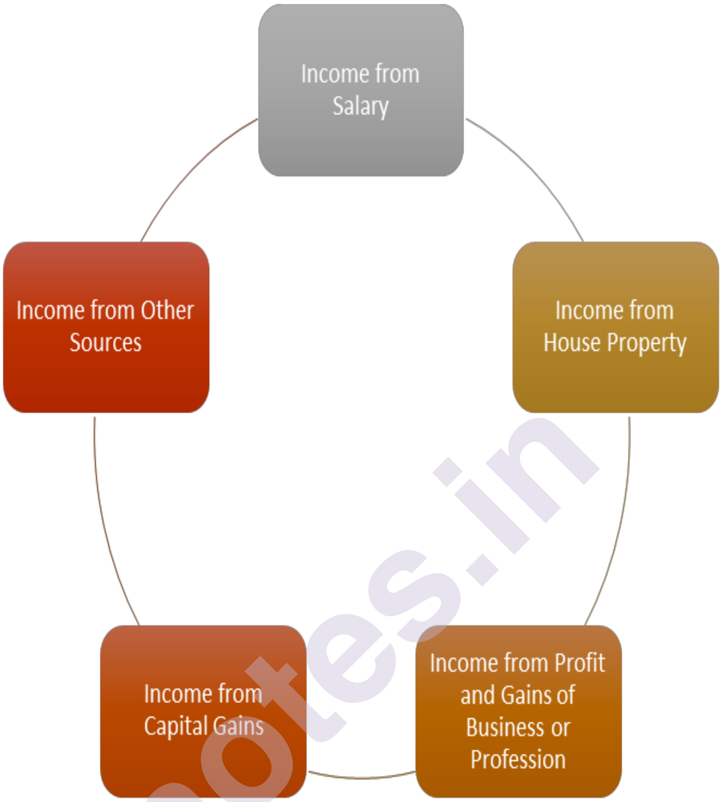

Fig. 10.1: Various Heads of Income

1. Income from Salary:

Under a contract of employment, a salary means any remuneration an individual receives in exchange for services rendered. The term "Salary" is a wide term and includes advance compensation, pension, commission, gratuity, perquisites, and annual bonus. It also includes -

- Conveyance Allowance
- House Rent Allowance
- Medical Allowance
- Leave Travel Allowance

According to Section 15 of the Act,

The following income shall be chargeable to income-tax under the head "Salaries"-

(a) any salary due from an employer or a former employer to an assessee in the previous year, whether paid or not;

(b) any salary paid or allowed to him in the previous year by or on behalf of an employer or a former employer though not due or before it became due to him;

(c) any arrears of salary paid or allowed to him in the previous year by or on behalf of an employer or a former employer, if not charged to income-tax for any earlier previous year.

According to Section 17(1) of the Income Tax, 1961, Salary means -

1. Wages;
2. Annuity or pension;
3. Gratuity;
4. Fees, commissions, perquisites or profits in lieu of or in addition to any salary or wages;
5. Advance of salary;
6. Payment received by an employee in respect of any period of leave not availed by him/her;
7. The portion of annual accretion in any previous year to the balance at the credit of an employee participating in a recognised provident fund to the extent it is taxable;
8. Transferred balance in a recognised provident fund to the extent it is taxable;
9. Contribution by the Central Government to the account of an employee under a pension scheme referred to in section 80CCD.

Table 10.1: Taxability of Various Salary Components

Salary Component	**Taxability under Income Tax Act**
Basic salary	Taxable
Dearness allowance	Taxable
Advance salary	Taxable in the year received
Arrears of salary	Taxable in the year received, if not taxed on due basis
Leave encashment at time of retirement	Taxable – Exempt in some scenarios
Salary in lieu of notice	Taxable on receipt

Salary to partner	Taxable under the head of "Profits and gains of business or profession"
Fees and commission	Taxable
Bonus	Taxable
Gratuity	Taxable – Exempt in some scenarios
Pension	Taxable – Exempt in some scenarios
Annuity from Employer	Taxable
Retrenchment compensation	Exempt from tax to a certain extent
Remuneration for extra work	Taxable
Salary to Foreign Citizens	Taxable – Exempt in some scenarios

Source: https://www.indiafilings.com

2. Income from House Property:

According to Section 22 of the Act, the annual value of property consisting of any buildings or lands appurtenant thereto of which the assessee is the owner, other than such portions of such property as he may occupy for the purposes of any business or profession carried on by him the profits of which are chargeable to income-tax, shall be chargeable to income-tax under the head "Income from house property".

Income from house property refers to the income generated from buildings or land. This includes any income an individual may generate from renting an owned property. The following factors are considered while determining the annual value:

- Actual rent received
- Municipal value
- Fair rent of the property
- Standard Rent

The following incomes are exempted from the Income of House Property:

- Farm House
- Property held for Charitable Purpose
- House property used for own business

- Self-occupied house
- Palace of Ex-ruler
- Property income from hospital, approved scientific research association, university, statutory corporation etc.

3. Income from Profit or Gains of Business or Profession:

The income from profit or gains of business or profession is an important head of Income tax. Any profit earned from the business or profession comes under this head. As per Section 28 of the Income Tax Act, 1961, the income from profits or gains of business or profession covers -

- Any profit from any business/profession
- Any perquisite/benefit arising from a business
- Interest/Salary/Remuneration/Commission/Bonus received by Partner of a firm
- Sums received under an agreement for forbearance, i.e., agreement for not doing something
- Sums received under Keyman Insurance Policy

According to Section 31 of the Income Tax Act, 1961, in respect of repairs and insurance of machinery, plant or furniture used for the purposes of the business or profession, the following deductions shall be allowed-

(i) the amount paid on account of current repairs thereto;

(ii) the amount of any premium paid in respect of insurance against risk of damage or destruction thereof.

4. Income from Capital Gains:

The gain or income that arises from capital is known as Capital Gains. When an individual sells or transfers his/her capital asset and obtains gains or profits, the profit or gain earned from that income is known as capital gain. It is earned on an investment made by an individual for a business or profession. This term includes earnings from -

- Investment in Equities
- Investment in Mutual Funds
- Investment in Real Estate
- Investment in Other Assets

When a person sells any capital assets, he/she can generate loss as well. There are total two types of gains, short term gains and long term gains -

Short Term Capital Gains:

Short-term capital gains are profits earned when an individual sells an asset within 36 months of acquiring it.

Long Term Capital Gains:

Long Term Capital Gains are the profits made on an asset transfer after 36 months from the day of acquiring it.

5. Income From Other Sources:

Income from other sources is the fifth and last head of income under which the total income of a person is computed and assessed. income from other sources is a residuary head of income. It includes all other types of income that do not fit into the above four categories. The income earned from various sources comes under this head. This head includes interest income in a savings account or interest income from deposits with the bank, gifts, etc. This head is also known as the residual head.

This head includes income from -

- Interest on bank deposits
- Prize Money
- Income from card games
- Income from gambling
- Income from other sports
- Income from other games or prizes
- Interest on Fixed Deposit
- Interest on Securities
- Dividend
- Winnings from Lottery

10.4 DEDUCTIONS

Deductions are helpful in reducing the taxable income of an individual. A deduction can be considered as a tax benefit that can be used to decrease your taxable income. It can be calculated as,

Taxable Income = Gross Income - Deductions

If the deductions are high, lower will be the tax liability. It is said that 80C is the best friend of any taxpayer. It helps to reduce the tax liability by making the taxpayer aware about doing investment in -

- Equity-linked savings scheme

- Insurance premium
- Public Provident Fund
- Employee Provident Fund
- Tax saving fixed deposit

An individual can save up to 1,50,000 rupees from the gross income and claim deduction under this act.

10.5 SUMMARY

- Fiscal policy plays an important role for the development of the economy by ensuring the proper money supply. The money is supplied to required sectors. Thus, the basic objective of finance is to promote the economic growth and development of the country by optimizing the use of finance for the welfare of the general public.
- Income tax is a compulsory payment that governments impose on income generated by businesses and individuals. It is the legal duty of a citizen to pay taxes. When the tax is levied on the income of a person and if his income falls under the preview of income tax, he/she is bound to pay taxes. Tax is not a voluntary contribution. It is a compulsory payment which is not considered a legal offense or penalty. No one has any right to challenge the tax levied by the government.
- Many economists have propounded many principles regarding a good taxation system. The father of Economics, Adam Smith has mentioned four principles of taxation which must be considered while designing a system. The first principle talks about the certainty regarding taxation. The second principle states that people should pay taxes according to their capacity. The third principle states that the state should collect taxes with minimum expenditure and the Fourth principal deals with the convenience of the taxpayer.
- The income of the individual can be traced from the various sources. As per the Income Tax Act, 1961, the income of the individuals can be classified under the various heads like income from salary, house property, income from business or procession, capital gains and other sources.
- Under a contract of employment, a salary means any remuneration an individual receives in exchange for services rendered. The term "Salary" is a wide term and includes advance compensation, pension, commission, gratuity, perquisites, and annual bonus. It also includes Conveyance Allowance, House Rent Allowance, Medical Allowance and Leave Travel Allowance.
- Income from house property refers to the income generated from buildings or land. This includes any income an individual may generate from renting an owned property.

- The income from profit or gains of business or profession is an important head of Income tax. Any profit earned from the business or profession comes under this head. As per Section 28 of the Income Tax Act, 1961, the income from profits or gains of business or profession covers any profit from any business/profession.

- The gain or income that arises from capital is known as Capital Gains. When an individual sells or transfers his/her capital asset and obtains gains or profits, the profit or gain earned from that income is known as capital gain. It is earned on an investment made by an individual for a business or profession.

- Income from other sources is the fifth and last head of income under which the total income of a person is computed and assessed. income from other sources is a residuary head of income. It includes all other types of income that do not fit into the above four categories. The income earned from various sources comes under this head. This head includes interest income in a savings account or interest income from deposits with the bank, gifts, etc.

- Deductions are helpful in reducing the taxable income of an individual. A deduction can be considered as a tax benefit that can be used to decrease your taxable income.

10.6 SELF ASSESSMENT TEST

1. Explain the basic concepts of income tax in detail.

2. "Income tax is charged on total income". Explain this statement.

3. Explain the terms "Assessment Year" and "Previous Year".

4. Define income as per Income Tax Act. Describe the important rules of income.

5. Explain the various heads of income.

6. What are the various types of deductions admissible under this act?

7. What is the meaning and concept of income from salary? Explain the various components of this head.

8. Describe the income specifically included under the head of income from other sources.

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11

PREPARING THE CTC OF AN EMPLOYEE/CANDIDATE

Unit Structure

11.1 OBJECTIVES

After studying this module, you should be able to:

- Understand the Concept of CTC
- Know about the Compensation Structure
- Understand Costing the CTC of each element of Compensation Structure
- Know about the preparation of CTC of an Employee
- Understand the Salary Ranges

11.1 CONCEPT OF CTC

11.1.1 Introduction:

The concept of Cost to Company is not a new term. In the field of human resource management, it plays a vital role. Cost to company is a term which denotes the total cost a company bears for an employee. The components of CTC are monetary and non-monetary. When a company bears any kind of cost on employees, it comes under the section of Cost to Company.

It is basically calculated yearly. Employees may not directly receive CTC in cash. Candidates often come across this term when they negotiate with the company about their salary. CTC and Take Home Salary are some basic terms which a candidate needs to understand before applying or joining any organization. If an organization is paying on any facility, it will come under CTC.

Every organization calculates CTC. It is also known as gross salary. Cost To Company is calculated by adding Basic Salary and other additional benefits that employees receive such as Gratuity, Employees Provident Fund, House Rent Allowance, Travel Allowance, Food coupons, and so on.

In the salary description of the organization. Many elements are listed in the salary package of an employee. Compared to the CTC, there is one term: Take Home Salary. Take Home Salary is the exact thing is the exact amount an employee takes home. It means it is the amount which gets deposited in the account of the employees after all the necessary deductions like -

- Tax Deducted at Source
- Provident Fund Etc.

11.1.2 Meaning:

Cost to company is a term which denotes the total cost a company bears for an employee. The components of CTC are monetary and non-monetary. When a company bears any kind of cost on employees, it comes under the section of Cost to Company.

It is basically calculated yearly. Employees may not directly receive CTC in cash. Candidates often come across this term when they negotiate with the company about their salary. CTC and Take Home Salary are some basic terms which a candidate needs to understand before applying or joining any organization. If an organization is paying on any facility, it will come under CTC.

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CTC is calculated as,

CTC = Gross salary + Allowances + Deductibles

1. Basic Salary:

Basic salary is the amount payable to the employees for the services they render to an organization. The basic salary is deducted under the head of income tax. It forms a part of their take home salary.

2. Allowances:

Allowances are all the perks and benefits (direct and indirect) that the company offers to the employee. The perks and benefits includes -

- Dearness Allowance
- Medical Allowance
- Entertainment Allowance
- Conveyance Allowance
- House Rent Allowance
- Other Allowances

3. Compulsory Deductibles:

The final component of CTC is compulsory deductibles. These deductions are Provident Fund, Professional Tax and Income Tax.

CTC is the cost an employer bears to hire and sustain its employees.

11.1.3 Conceptual Framework:

With the help of the following diagram, we can understand the conceptual framework of CTC -

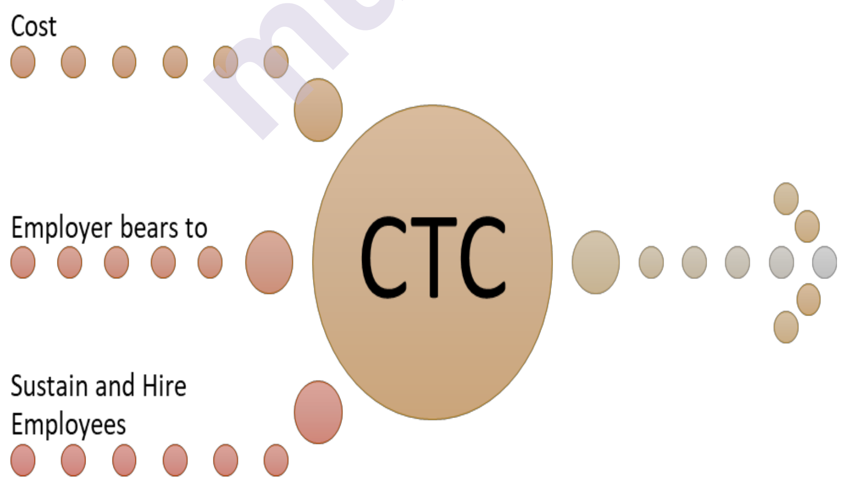

Fig. 11.1: Concept of CTC

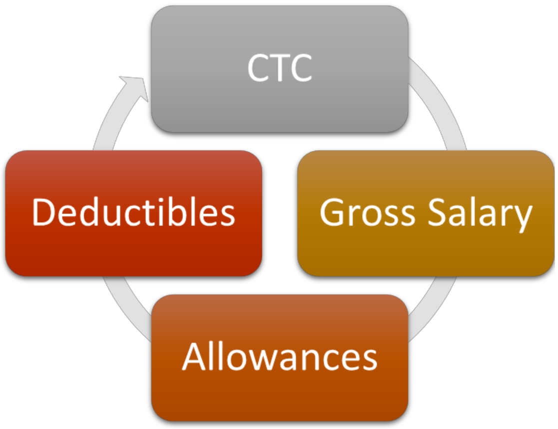

Fig. 11.2: Components of CTC

11.2 COSTING THE CTC OF EACH ELEMENT OF COMPENSATION STRUCTURE

The components of CTC are monetary and non-monetary. The following are the components of CTC:

- Basic Pay
- Dearness Allowance (DA)
- Incentives or bonuses
- Conveyance allowance
- House Rent Allowance (HRA)
- Medical allowance
- Leave Travel Allowance or Concession (LTA / LTC)
- Vehicle Allowance
- Telephone / Mobile Phone Allowance
- Special Allowance

1. Basic Pay:

Basic pay or basic salary is a fixed amount paid to employees by their employers in return for the work performed or performance of professional duties by the employee. It is the amount apart from surplus or additional factors, such as bonuses, benefits or compensation from an employer's end. Basic Pay includes -

Gross Pay- Total allowances (Medical Insurance, HRA, DA, Conveyance, etc.)

Or

Basic Salary = Percentage of the CTC or Gross Pay

2. Dearness Allowances:

Dearness allowance is a component of salary which is some fixed percentage of the basic salary, aimed at hedging the impact of inflation. It is paid by the government to its employees as well as pensioners to offset the impact of inflation. It is calculated as-

For the employees of Central Government

% of DA = {(Average of the All-India Consumer Price Index (Base year - 2001 =100) for the last 12 months -115.76)/115.76} x 100

For Central Public Sector Employees

% of DA = {(Average of the All-India Consumer Price Index (Base year - 2001 =100) for the last 3 months -126.33)/126.33} x 100

3. Incentives or Bonuses:

Incentives are rewards and benefits used to motivate positive behaviors in your workforce. Incentives in the form of compensation, reimbursement, recognition, and rewards are given to employees to motivate and boost their morale.

Bonus is a financial compensation an employer pays to his/her employees. Bonus is a gift paid to an employee occasionally to reward the exceptional performance or for some special occasions. The concept of bonus plays a vital role in today's competitive executive payment program. In the form of bonuses, an employer appreciated his/her employees. This type of incentive is special and occasionally given to the employees.

According to the definition of Cambridge Dictionary, " Bonus is an amount of money given to an employee in addition to their salary as a reward for working well.

The following are the types of bonuses namely, Production Bonus, Profit Bonus, Customary Bonus and Implied Bonus.

4. Conveyance Allowance:

As the name suggests, conveyance allowance is paid to an employee to compensate for the travel they have to undertake from their residence to the workplace. It is also called a transport allowance. conveyance allowance is paid by an employer only if there is no transportation provided by the employer. In case an employer offers transport, conveyance allowance will not be provided to employees.

5. House Rent Allowance:

House Rent Allowance is popularly known as HRA. House Rent Allowance an amount that an employer pays an employee to compensate for rent paid to live in the place of employment. In Income Tax, HRA means house rent allowance which is paid by an employer to the employee.

6. Medical Allowance:

A medical allowance is a fixed payment that employers provide to employees to cover their medical expenses. The Owner provides this benefit to promote staff health and support medical expenses that workers incur in a financial year. As per the Income Tax rules, No tax is levied on medical reimbursement up to Rs. 15,000 if all bills are furnished by an employee to his or her employer as per clause (b) of Section 17 (2) of the IT Act, 1961.

7. Leave Travel Allowance or Concession (LTA / LTC):

Leave Travel Allowance is a form of stipend given by an employer to an employee who is on leave from work to fund his or her travel.

Leave Travel Concession (LTC) is granted to Central Government employees for travel to various parts of the country and home as well. Leave Travel Allowance is one of the best tax-saving tools that an employee can avail.

8. Vehicle Allowance:

Vehicle allowance is also a transport allowance. It is an allowance given to meet commuting expenses between place of residence and office or to meet personal expenditure of employees of transport business. Few companies pay car maintenance allowance to their employees.

9. Telephone/ Mobile Phone Allowance:

As the name suggests, Telephone/Mobile allowance is an allowance which The company pays monthly to employees as compensation for the use of mobiles or telephones for office or personal use.

10. Special Allowance:

Companies pay these allowances which are special and not general in nature. Special allowance is a sum of money that an organization pays its employees for various reasons. The examples are -

- Tuition fees allowance for children
- Children Education Allowance
- Hostel Allowance
- Underground Allowance

11.3 ARRIVING AT THE CTC OF AN EMPLOYEE / CANDIDATE

Arriving or preparing the CTC of an employee is not an easy task. The components of CTC are monetary and non-monetary. It is important to understand the components of CTC before preparing the CTC of an employee. The following number of steps can be performed while arriving at the final CTC of an employee:

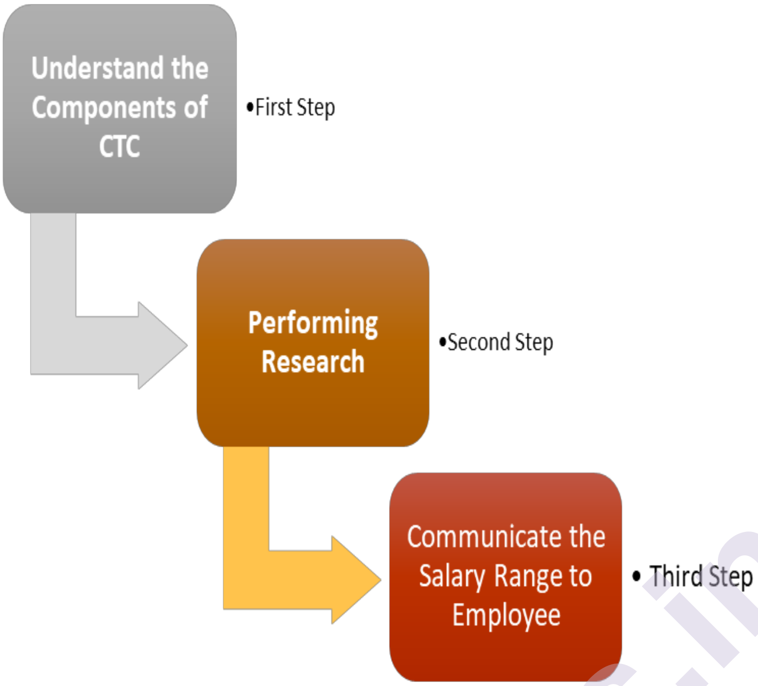

Fig. 11.3: Arriving at the CTC of an Employee

1. Understand the Components of CTC:

The first step is to understand the components of CTC. Cost to company is a term which denotes the total cost a company bears for an employee. The components of CTC are monetary and non-monetary. When a company bears any kind of cost on employees, it comes under the section of Cost to Company. The following components has to consider the following elements while understanding the components of CTC -

- Basic Pay
- Dearness Allowance (DA)
- Incentives or bonuses
- Conveyance allowance
- House Rent Allowance (HRA)
- Medical allowance
- Leave Travel Allowance or Concession (LTA / LTC)
- Vehicle Allowance
- Telephone / Mobile Phone Allowance
- Special Allowance

2. Performing Research:

The second step is crucial as research will be performed on the following components of CTC. The company has to see the salary trends as it may vary from location to location. If a company works only at one location, the variation will not be considered. But, with the changing surroundings of business, research is important to perform.

3. Communicate the Salary Range to Employee:

After selecting a candidate, it is important to communicate the salary to the employee. The final component of CTC is compulsory deductibles. These deductions are Provident Fund, Professional Tax and Income Tax. It is important to communicate the same to employees.

CTC is calculated as,

Gross salary + Allowances + Deductibles

Basic pay or basic salary is a fixed amount paid to employees by their employers in return for the work performed or performance of professional duties by the employee. Companies pay these allowances which are special and not general in nature.

11.4 EMPLOYEE UNDERSTANDING SALARY RANGES

In the salary description of the organization. Many elements are listed in the salary package of an employee. Compared to the CTC, there is one term: Take Home Salary. Take Home Salary is the exact thing is the exact amount an employee takes home. It means it is the amount which gets deposited in the account of the employees after all the necessary deductions like Tax Deducted at Source and Provident Fund Etc.

It is important for an employee to understand the various salary ranges. An employee can understand the difference between the CTC and the Take Home Salary. The Take Home Salary can be calculated by understanding the following steps -

Step I - Calculate the Gross Salary

Step II - Calculate the Taxable Income

Step III - Calculate the Income Tax

Step IV - Calculate the Take Home Salary

Step I:

In this step, an employee after knowing is expected to calculate his/her gross salary. Basic pay or basic salary is a fixed amount paid to employees by their employers in return for the work performed or performance of professional duties by the employee. It includes various types of allowances which are special and general in nature

Step II:

In this step, an employee is expected to calculate his/her taxable income. Taxable income is calculated by subtracting the deductions from the salary. The deductions like allowances (LTA, Conveyance Allowance, HRA), professional tax, medical bills, medical insurance, tax saving investments, if any and other deductions from the gross salary.

As per the Income Tax Act, 1961 the following deductions are allowed:

1. 80 C deals with the basic deductions from total income. The maximum amount is Rs. 1,50,000.

2. 80 TTA deals with the interest from deposits. The maximum amount which can be excluded is Rs. 10,000.

3. 80 G deals with the donations to charity. 50% of the amount of donation is allowed to be deducted.

4. 80 E deals with the Education Loan. The deductions are allowed on the total EMI part and there is no limit.

5. 80 EE deals with the home loan interest. The maximum amount is Rs. 50,000.

6. 80 D deals with medical insurance premiums. Rs. 25,000 for family and self, Rs. 50,000 for family, self and parents, Rs. 80,000 family, self and senior citizens parents.

Step III:

The third step deals with the calculation of the amount of income tax. One can refer to the income tax slab and the current income tax rate. The income tax slabs are revised every year. For the reference, the following is the tax slab for the current assessment year -

Existing Tax Regime		**New Tax Regime u/s 115 BAC**
Income Tax Slab	Income Tax Rate	Income Tax Rate
Up to □ 2,50,000	Nil	Nil
□ 2,50,001- □ 5,00,000	5% above □ 2,50,000	5% above □ 2,50,000
□ 5,00,001- □ 10,00,000	□ 12,500 + 20% above □ 5,00,000	□ 12,500 + 10% above □ 5,00,000

Source: https://www.incometax.gov.in/

Step IV:

The last step is to calculate the in-hand or take home salary. It is calculated as,

Take Home Salary = Basic Pay + House Rent Allowance + Allowances - Income Tax - EPF

11.5 SUMMARY

- Cost to company is a term which denotes the total cost a company bears for an employee. The components of CTC are monetary and non-monetary. When a company bears any kind of cost on employees, it comes under the section of Cost to Company.
- It is basically calculated yearly. Employees may not directly receive CTC in cash. Candidates often come across this term when they negotiate with the company about their salary. CTC and Take Home Salary are some basic terms which a candidate needs to understand before applying or joining any organization. If an organization is paying on any facility, it will come under CTC.
- The components of CTC are monetary and non-monetary. The following are the components of CTC - Basic Pay, Dearness Allowance (DA), Incentives or bonuses, Conveyance allowance, House Rent Allowance (HRA), Medical allowance, Leave Travel Allowance or Concession (LTA / LTC), Vehicle Allowance, Telephone / Mobile Phone Allowance and Special Allowance.
- Arriving or preparing the CTC of an employee is not an easy task. The components of CTC are monetary and non-monetary. It is important to understand the components of CTC before preparing the CTC of an employee. The following number of steps can be performed while arriving at the final CTC of an employee - Understand the components of CTC, perform research and communicate the salary range to employees.
- In the salary description of the organization. Many elements are listed in the salary package of an employee. Compared to the CTC, there is one term: Take Home Salary. Take Home Salary is the exact thing is the exact amount an employee takes home. It means it is the amount which gets deposited in the account of the employees after all the necessary deductions like Tax Deducted at Source and Provident Fund Etc.
- It is important for an employee to understand the various salary ranges. An employee can understand the difference between the CTC and the Take Home Salary. The Take Home Salary can be calculated by understanding the following steps - Calculate the Gross Salary, Calculate the Taxable Income, Calculate the Income Tax and Calculate the Take Home Salary.

11.6 SELF ASSESSMENT TEST

1. Explain the concept of CTC. How is it calculated?
2. What is CTC? Explain the various elements which an employer considered while calculating CTC.
3. What comes under the scope of CTC? Explain the various components of CTC.
4. Write a detail on arriving at the CTC of an employee.
5. How can an employee understand the salary ranges? Support your answer with the help of some examples.

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12

REMUNERATION SURVEY

Unit Structure

12.0 OBJECTIVES

After studying this module, you should be able to:

- Understand the nature and relevance of Remuneration
- Importance of Remuneration
- Know about the Remuneration Survey
- How can Remuneration Survey result in a Salary Proposal

12.1 INTRODUCTION

12.1.1 Overview:

Remuneration is one of the most important human resource functions of an organization. The concept of remuneration represents the most important element in the employment relationship. For many organizations, the remuneration factor is the biggest single cost of running a business. The 21st century economy is a knowledge based and performance driven economy. A businessman drives his business with the help of innovations and technology to transform it as per the customer expectations.

In a course of time, every business develops with complexities. Beyond a level, managing alone becomes a difficult task for a person. The need for management has increased tremendously. So is the need for organizational development. The remuneration management helps organizations to develop and grow. In a changing business climate, it is important to understand the structural, cultural and strategic reality of work.

To facilitate organizational success, organizational development plays an important role. The existence and application of management is not only essential for growth and development but also it is essential for the survival of business organizations. There are several types of groups. Every human being has needs and desires. Organizations understand and work in this direction to provide better goods and services to the customers. These needs and wants can be satisfied by working and living together in an organized group of organizations.

A good remuneration model can help to reinforce the key corporate values and facilitate the achievement of organizational objectives. In the globalization era, where the business environment has become increasingly challenging, an effective compensation system helps to attract the talent candidates for the organization. The concept of remuneration can be divided into three types - direct remuneration, indirect remuneration and non-monetary remuneration.

12.1.2 Meaning:

Remuneration is a systematic approach of providing monetary value to employees in exchange for the work or services they performed. The term remuneration denotes all forms of financial returns and tangible benefits that an employee receives for the work performed in an organization. Remuneration management is also known as salary and profits administration, remuneration control, or reward management.

Remuneration is a monetary payment given to an individual in exchange for their services. It may be defined as money received in performance of work and many kinds of services and benefits. An organization provides many kinds of services and benefits to their employees. This all comes under remuneration management. In simple words, we can say that remuneration is the remuneration received by an employee in return for their contribution to the organization.

The main objective of remuneration management is to recruit and retain the qualified employees. A proper system of remuneration and sure that the employer is willing to pay and the employees are going to perform in the best way. A good remuneration system represents the most important element in the employment relationship between the employer and employee. It also helps to motivate employees for better performance and maintain morale.

12.1.3 Definition:

Section 2(78) of the the Companies Act, 2013 defines 'remuneration' as follows: "means any money or its equivalent given or passed to any person for services rendered by him and includes perquisites as defined under the Income-tax Act, 1961"

Remuneration refers to the money or the value equivalent like perquisites paid to any person for the services rendered by him / her to the Company. The term ‘perquisites’ refers to the benefits as defined under the Income Tax Act, 1961.

According to section 17(2) of the Income Tax Act, 1961, ‘perquisite’ includes the following: “perquisite” includes:

(i) the value of rent-free accommodation provided to the assessee by his employer;

(ii) the value of any concession in the matter of rent respecting any accommodation provided to the assessee by his employer;

Remuneration management is an integral part of human resource management. It is a tool used by management for a variety of purposes to further the existence of the company. Compensation management consists of a number of activities pertaining to job evaluation, market rate analysis, job analysis, pay structure design and maintenance, etc. Compensation is one of the most important human resource functions of an organization.

Remuneration is a systematic approach of providing monetary value to employees in exchange for the work or services they performed. The term remuneration denotes all forms of financial returns and tangible benefits that an employee receives for the work performed in an organization.

Remuneration is a monetary payment given to an individual in exchange for their services. It may be defined as money received in performance of work and many kinds of services and benefits. An organization provides many kinds of services and benefits to their employees.

Remuneration helps to determine the employees wages and salary. A good remuneration model can help to reinforce the key corporate values and facilitate the achievement of organizational objectives. In the globalization era, where the business environment has become increasingly challenging, an effective compensation system helps to attract the talent candidates for the organization. Remuneration is an organized practice and it also represents the most important element in the employment relationship. The structure comprises a number of different elements that may be cash and non-cash payments.

12.2 REMUNERATION SURVEY

12.2.1 Introduction:

Remuneration survey is a tool used to determine the median or average compensation paid to employees in one or more jobs. Remuneration data, collected from several employers, is analyzed to develop an understanding of the amount of remuneration paid. The survey data of compensation is often time sensitive and may become out-of-date quickly. The remuneration survey may focus on:

- Job titles

- Geographic regions
- Employer size
- Industries

Remuneration surveys are analyses of the data. The data of remuneration survey may include the following aspects:

1. Basic salaries
2. Working hours
3. Work profile
4. Increase amounts
5. Range of salary
6. Initial salary
7. Bonuses
8. Incentives
9. Benefits
10. Allowances
11. Educational qualifications
12. Location of the work
13. Hiring source
14. Recruitment process

12.2.2 Sample Questions:

The following questions can be taken as a survey for the remuneration survey:

1. Name of the Respondent

……………………………………………………………………..
……………………………………………………………………..

2. Employment Status

- Full Time Employed
- Part Time Employed
- Self-employed
- Hourly Contract
- Retired
- Seeking Work

3. Gender
- Male
- Female
- Third Gender

4. Years of Experience
- Fresher
- 1-4 Years
- 5-10 Years
- 11-15 Years
- 16-20 Years
- More than 20 years

5. Type of Work
- Manual
- Computer Based
- Machine Based
- Professional
- Other …………………….

6. My organization believe in gender equality
- Strongly Agree
- Partly Agree
- Disagree
- No opinion

7. My organization is culturally and ethnically diverse -
- Strongly Agree
- Partly Agree
- Disagree
- No opinion

8. My organization has a career plan for my future -
- Yes
- No

9. While considering a job, which factor is more important?

- Salary
- Working conditions
- Work life balance
- Opportunities to progress career
- Flexible working conditions
- Job satisfaction
- Reputation at work
- Reputation of company and job

10. Please mark the non-cash benefits offered by the company -

- Health Insurance
- Transport facility
- Annual Leaves
- Vacation Leaves
- No benefits

11. What is the most important factor for your well being?

- Health
- Finances
- Insurance
- Work life balance
- Workload
- Personal relations
- Worklife relations
- Flexible work
- Job security
- Employment

12. Is your employer concerned about your wellbeing?

- Yes
- No

While participating in a survey, the following steps can be considered:

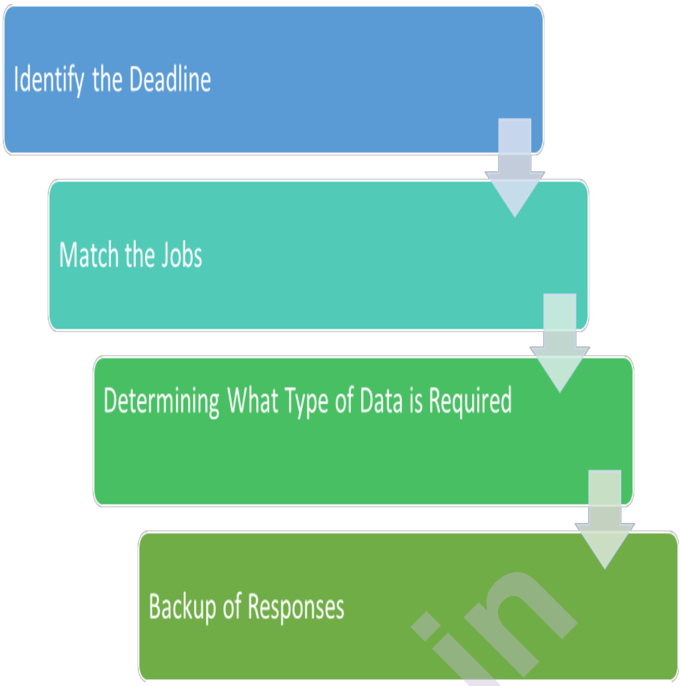

Fig. 12.1: Steps for Participating in a Survey

1. Identify the Deadline:

It is important to identify the last date or deadline for submitting any survey. The remuneration survey data is collected for and during a specific time frame. Respondents while participating should identify the deadline for the remuneration survey.

2. Match the Jobs:

The second step is based on matching the jobs with the survey questionnaire. Matching the jobs with the survey questionnaire should consider several factors like job title, the structure of the organization and duties required for a particular job.

3. Determining the Type of Data Required:

The third step requires the data determination process. In this step, it is important to determine the type of data required for the remuneration survey. If the things are not clear to the respondents, the data required for the remuneration survey may get deviated and will not meet the purpose.

This step should match the:

- Salary ranges
- List of employees
- Job titles etc.

4. Backup of Responses:

In this step, a respondent can keep a copy of responses before submitting the remuneration survey.

12.3 MARKET DATA

In the 21st century, meeting the challenges of recognising and rewarding employees will be the cornerstone of business success in the long term. Most of the organizations have not anticipated the resources which are required to meet the challenges of retaining and motivating the employees. When an organization works in a competitive market, it becomes essential for them to understand the kind of employees employed in their organization and the compensation required to keep and maintain them.

It is important to consider that the successful management of compensation surveys should be based on the knowledge of the employment and taxation laws, customs, environment and employment practices of many companies. While designing a compensation survey, it is important to you the market data. Market data also deals with the currency fluctuation and the effect of inflation on compensation. It also helps to understand why the special allowances are necessary in any country.

Market data also helps to understand the:

- Grading system
- Salary ranges
- External factors
- Performance management system
- Guidelines
- Economic factors etc.

Market data also helps organizations to control the labor cost. While designing a remuneration survey, one must understand that the compensation management should focus on the objective of increasing productivity and enhancing quality and customer service. The present competitive environment requires new strategies towards employees. While designing a survey, it is important to keep such kind of things in mind

12.4 REMUNERATION SURVEY RESULT IN A SALARY PROPOSAL

Remuneration surveys are tools used to determine the median or average remuneration paid to employees in one or more jobs. Remuneration data, collected from several employers and respondents , is analyzed to develop an understanding of the amount of remuneration paid. It also helps to convert the data into a salary proposal. An employee receives compensation from a company and in return for the work performed. Most people think that compensation and payment are the same concept. The fact is compensation is much more than just the payment provided by an employer.

The key in designing any remuneration survey into a salary proposal requires the study of multiple factors of the organization. The study states that if the compensation and remuneration management model is properly designed, it helps an organization to take the best from the employees in terms of productivity and performance. On the basis of remuneration survey, the people were involved in the committee of designing a compensation system can work on the following steps -

Step I - Putting focus on the strategy objectives and goals

Step II - Ensuring the participation and commitment through communication

Step III - Analyzing the job functions

Step IV - Writing the job description

Step V - Determination of internal pay equity

Step VI - Determination of External pay equity

Step VII - Designing the salary and remuneration structure

Step I - Putting focus on the strategy objectives and goals:

The first step in designing a remuneration system is to focus on the strategy objectives and goals. Before designing a compensation strategy, focusing on designing a compensation system to support the strategic objectives of the organization has to be taken into consideration. The following factors need to be determined -

- Vision and mission of the organization
- Strategic goals and objectives
- Cost to replace employees
- Designing the total compensation package
- External market equity and internal worth etc.

Step II - Ensuring the participation and commitment through communication:

Communication is one of the most important management functions. It also helps organizations to run. Ensuring the commitment and participation of employees through communication is an important element of the remuneration system. Before beginning to tackle something, it is important that the executive staff is absolutely committed to the process. This step involves following components to be worked upon:

- Techniques of participation
- Current issues with the remuneration
- Job clarification
- Salary administration
- Feedback collection
- Reviews and ideas collection

Step III - Analyzing the job functions:

Analyzing the job functions is the third step while preparing a salary proposal for the candidate. An executive must develop a current and thorough understanding of the work that will be performed by the employee in future. While analyzing a job, it is important to collect the relevant information like -

- Type of the job
- Scope of the job
- Duties to be performed
- Responsibility of the job

This step is the foundation for job description and also enables the organization to establish the information about the type and level of responsibility along with the qualification required to perform the work in an organization.

Step IV - Writing the job description:

A job description explains the tasks, duties, function and responsibilities of a position. Once the information is collected and analyzed, it can be used for job description. To perform any job, the general nature of the work, tasks, responsibilities and duties need to be communicated to the employees. Before that, the pay structure should be finalized on the basis of the work to be performed by the employee. That's why this process is considered important.

Step V - Determination of internal pay equity:

The internal pay equity determines the fairness within the organization. It can be determined by the job evaluation techniques. When the pay is equitable, it is considered fair and just for an employee to work in an organization.

The techniques like:

- Job ranking method
- Factor comparison technique can be used to evaluate the job.

Step VI - Determination of external pay equity:

After determining the internal pay equity, the determination of external pay equity is also required. It is the perceived fairness in pay relative to what other employees are paying for the same type of labor. Market price if recommended to stand in this competitive world while designing a pay structure.

Step VII - Designing the salary and remuneration structure:

On the basis of the above steps, the final step deals with designing the salary and remuneration structure. In this step,

- Salary structure is designed
- Pay structure is designed
- Remuneration and compensation system is established
- Pay ranges
- Positions are assigned to grades
- Minimum, midpoint and maximum salary range is discussed.

12.5 SUMMARY

- A good remuneration model can help to reinforce the key corporate values and facilitate the achievement of organizational objectives. In the globalization era, where the business environment has become increasingly challenging, an effective compensation system helps to attract the talent candidates for the organization. The concept of remuneration can be divided into three types - direct remuneration, indirect remuneration and non-monetary remuneration.
- Remuneration is a monetary payment given to an individual in exchange for their services. It may be defined as money received in performance of work and many kinds of services and benefits. An organization provides many kinds of services and benefits to their employees. This all comes under remuneration management. In simple words, we can say that remuneration is the remuneration received by an employee in return for their contribution to the organization.
- Remuneration survey is a tool used to determine the median or average compensation paid to employees in one or more jobs. Remuneration data, collected from several employers, is analyzed to develop an understanding of the amount of remuneration paid. The

survey data of compensation is often time sensitive and may become out-of-date quickly. The remuneration survey may focus on Job titles, Geographic regions, Employer size and Industries.

- It is important to consider that the successful management of compensation surveys should be based on the knowledge of the employment and taxation laws, customs, environment and employment practices of many companies. While designing a compensation survey, it is important to you the market data. market data also deals with the currency fluctuation and the effect of inflation on compensation. It also helps to understand why the special allowances are necessary in any country.
- Market data also helps to understand the - Grading system, Salary ranges, External factors, Performance management system, Guidelines, Economic factors etc.
- Remuneration surveys are tools used to determine the median or average remuneration paid to employees in one or more jobs. Remuneration data, collected from several employers and respondents , is analyzed to develop an understanding of the amount of remuneration paid. It also helps to convert the data into a salary proposal. An employee receives compensation from a company and in return for the work performed. Most people think that compensation and payment are the same concept. The fact is compensation is much more than just the payment provided by an employer.

12.6 SELF ASSESSMENT TESTS

1. What is a remuneration survey? Explain in detail.
2. Explain the rationality of remuneration surveys.
3. Why is market data important? How does it help in designing a remuneration survey?
4. “Remuneration surveys are essential in fixing pay” Explain this statement in the light of the present remuneration system.
5. Explain various prerequisites and factors while designing a salary structure.
6. How does a remuneration survey result in a salary proposal.

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13

EQUITY COMPENSATION PLANS

Unit Structure

13.0 OBJECTIVES

After studying this module, you should be able to:

- Understand the nature and relevance of Equity Compensation
- Know the various Types of Equity Compensation Plans
- Understand How does ESOP work?
- Understand the Advantages and Disadvantages of Equity Compensation Plans

13.1 WHAT IS EQUITY COMPENSATION?

13.1.1 Overview:

Compensation helps to determine the employees wages and salary. A good compensation model can help to reinforce the key corporate values and facilitate the achievement of organizational objectives. In the globalization era, where the business environment has become increasingly challenging, an effective compensation system helps to attract the talent candidates for the organization. Compensation is an organized practice and it also represents the most important element in the employment relationship. The structure comprises a number of different elements that may be cash and non-cash payments.

According to **Milkovitch and Newman,** "Compensation is all forms of financial returns, tangible services and benefits employees receive as part of an employment relationship."

From the employer's point of view, the compensation model represents a significant part of his cost. As mentioned earlier, a good compensation model increases the productivity and performance of an employee. Ultimately, their increased performance and productivity contributes to increasing the competitiveness of the organization. A good compensation model helps organizations to attract and retain the new talent. It attracts the best candidates for the organization. People before joining any organization always give first preference to salary and goodwill of the company.

When employees get good pay, they like to stay in an organization. The proper compensation model helps them to stay with the employer for the long term or may be forever. It boosts employee loyalty towards organization as they dont leave and employers don't need to continue to spend time, money and energy on recruiting new candidates. It is observed that the contented employees are the most productive employees. When the organization, through a good compensation model, pays a sufficient amount for the work of employees, they automatically feel motivated and perform well. Equity compensation plans play a vital role in increasing the overall productivity and performance of the organization.

13.1.2 Concept of Equity Compensation:

Stock options are popularly known as Employee Stock Option. Employee Stock Option is a contract between two parties that gives the buyer the right to buy or sell underlying stocks at a predetermined price and within a specified time period.

There are two types of stock option:

- Call Option
- Put Option

A seller is paid a premium from the contract purchased by the buyer and known as option writer. He is the one who sells the stock option to the employees. This practice of compensation is also known as equity option. Many companies are offering equity to their employees. As the name suggests, it is an option not an obligation on the part of the investor.

The employee stock option is a type of equity compensation. It is granted by the companies to their executives and employees. In this type of compensation rather than granting shares of stock directly, the company gives derivative options on the stock instead. The great benefit of this type of compensation can be determined when the stock prices of the company rises.

It also contributes in increasing the worth of the employees in terms of the stocks they have in their names. It provides an opportunity to employees to share directly in the company's success through stock holdings. As the employees own a stake in the company, they feel more productive and motivated. From the employer's point of view, it is understood that a productive employee produces more. The employee stock option boosts job satisfaction. It also helps them to boost their financial strength. It is a key tool to recruit the best and retain the best.

13.1.3 Features of Equity Compensation Plans:

To understand the elements of the stock option, it is important to understand the following features of stock option:

1. Understanding the Concept:

Stock options are popularly known as Employee Stock Option. Employee Stock Option is a contract between two parties that gives the buyer the right to buy or sell underlying stocks at a predetermined price and within a specified time period. There are two types of stock options - Call Option and Put Option.

The employee stock option is a type of equity compensation. It is granted by the companies to their executives and employees. In this type of compensation rather than granting shares of stock directly, the company gives derivative options on the stock instead. The great benefit of this type of compensation can be determined when the stock prices of the company rises. It also contributes in increasing the worth of the employees in terms of the stocks they have in their names.

2. Right to Buy Companies Share:

The employees of the organization get rights to but the companies share at a fixed price. A seller is paid a premium from the contract purchased by the buyer and known as option writer. He is the one who sells the stock option to the employees. This practice of compensation is also known as equity option. Many companies are offering equity to their employees. As the name suggests, it is an option not an obligation on the part of the investor.

3. Working of Stock Option:

The option value can go up and down. It is not easy to understand the working of a stock option. One must have some knowledge of finance when it comes to understanding this topic. The option can go up and down. The great benefit of this type of compensation can be determined when the stock prices of the company rises.

4. Vesting Period:

Vesting is a word which deals with acquiring the stock option of a company. It is a process by which an employee acquires a "vested interest" or "stock option" in their company. It is a process of earning like an asset.

5. Two Types of Stock Option:

Companies can offer or grant two types of stock option:

a. Non-qualified Stock Option

b. Incentives Stock Options

Non-qualified stock options do not qualify for special tax treatment. While, incentives stock options qualify for special tax treatment.

6. Expiration Feature:

The term of the stock option is limited. If it is not exercised within the time limit, it may expire. Stock options always have a limited term during which they can be exercised. The most common term is 10 years from the day of grant.

13.2 TYPES OF EQUITY COMPENSATION PLANS

The following are the various types of equity compensation plans:

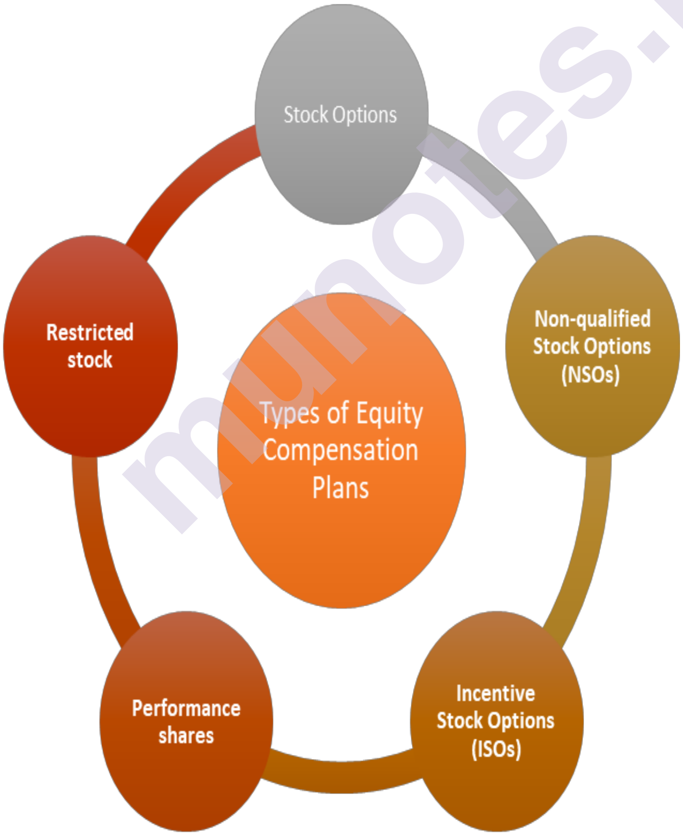

Fig. 13.1: Types of Equity Compensation Plans

1. Stock Options:

As mentioned earlier, stock options are popularly known as Employee Stock Option. Employee Stock Option is a contract between two parties that gives the buyer the right to buy or sell underlying stocks at a predetermined price and within a specified time period. The employee stock option is a type of equity compensation. It is granted by the companies to their executives and employees. In this type of compensation rather than granting shares of stock directly, the company gives derivative options on the stock instead. The great benefit of this type of compensation can be determined when the stock prices of the company rises.

There are two types of stock option:

- Call Option
- Put Option

2. Non-qualified Stock Options:

Non-qualified stock option is an additional type of equity compensation. It is a type of employee stock option wherein an employee pays ordinary income tax on the difference between the grant price and the price at which a person exercises the option. The non-qualified stock option gave the right to employers. Employers do not have to report when they receive this option or when it is exercised.

3. Incentive Stock Options:

Incentive stock options are favored because of tax. They offer special tax advantages. This option is available only for employees. This stock option provides an opportunity to employees to acquire shares at a set price at a later date. The date on which given the options is known as the “grant date” and the fixed price at which one can purchase shares is known as the “strike price” or “exercise price.”

4. Performance Shares:

As the name suggests, performance shares are awarded to employees on the basis of their performance. These shares are awarded to employees only when specific metrics are fulfilled. The specific metrics are -

- Return on equity
- Earning per share
- total return of the company’s stock

5. Restricted Stock:

Restricted stocks do not provide any ownership to employees. Restricted stocks are unfunded promises to issue shares in the future, and the employee will not be able to vote the shares or have a right to dividends.

13.3 HOW DOES EQUITY COMPENSATION PLANS WORK?

Employee stock ownership plan is a defined contribution benefit that allows employees to become owners of stock in the company they are working for. In an equity compensation plan, the organization distributes shares of stock to its employees. After getting the stock, the employees become owners of stock. The employees receive regular updates and resorts on the value of the stock owned by them. When they leave the organization, they may sell the stock to the organization or on the open market.

In this section, we will also see how does equity compensation plans work:

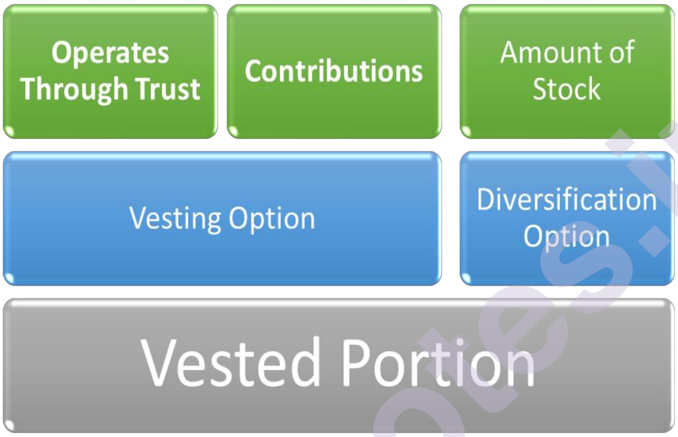

Fig. 13.2: Working of Equity Compensation Plan

1. Operates Through Trust:

Most of the equity compensation plans work through a trust. This trust is set up by the company. The company accepts tax deductible contributions from the company to purchase the stock of the company.

2. Contributions:

After arranging the contributions, the company distributed them among individual employee's accounts. The distribution takes place within the trust.

3. Amount of Stock:

The amount of stock which was distributed by the company may vary. It may vary according to pre-established formulas. The pre-established formulas may be based on:

- Salary
- Position
- Service

4. Vesting Option:

After getting the stock the employee may cash out after vesting. When they leave the company, they may do that. On the basis of their vesting requirements, they may cash out the amount. Vesting is a word which deals with acquiring the stock option of a company. It is a process by which an employee acquires a "vested interest" or "stock option" in their company. It is a process of earning like an asset.

5. Diversification Option:

When the employee age reaches the age of 55, a stockholder employee who has at least ten years of participation must be given the option of diversification. In this option, he/she can diversify the amount of stock up to 25% of the value.

They can avail this option until they reach the age of sixty.

6. Vested Portion:

At the time of termination, disability, death or retirement, the employee receives the vested portion of their accounts. The amount may be made in lump sum or in installments over a period of years. In case of death or disablement of an employee, his beneficiary may get the portion.

13.4 ADVANTAGES OF EQUITY COMPENSATION PLAN

The equity compensation plans have proved to be very beneficial for the organizations. The most popular among all is stock options. Stock options are popularly known as Employee Stock Option. Employee Stock Option is a contract between two parties that gives the buyer the right to buy or sell underlying stocks at a predetermined price and within a specified time period. There are two types of stock options - Call Option and Put Option.

The employee stock option is a type of equity compensation. It is granted by the companies to their executives and employees. In this type of compensation rather than granting shares of stock directly, the company gives derivative options on the stock instead. The great benefit of this type of compensation can be determined when the stock prices of the company rises. It also contributes in increasing the worth of the employees in terms of the stocks they have in their names.

The option value can go up and down. It is not easy to understand the working of a stock option. One must have some knowledge of finance when it comes to understanding this topic. The option can go up and down. The great benefit of this type of compensation can be determined when the stock prices of the company rises.

Many retirement plans under the equity compensation plans have proved to be effective. At the time of termination, disability, death or retirement, the employee receives the vested portion of their accounts. The amount may be made in lump sum or in installments over a period of years. In case of death or disablement of an employee, his beneficiary may get the portion.

Apart from this in general, the following points can be considered to understand the advantages of equity compensation plan:

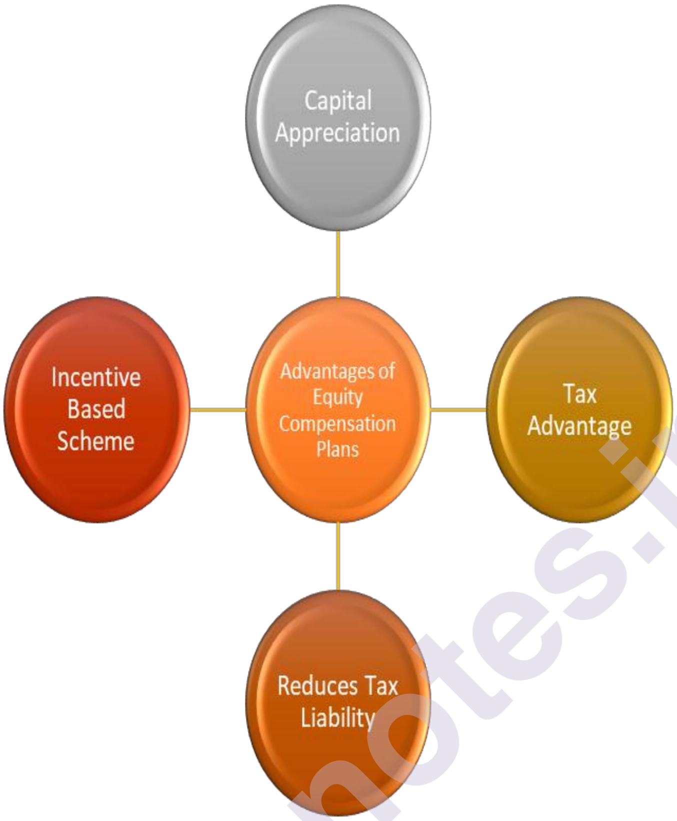

Fig. 13.3: Advantages of Equity Compensation Plan

1. Capital Appreciation:

The concept of equity compensation plan allows the owner to sell the major portion or 100% of his company to get money. The money is tax free and the owner still gets the control of the company though he enjoys sharing the ownership of the company with others too to a limited extent.

Companies sell some of their equity to employees. By selling their equity, they convert the corporate and personal taxes into text free capital appreciation. That's why it is considered as one of the advantages of an equity compensation plan.

2. Tax Advantage:

Tax advantage is also one of the benefits a company draws by taking up equity compensation plans. As mentioned earlier, companies sell some of their equity to employees. By selling their equity, they convert the corporate and personal taxes into text free capital appreciation.

It enables tax advantage purchasing of stock of a retiring company owner. A company owner may sell their shares to Employee Stock Ownership Plan and incur no taxable gain on the sale of these shares.

3. Reduces Tax Liability:

The tax liability increases the expenditure pattern of a company. A company can reduce corporate income taxes and increase its cash flows. The corporate tax amount can be reduced with the help of equity compensation plans.

4. Incentive Based Scheme:

Profit sharing is a plan in which an employer gives the right to an employee to be a part of profit sharing of the organization. It is a type of pre-tax contribution plan for employees that gives workers a certain amount of a company's profits. The amount of profit sharing is up to the company how much they would like to share with the employees.

Equity compensation plans are also termed as incentive based schemes just like profit sharing. It helps employees to increase the worth of their assets.

13.5 DISADVANTAGES OF EQUITY COMPENSATION PLAN

Just like advantages, there are some disadvantages of equity compensation plans. We will study these points one by one:

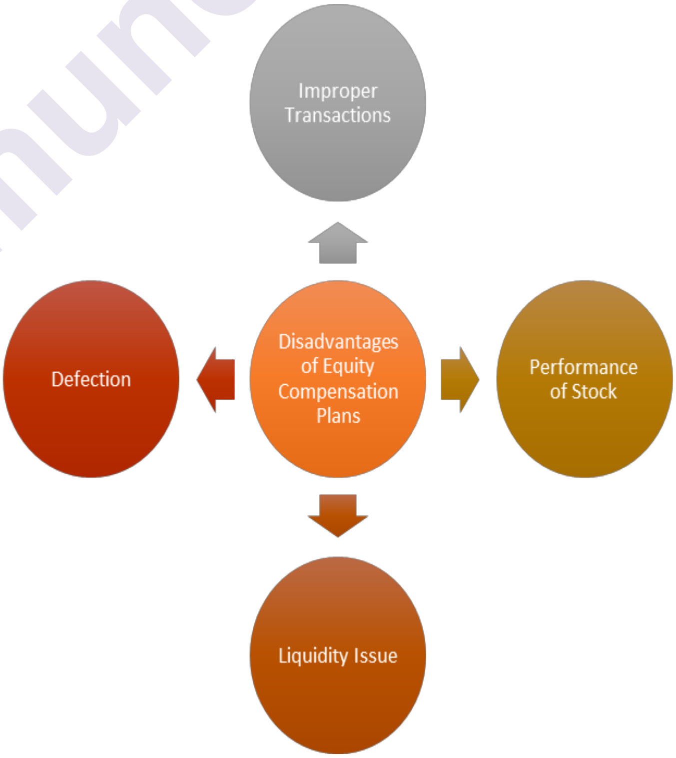

Fig. 13.4: Disadvantages of Equity Compensation Plans

1. Improper Transactions:

If the company or the executive body of the equity compensation plan are knowingly participating in improper transactions, they can be held liable. Sometimes, the executive members of the equity compensation plan are deemed to be fiduciaries.

2. Performance of Stock:

Not every stock of the company performs well. If the value of the stock of the company does not perform well, the employee may feel that the equity compensation plan is less attractive than a profit sharing plan. Profit sharing is a plan in which an employer gives the right to an employee to be a part of profit sharing of the organization. It is a type of pre-tax contribution plan for employees that gives workers a certain amount of a company's profits.

3. Liquidity Issue:

The liquidity issue may rise due to the appreciation of the value of stock. The option value can go up and down. It is not easy to understand the working of a stock option. One must have some knowledge of finance when it comes to understanding this topic. The option can go up and down. The great benefit of this type of compensation can be determined when the stock prices of the company rises.

At the time of termination, disability, death or retirement, the employee receives the vested portion of their accounts. The amount may be made in lump sum or in installments over a period of years. In case of death or disablement of an employee, his beneficiary may get the portion.

If the company will face the liquidity issues, they may not be in a solution to repurchase stock upon employees retirement.

4. Defection:

There may be cases of defection, if the cash flow benefits are weighted against the rate of dilution. Sometimes, companies use an equity compensation plan to finance the operation to achieve company growth.

13.6 SUMMARY

- A good compensation model increases the productivity and performance of an employee. Ultimately, their increased performance and productivity contributes to increasing the competitiveness of the organization. A good compensation model helps organizations to attract and retain the new talent. It attracts the best candidates for the organization. People before joining any organization always give first preference to salary and goodwill of the company.
- The employee stock option is a type of equity compensation. It is granted by the companies to their executives and employees. In this type of compensation rather than granting shares of stock directly, the

company gives derivative options on the stock instead. The great benefit of this type of compensation can be determined when the stock prices of the company rises.

- Stock options, NSOs, ISOs, Performance Shares, Restricted stock are some important types of equity compensation plans. Among them, stock options are the most popular tool.
- Employee stock ownership plan is a defined contribution benefit that allows employees to become owners of stock in the company they are working for. In an equity compensation plan, the organization distributes shares of stock to its employees. After getting the stock, the employees become owners of stock. The employees receive regular updates and resorts on the value of the stock owned by them. When they leave the organization, they may sell the stock to the organization or on the open market.
- Capital appreciation, tax benefits, less tax liability and incentive based schemes are some advantages of equity compensation plans.
- Improper transactions, performance of stock, liquidity issues and defection are some disadvantages of equity compensation plans.

13.7 SELF ASSESSMENT TESTS

1. Describe the concept of Stock Option. Explain the salient features of stock options.
2. Write a note on understanding the elements of stock options.
3. What is an equity compensation plan? Explain the important features of an equity compensation plan.
4. How does Equity Compensation Plans work?
5. Explain the various types of Equity Compensation Plans.
6. Write down the advantages of Equity Compensation Plans.
7. Highlight the disadvantages of Equity Compensation Plans.

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14

CASE STUDIES AND PRESENTATIONS

Unit Structure

14.0 OBJECTIVES

After studying this module, you should be able to:

- Understand the relevance of case studies.
- Know about the methodology to solve case studies.
- Understand how it helps to increase the intellectual ability among students.
- Study how it helps to create a decision making skill among students.

14.1 CASE STUDY - I

The Alpha Company Limited decided to open a new branch in Kanha, Mandla District, Madhya Pradesh. Kanha is an exclusive tourist place. People who love to see nature and visit the sanctuaries used to come frequently to this place. There is no office of Alpha Company Limited at present. The company has determined the appropriate salary for the clerical staff it needs to recruit in the new office. The clerks who are employed in other offices receive a starting salary of Rs. 12,000 /- per month. The pay scales have been fixed at par with other offices in the city.

A survey was taken to estimate the cost of living in a tourist place like Kanha. The survey results showed that the salary at present being paid to staff should be 14,000 /- due to high cost of living. Kanha is a tourist destination and a limited number of people are employed like any other city.

Questions:

1. What are the issues involved in this case?
2. Is it justifiable to provide different pay scales for the same job at two different locations? Give reasons.
3. Determine the appropriate salary structure for the staff of the company.

14.2 CASE STUDY - II

Mr. Atul is working as a Branch manager in Yes Bank. He is posted in the East Mumbai branch. He along with his four clerks, one cashier and two attendants works in a branch. Very often, he works alone after 5:00 PMfor the bank work. He stays to tally accounts, day books and the other formalities of the bank. 1st April is a holiday for banks. On the night of 31st March, he was completing his work as it was the last working day of the financial year. He stayed in the bank till past 1:00 AM.

Unfortunately, Mr. Atul was attacked by a group of robbers. The robbers not only attacked the branch manager but also looted Rs. 10 Lakhs cash from the bank. Mr. Atul was admitted immediately as he was seriously injured. After recovering, Mr. Atul applied for compensation. The bank management was of the opinion that he violated the job conditions by working beyond the working hours and should not be compensated. In fact, he was called for an explanation as to why the amount which the bank lost in the form of cash cannot recovered from his salary or provident fund.

After the accident, the FIR was lodged but even after his recovery, the police was not able to arrest the culprits.

Questions:

1. Where do you see the position of Atul in this case?
2. How do you justify the bank management decision and explanation they are demanding in this case?
3. Who is at fault in this case?
4. It is wrong to work beyond the working hours to complete the work in time - Give your opinion

14.3 CASE STUDY - III

The human resource Management team of the CB Company Limited suggest to the management how to strategically manage people as business resources. The team feels that the compensation is the most important factor to run an organization. Miss Abha, the vice president of the company, was addressing the meeting. In her address, She puts stress on increasing the productivity and efficiency of the employees.

She was asking for a suggestion from the executive team of the company. During the discussion, Mr. Aditya , Human Resource Manager of the company suggested to involve the employees directly in framing the compensation policy of the company. As it was an open discussion, everyone was free to share their opinion. After hearing this, Miss Abha reacted negatively and left the meeting.

The people working in the company are generalists rather than specialists. After the meeting, Mr. Aditya was blamed for spoiling the agendas of the meeting. Soon, he was handed over the show cause notice for violating the norms of the meeting.

Questions:

1. What impact will the above case leave in the mind of the remaining executives?

2. Who is at fault in this case?

3. Why did Miss Abha react like this? If you were at her place, what would be your reaction?

4. Is it wrong to involve people in compensation policy? Support your answer from the point of view of Mr. Aditya.

14.4 CASE STUDY - IV

Mr. Ravi, Human Resource Manager of ITC group contacted the Managing Director and informed him about the absence of Mr. Ram, the clerk of the office for the past 20 days. He requested him to approve the show cause notice to be served to Mr. Ram for being absent for so long from the office without intimation.

The Managing Director advised Mr. Ravi to find out the reason for his absence from the office for so long. He instructed him to go or send someone today and check him. Mr. Ravi personally went and found that Mr. Ram was absent due to health issues. He has been trying to arrange the money for his treatment and was unable to arrange the same. Mr. Ravi after knowing and coming back to office reported his condition to the Managing Director and told the reason for his distress and absenteeism from the work.

The M.D. immediately instructed Mr. Ravi to provide the financial assistance to Mr. Ram from the company's fund. This news spread in the entire company within no time.

Questions:

1. Which approach of human resource management was used in this case?

2. "Treating the employees as human beings is a fundamental theme of human resource management"- Explain this statement.

3. What would have been your stand if you were at the place of Mr. Ravi?

4. Who is the hero of this case?

14.5 CASE STUDY - V

While designing a CTC for an employee, Mr. Raj received a complaint from the supervisor that the new employees are not following instructions properly. Mr. Raj, the Human resource manager, thought to observe the case first. He instructed the supervisor to determine the behavior of new employees and prepare a simple checklist based on their behavior. The checklist spud contain the following questions -

1. Are the employees satisfied with the present salary structure?

2. Do they follow the instructions of superiors?

3. Are they happy with the allowances?

4. Do they make mistakes unknowingly?

After observing the answers, Mr. Raj analyzed that the new employees are not satisfied with the present salary structure. They feel the company is giving them less and the comparative to that is more.

Questions:

1. What would you do if you were at the place of Mr. Raj?

2. What should be the stand of the supervisor in this case?

3. Is it possible to revise the present salary structure for the new employees.

14.6 CASE STUDY - VI

Naria Company is a pesticide manufacturing company. There are extensive rules and regulations that employees are instructed to follow. Every employee has specific work and objectives to achieve in his job. Managers supervise employees closely to ensure that there are no deviations. People are allowed to do little deviations in doing their jobs.

The employees are allowed to bring and report any unusual problems to communicate through normal channels. In this company, the management has little confidence in the employees. The imposement of rules and regulations is very tight. The job rotation is very common. All the employees in their work are generalists rather than specialists. The employees are not happy with the current reward strategy. Though, efforts, loyalty and cooperation are highly rewarded.

Questions:

1. Are employees likely to be committed?

2. What impact will it have on the reward strategy?

3. Explore the role of allowances in reward strategy.

14.7 CASE STUDY - VII

Vishal joined a pulp making plant located in Punjab, as AGM material. The plant which is a part of a huge conglomerate lured Vishal away from his previous organization. When he joined the organization, he did not go through any induction or orientation programme. In this organization, it was important to take the prior permission before ordering the material. Mr. Vishal was not aware of this rule.

In his previous organization, he was well inducted and oriented in the first week of his joining. Though he was not satisfied with the salary, the rest was good in the previous company. Before knowing, he placed the order. Mr. Ram, his manager refused to sign the bill as his approval was not taken by Mr. Vishal. Mr. Vishal for the first time felt humiliated at workplace. He was told to read the rules before doing anything in the company. His Salary was good and allowances was better than the previous organization.

Mr. Vishal after this incident decided to resign.

Questions:

1. What are the issues involved in this case?

2. Why the compensation structure of the company did not convince Mr. Vishal to stay in this organization?

3. Who is right in this case?

14.8 CASE STUDY - VIII

The reward strategy of the RRR Tech. Limited is found to be attractive. People working in the organization are happy with the current reward strategy. While dealing with the customers, company put emphasis on the following attributes:

- Ability to deal sensitively with customers.
- Not to threaten or talk arrogantly with the customers.
- Human skills like tolerance and patience should be practiced
- Always display pride in working with RRR

While doing the appraisal, these key points were considered first. Oneday, a customer created a problem. Miss Renu was the new joiner. During the discussion, an argument took place between her and the customer. She was fired immediately after this case.

Questions:

1. What are the issues involved in this case?
2. A proper reward strategy should involve the strategy for the retention of employees as well. - Discuss this statement in light of the above case.
3. What was the fault of Miss Renu? Was she not aware about the policy of the company?

14.9 CASE STUDY - IX

Sachin is a dynamic young man. He got his diploma in management and joined a Chennai based company as a management assistant. He pursued his studies and obtained a degree in the field of management. After obtaining the degree, he was promoted as the Sales Manager. He worked hard and became senior sales manager. His compensation and allowances increase by the time.

He was entrusted with one of the talented groups of the company. Issues started when the coordination between the group members got disturbed. He was agitated to receive new complaints everyday. He was in a thought to provide training to employees about team building and group cohesiveness. For that, he invited a few trainers from the different fields. After evaluating their behaviors, he found that the main problem was communication. He decided to have one to one talk with the employees to understand the situation better.

Sachin was a part of the appraisal committee. While evaluating the salary structure of his subordinates, he found that Anil and Sunil were appointed on the same post, same day but there is a deviation in their salary which was unusual. He pointed out this matter to his superiors and nothing came from them in the form of a response.

Anil whose pay was less resigned and joined the new organization. \

Questions:

1. Write the ethical issues involved in this case.
2. What do you feel about the role of Sachin in this case?
3. Why did the superiors not give any response to Sachin when the compensation deviation was informed to them?
4. Why did Anil leave the organization? Was he aware about this deviation in pay?

14.10 ROLE PLAY

Role play is an act where the participants are given some situations and they are expected to act in the role. The following steps can be followed for role play:

Step I - Introduce the Situation

Step II - Provide details

Step II - Assign Roles

Step III - Act

Step IV - Discuss the experience

Role Play - Situation I:

"I can't work with you anymore. It is getting unbearable to work under you in this organization. The pay in this organization is less and the work is more" Mr. Reddy said this to Mr. Rohan, hsi manager.

Kindly assign this role to two students and discuss this statement in the light of compensation and benefits.

Situation - II:

"I am amazed to hear this, the Board wishes to have residential quarters built for our employees close to the factory and has provided crores of rupees. And you are in an opinion and saying don't do it." Mrs. Radha Iyer said this to Miss Ramaiya, who works in an allowance department (A sub-department of HR)

Kindly assign this role to two students and discuss this statement in the light of compensation and benefits.

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