

Internal Assessment Test - I

Sub:	Compensation & Benefits (C&B)	Code:	16MBAHR303
Date:	27.09.17	Duration:	90 mins
		Max Marks:	40
		Sem:	III
		Branch:	MBA

		Marks	OBE	
			CO	RBT
Part A - Answer Any Two Full Questions (16*02=32 Marks)				
1 (a)	Define compensation.	[02]	CO1	L1
	(b) Discuss the Subsistence theory?	[06]	CO2	L2
	(c) Describe the Wage Fund theory and list the common criticisms.	[08]	CO3	L2
2 (a)	What do you mean by Dearness Allowances (DA).	[02]	CO3	L1
	(b) Elaborate on the concept of commission, reward and bonus?	[06]	CO1	L4
	(c) Discuss in details the three parameters used for determining & sanctioning DA.	[08]	CO2	L2
3 (a)	Define the term wage.	[02]	CO3	L1
	(b) Explain the Payment of Wage act, 1936	[06]	CO1	L2
	(c) Elaborate on the concept of Best Practices vs. Best Fit Options.	[08]	CO1	L4
Part B - Compulsory (01*08=08 marks)				
4. (a)	Explain the pay model considering an Indian or MNC company as example?	[08]	CO1	L2
			CO3	L4

Course Outcomes		PO1	PO2	PO3	PO4	PO5	PO6	PO7	PO8	PO9
CO1:	To know the theoretical and practical developments in the area of compensation and benefits.	1a,2 b,3b		3c			4a			
CO2:	To discuss the strategic importance of compensation for the achievement of organizational goals.									
CO3:	To understand the relationship between	1c,, 2c,3		1b,2 a						

	compensation objectives and business strategy.	a,								
CO4:	To discuss the role of compensation in attracting, motivating, and retaining a high-quality workforce.									
CO5:										
CO6:										

Cognitive level	KEYWORDS
L1	List, define, tell, describe, identify, show, label, collect, examine, tabulate, quote, name, who, when, where, etc.
L2	summarize, describe, interpret, contrast, predict, associate, distinguish, estimate, differentiate, discuss, extend
L3	Apply, demonstrate, calculate, complete, illustrate, show, solve, examine, modify, relate, change, classify, experiment, discover.
L4	Analyze, separate, order, explain, connect, classify, arrange, divide, compare, select, explain, infer.
L5	Assess, decide, rank, grade, test, measure, recommend, convince, select, judge, explain, discriminate, support, conclude, compare, summarize.

IAT-1 Answer Keys

Compensation & Benefits

Code: 16MBA HR303

1. *Define compensation?*

Ans. Compensation is all forms of financial returns and tangible services and benefits employees receive as part of an employment relationship.

2. *Discuss the subsistence theory?*

Ans. This theory is developed by David Ricardo (1772-1832). Based on the population theory of Thomas Malthus, advocated the Subsistence Theory. It held that the market price of labour would always tend toward the minimum required for subsistence. To enable them to subsist and perpetuate the race without increase or diminution "The theory was based on assumption that if the workers were paid more than the subsistence wage, their numbers would increase. If the wages fell below subsistence level, the number of workers would decrease, as many would die of hunger, malnutrition, disease, cold, etc and many would not marry. Generally, there are two kinds of subsistence

1. *Subsistence Living*: Subsistence means the minimal resources that are necessary for survival. If you work for subsistence, you'll probably receive food, water, and lodging (internet access not included). Subsistence can be used in a variety of subtly different ways.
2. *Subsistence Allowances*: "Is an allowance which is intended to account for lodging, meals, gratuities and other expenses. It is also called as Daily subsistence allowance (DSA)

3. *Describe the wage fund theory and list the common criticisms.*

Ans. It is developed by Adam Smith (1723-1790). On the assumption that wages are paid out of a predetermined fund of wealth, the surplus savings of the wealthy. The amount of wages fund is fixed. Wages can't be increased without decreasing the number of workers and vice versa. It is wage fund which determines the demand for labour. The funds could be utilized for employing labourers for work.

If the fund was large, wages would be high, if it was small, wages would be reduced to subsistence level. However, the supply of labour can't be changed at a given time, but if the supply of labour increases along with increase in population, the average wages will go down. Therefore in order to increase the average wages, firstly, the Wages Fund should be enlarged, secondly, the number of workers asking for employment should be reduced.

Criticisms of Wage Fund Theory

- This theory does not explain differences in wages at different levels and in different regions.
- It is not clear from where the Wages Fund will come.
- No emphasis has been given to the efficiency of workers and productive capacity of firms.
- This theory is unscientific as Wages Fund is created first and wages are determined later on. But in practice, the reverse is true.

4. What do you mean by Dearness Allowances (DA).

Ans. The words 'Dearness Allowances' primarily suggest and refer to allowances paid to employees in order to enable them to face the increasing dearness of essential commodities"

5. Elaborate on the concept commission, reward and bonus?

Ans. Commission is a sum of money that is paid to an employee upon completion of a task, usually selling a certain amount of goods or services

It can be paid as a percentage of the sale or as a flat dollar amount based on sales volume.

Employers often use sales commissions as incentives to increase worker productivity. When commission is paid in addition to a salary, it may be included in the employee's paycheck or paid on a separate schedule i.e. bi-monthly or monthly

Types of Commission Pay:

Base salary plus commission offers the employee a guaranteed base salary, plus a percentage of the sales that they make during a given period.

The advantage for the employee is that they can rely on their base salary during leaner sales periods. There is always fluctuation in sales during the course of the year, regardless of the product or service.

Straight commission means that the employee earns their entire salary based on a percentage of the sales they complete. This can be a very lucrative arrangement for highly talented and motivated salespeople

Residual Commission. Sometimes commissioned salespeople can earn residual commission on their clients goods and services for as long as the client continues to purchase from the company. This is common in insurance companies, where the salesperson would continue to receive a percentage of their clients payments for as long as the client stays with the company

Reward:

A thing given in recognition of service, effort, or achievement. Give something to (someone) in recognition of their services, efforts, or achievements. A **reward** is something that you are given, for example because you have behaved well, worked hard, or provided a service to the community. Rewards can be in the form of *money as a motivator* and *Non-Financial Rewards*. Money- Incentives, bonus & etc. Non-Financial Reward- Holiday, gifts and promotions

Bonus

A sum of money added to a person's wages as a reward for good performance

Bonus- India Perspective; Statutory status with the enactment of the payment of bonus act, 1965.

The act is applicable to factories and other establishments employing 20 or more employees

- The act has statutorily imposed an obligation on the employer to pay bonus to employees at the minimum rate of 8.33 percent of the salary earned. The maximum is fixed at 20 %, The act has restricted payment of bonus to employees drawing wages or salaries up to Rs 10,000 per mensem (is defined as by the month)

6. *Discuss in details the three parameters used for determining & sanctioning DA.*

Ans. The system of DA for employees began during the second world war when the government sanctioned a scheme of grain allowance to their lowest paid employees

Gradually, many other classes of employees in organized and partly unorganized sector began to receive DA as means to protect, to some extent, the real income of wage earners and salaried employees from the effects of price rise. DA is paid to neutralize the rise in prices

In other countries where similar practice exists, it is referred to as a practice of inflation adjusted earnings or COLA (Cost of Living allowances)

Even in India, section 3 of the minimum wages act refers to it as Cost of Living Allowances

The existing scheme for the determination and sanction of DA usually has three parameters i.e

✓ The index factor

Is usually the All India Consumer Price Index (AICPI) number for industrial workers (Base 1960=100 AICPI)

This is compiled and published by the Labour Bureau, Shimla

Since 1977, two committees, one headed by Nilakanth Rath and other by seal, have gone into the matter.

The findings of both the committees have been debated and disputed federation of workers unions and employers (Reason being- Why can't it be local or regional level)

✓ The Time Factor

The second parameter is the manner in which the variation in the index selected is used

The scheme of DA should be related directly to the rise in the index selected

The allowances may go up with the revision in the index based on the average for a selected period to offset the temporary fluctuations in the index.

Thus, the time factor also plays a role in determining the allowance and many schemes related to averages ranging from a quarter to a 12 monthly moving average

✓ The Points Factor

The third parameter is related to the point factor. A dose of DA is related to certain prescribed increase in the number of the index points.

1. The Central DA (CDA): Applicable to employees of the central government; the index used is the AICPI
2. The industrial DA (IDA); This is vogue in over two-thirds of central public sector undertakings and a large number of private sector organizations
3. DA System in Banks and LIC; The index used is AICPI. DA is sanctioned every quarter. The rate of neutralization is different from CDA and IDA and varies depending upon basic pay range. This provides for a higher neutralization at senior levels than is possible under IDA
4. Double Linkage: In certain industries, particularly in chemical and pharmaceutical industries in the Mumbai region, DA is paid on the basis of double linkage. Under the system, DA is paid at;
 1. 100% for the first slab of basic pay of Rs 100
 2. Additional 50% for the next Rs 100. 25% more for every slab of the next Rs 100 or part thereof, and

3. A person with a basic pay Rs 400 will get Rs 800 as DA (200%) and the one with a basic pay of Rs 600 will get Rs 1500 (250%) as DA

Overall a DA is meant to neutralize for rise in cost of living. It is entitlement for the worker and cannot be reduced except in cases of a decline in prices. There shall be no discrimination in DA formula for people drawing similar wages within an organization

7. *Define the term wage?*

Ans. Wage- Refers to basic compensation for labour

Labour cost is the cost incurred by the employer in the employment of labour (ILO Geneva 1966)

Wage Rate- Refers to Per Period of Time or per unit of time (Typically an Hour) Wages are also referred as 'Economic Rent' Etymologically, the term wage is derived from words, which indicate making a promise in monetary form

8. *Explain the payment of wage act, 1936*

Ans. The Payment of Wages Act, 1936

- ✓ Regular and prompt payment of wages
- ✓ To prevent the exploitation of wage earner by prohibiting arbitrary fines and deductions for his wages
- ✓ It also stipulates the rate of payment for overtime work and penal deductions for participation in illegal strikes
- ✓ The act is applicable to all those employed in factories/establishment declared as factories under section 85 of the factories act, 1948, etc and drawing less than Rs 6500 per month

9. *Elaborate on the concept of Best Practices vs. Best Fit Options.*

Ans. Best Practices: Assumptions

- A set of best-pay practices exists
- Practices can be applied universally across all situations
- Results in better performance with almost any business strategy

Best Fit

If design of pay system

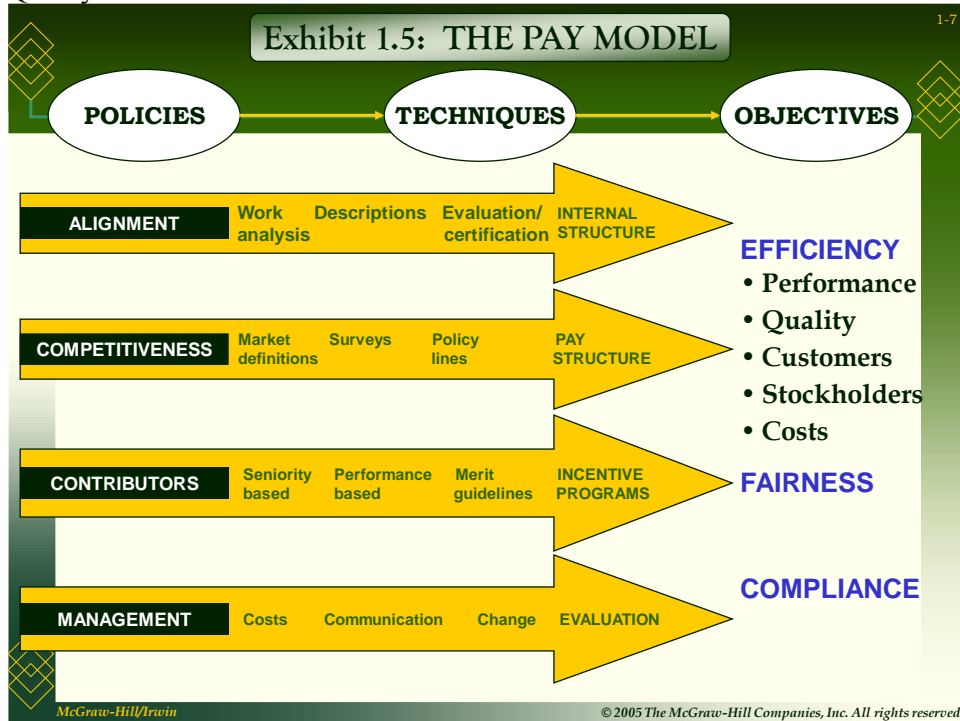
- Reflects company's strategy and values
- Is responsive to employees' and unions' needs
- Is globally competitive
- Company is more likely to achieve competitive advantage

10. Explain the pay model considering an Indian or MNC company as example?

PAY MODEL

The pay model serves as both a framework for examining current pay systems and a guide to most of this book. It contains three basic building blocks: (1) the strategic compensation objectives, (2) the strategic policies that form the foundation of the compensation system, and (3) the techniques of compensation.

11. • Quality



12. •

Strategic Compensation Objectives

Pay systems are designed and managed to achieve certain strategic objectives. The basic objectives,

shown at the right side of the model, include efficiency, fairness, and compliance with laws and regulations. The efficiency objective can be stated more specifically: (1) improving performance, quality, delighting customers and stockholders, and (2) controlling labour costs. Compensation objectives at Medtronic and AES are contrasted in. Medtronic is a medical technology company that pioneered cardiac pacemakers. Its compensation objectives emphasize performance, business success, and salaries that are competitive with other companies whose financial performance matches Medtronic’s. AES generates and markets electricity around the world. Its goal is to “provide electricity worldwide in a socially responsible way.” The notion of social responsibility pervades the company.

Fairness is a fundamental objective of pay systems. In Medtronic’s objectives, fairness is reflected in “ensure fair treatment” and “be open and understandable.” AES’s mission statement acknowledges that, “Defining what is fair is often difficult, but we believe it is helpful to

routinely question the relative fairness of alternative courses of action. It does not mean that everyone gets treated equally, but instead treated fairly or with justice given the appropriate situation.”¹⁸ Thus, the fairness objective attempts to ensure fair treatment for all employees by recognizing both employee contributions (e.g., higher pay for greater performance, experience, or training) and employee needs (e.g., a fair wage as well as fair procedures). Procedural fairness is concerned with the processes used to make decisions about pay. It suggests that the way a pay decision is made may be as important to employees as the results of the decision. Compliance as a pay objective involves conforming to various federal, provincial, and territorial compensation laws and regulations. As these laws and regulations change, pay systems may need to be adjusted to ensure continued compliance.

There probably are as many statements of pay objectives as there are employers. In fact, highly diversified firms such as George Weston Ltd and Onex Corp, which compete in multiple lines of businesses, may have different pay objectives for different business units. Objectives at these companies emphasize the increased complexity of the business and importance of integrity.

Comparison of Pay System Objectives at Medtronic and AES

Medtronic AES

Support objectives and increased Our guiding principles are to act with complexity of business integrity, treat people fairly, have fun, and be Minimize increases in fixed costs involved in projects that provide social Emphasize performance through variable benefits. This means we will pay and stock Help AES attract self-motivated, Competitiveness aligned with financial dependable people who want to keep performance: 50th percentile performance learning new things paid at 50th percentile of market, Hire people who really like the place and 75th percentile performance paid at believe in the AES system 75th percentile of market Pay what others are paid both inside and outside AES, but willing to take less to join AES Use teams of employees and managers to manage the compensation system Make all employees stockholders procedural fairness of the process used to make a decision holders Costs

FAIRNESS

Four Strategic Policies

Every employer must address the strategic policy decisions shown on the left side of the pay model: (1) internal alignment, (2) external competitiveness, (3) employee contributions, and (4) administration of the pay system. These policies form the foundation on which pay systems are built. These policies also serve as guidelines for managing pay in ways that accomplish the system's objectives.

Internal Alignment: Refers to comparisons between jobs or skill levels inside a single organization. Jobs and people's skills are compared in terms of their relative contributions to the organization's objectives. How, for example, does the work of the programmer compare with the work of the systems analyst, the software engineer, and the software architect? Does one contribute to providing solutions to customers and satisfying shareholders more than another? Does one require more knowledge or experience than another?

Refers to the pay rates both for employees doing equal work and for those doing dissimilar work. In fact, determining what is an appropriate difference in pay for people performing different work is one of the key challenges facing managers. Internal alignment policies affect all three compensation objectives. Pay relationships within the organization affect employee decisions to stay with the organization, to become more flexible by investing in additional training, or to seek greater responsibility. By motivating employees to choose increased training and greater responsibility in dealing with customers, pay relationships indirectly affect the capabilities of the workforce and hence the efficiency of the entire organization. Fairness is affected in employees' comparisons of their pay to the pay of others in the organization. Basic fairness is provided by Canadian human rights laws, which make paying on the basis of race, gender, age, and other grounds, illegal.

External competitiveness: Refers to compensation relationships external to the organization; i.e., comparison with competitors. How should an employer position its pay relative to what competitors are paying? How much do we wish to pay accountants in comparison to what other employers would pay them? What mix of pay forms—base, incentives, stock, benefits—will help achieve the compensation objectives? Employers have several policy options. Medtronic's policy is to pay competitively in its market based on its financial performance versus the financial performance of its competitors, while AES's policy is to expect people to be willing to take less to join the company. Increasingly, organizations claim their pay systems are market driven, i.e., based almost exclusively on what competitors pay. However, "market driven" gets translated into practice in different ways. Some employers may set their pay levels higher than their competition, hoping to attract the best applicants. Of course, this assumes that someone is able to identify and hire the "best" from the pool of applicants.

Employee Contributions: The policy on employee contributions refers to the relative emphasis placed on performance. Should one programmer be paid differently from another if one has better performance and/or greater seniority? Or should all employees share in the organization's financial success (or failure) via incentives based on profit? Perhaps more productive teams of employees should be paid more than less productive teams. The degree of emphasis to be placed on performance is an important policy decision, since it directly affects employees' attitudes and work behaviours. Employers with strong pay-for-performance policies are more likely to place greater emphasis on incentives and merit pay. Starbucks emphasizes stock options and sharing the success of corporate performance with the employees. General Electric emphasizes performance at the unit, division, and companywide level. Recognition of contributions also affects fairness, since employees need to understand the basis for judging performance in order to believe that their pay is fair.

Administration/Management: Policy regarding administration of the pay system is the last building block in our model. Although it is possible to design a system that is based on internal alignment, external competitiveness, and employee contributions, the system will not achieve its objectives unless it is managed properly. The greatest system design in the world is useless without competent management. Managers choose what forms of pay to include and how to position pay against competitors. They must communicate with employees and judge whether the

system is achieving its objectives. They must ask, Are we able to attract skilled workers? Can we keep them? Do our employees feel our system is fair? Do they understand how their pay is determined? How do the better-performing firms, with better financial returns and a larger share of the market, pay their employees? Are the systems used by these firms different from those used by less successful firms? How do our labour costs compare to our competitors? Answers to these questions are necessary in order to tune or redesign the system, to adjust to changes, and to highlight potential areas for further investigation. At AES, there is no compensation department, nor even a human resources management department. Instead, teams of employees make all the compensation decisions.