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Impact of Compensation on Employee Performance

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ABSTRACT
Compensation is the remuneration received by an employee in return for their contribution to the organization. It is an organized practice that involves balancing the work-employee relation by providing monetary and non-monetary benefits to employees. Compensation includes payments such as bonuses, profit sharing, overtime pay, recognition rewards and sales commission. Compensation is an integral part of human resource management which helps in motivating the employees and improving organizational effectiveness. Direct Compensation is typically made up of salary payments and health benefits. The creation of salary ranges and pay scales for different positions within the company are the central responsibility of compensation management staff. Direct compensation that is in line with industry standards provides employees with the assurance that they are getting paid fairly. Indirect Compensation focuses on the personal motivations of each person to work. Although salary is important, people are most productive in jobs where they share the company's values and priorities. These benefits can include things like free staff development courses, subsidized day care, the opportunity for promotion or transfer within the company, public recognition, the ability to effect change in the workplace, and service to others. Employees should be managed properly and motivated by providing best remuneration and compensation as per the industry standards. The lucrative compensation will also serve the need for attracting and retaining the best employees. The impact of compensation and benefits on employee performance and organizational effectiveness depends on the existing compensation and performance management programs in the organization. Typically, most employees respond to increases in pay and benefits with a positive and more productive attitude. Sometimes, employees only notice rewards of a salary increase the day the increase is communicated to them, and the day they receive the first paycheck that includes the salary increase. In this Paper I would like to discuss the components and importance of compensation and I would like to emphasis more on the impact of compensation on employee performance in the organization.
KEYWORDS: Compensation, Components, Employee Performance and Importance.
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I. INTRODUCTION

Human Resource Management is the management of an organization's employees. Providing and maintaining necessary balance of human resource for smooth operations of organization is a primary function of HRM. Now HR work is not only concerned with traditional activities of recruitment and selection, training and development but its scope has been widened to many new and distinguished areas. Rewards are direct and indirect. Providing respectable compensation to persons working in organization have soothing effect on both employee and organizational performance.

Compensation is an integral part of human resource management which helps in motivating the employees and improving organizational effectiveness. The impact of compensation and benefits on employee performance and organizational effectiveness depends on the existing compensation and performance management programs at an individual company. Typically, most employees respond to increases in pay and benefits with a positive and more productive attitude. However, the opposite is true as well. Sometimes, employees only notice rewards of a salary increase the day the increase is communicated to them, and the day they receive the first paycheck that includes the salary increase. The best people are most often drawn to the companies that pay the most and offer the best opportunity for advancement. There are still some people in the work force that have a very strong work ethic, and continue to stay motivated regardless of the compensation package provided. On the other hand, there are also employees that need constant increases in pay, better benefits, more work-life balance, etc., in order to perform well on a consistent basis.

II. REVIEW OF LITERATURE

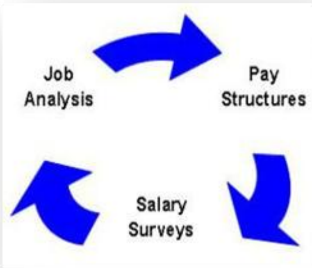
Compensation processes are based on Compensation Philosophies and strategies and contain arrangement in the shape of Policies and strategies, guiding principles, structures and procedures which are devised and managed to provide and maintain appropriate types and levels of pay, benefits and other forms of compensation (Bob, 2011). Compensation implies having a compensation structure in which the employees who perform better are paid more than the average performing employees (Pearce, 2010). Compensation management is one of the central pillars of human resources management (HRM). It is concerned with the formulation and implementation of strategies and policies that aim to compensate people fairly, equitably and consistently in accordance with their value to the organization (Armstrong, 2005). Compensation Management as the name suggests, implies having a compensation structure in which the employees who perform better are paid more than the average performing employees (Hewitt, 2009). Harrison and Liska (2008) in their study posit that reward is the centre piece of the employment contract-after all it is the main reason why people work. This includes all types of rewards, both intrinsic and extrinsic, that are received as a result of employment by the organization. In another study, Brown (2003) sees compensation as a return in exchange between their employees and themselves as an entitlement for being an employee of the organization, or as a reward for a job well done.

III. COMPONENTS OF COMPENSATION SYSTEM

Human Resource is the most vital resource for any organization. It is responsible for each and every decision taken, each and every work done and each and every result. Employees should be managed properly and motivated by providing best remuneration and compensation as per the industry standards. Compensation is the remuneration received by an employee in return for his/her contribution to the organization. It is an organized practice that involves balancing the work-employee relation by providing monetary and non-monetary benefits to employees. Compensation is an integral part of human resource management which helps in motivating the employees and improving organizational effectiveness.

Compensation System:

Compensation systems are designed keeping in minds the strategic goals and business objectives. Compensation system is designed on the basis of certain factors after analyzing the job work and responsibilities. Components of a compensation system are as follows:



Compensation System

Compensation provided to employees can direct in the form of monetary benefits and/or indirect in the form of non-monetary benefits known as perks, time off, etc. Compensation does not include only salary but it is the sum total of all rewards and allowances provided to the employees in return for their services. If the compensation offered is effectively managed, it contributes to high organizational productivity.

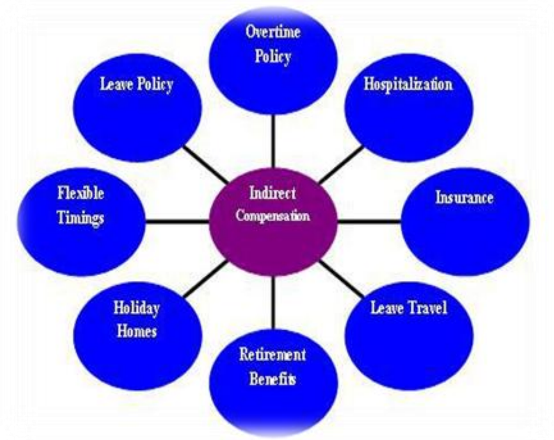
a. Direct Compensation:

Direct compensation refers to monetary benefits offered and provided to employees in return of the services they provide to the organization. The monetary benefits include basic salary, house rent allowance, conveyance, leave travel allowance, medical reimbursements, special allowances, bonus, Pf/Gratuity, etc. They are given at a regular interval at a definite time.

Direct Compensation

b. Indirect Compensation:

Indirect compensation refers to non-monetary benefits offered and provided to employees in lieu of the services provided by them to the organization. They include Leave Policy, Overtime Policy, Car policy, Hospitalization, Insurance, Leave travel Assistance Limits, Retirement Benefits, Holiday Homes.



Indirect Compensation

IV. MANAGING EMPLOYEE COMPENSATION

Compensation continues to be influenced by several factors that are producing some important trends in compensating workers. One of such trends is aligning wages to the organizations goals. Others include tailoring compensation to the needs of employees; better salary, and pay equity (Fisk 2001). Various existing theories to support this argument have been identified and one of such is the Reinforcement theory which is propounded by B.F. Skinner. This theory holds that individuals can actually be motivated by their work environment when it is properly developed. Hence, rather than considering internal factors such as attitudes, feelings, impressions and other cognitive behaviour, employers should keep on making positive changes in the external environment of the organization. It emphasizes the importance of a person's actual experience of a reward, and the implication of this for compensation management is that high employee performance followed by a monetary reward will make future high performance more likely.

Another theory that is relevant to the study is the Expectancy theory propounded by Victor Vroom. This theory though focuses on the link between rewards and behaviour too emphasizes expected rewards rather than experienced rewards. In other words, it is mainly concerned with effects of incentives. It stresses that behaviours (job performance) can be described as a function of ability and motivation while motivation is a function of expectancy, instrumentality, and valence perceptions. Expectancy perceptions often have more to do with job design and training than pay systems. Although this theory implies that linking an increasing amount of rewards to performance will increase motivation and performance, some authors have questioned this assumption, arguing that monetary rewards may increase intrinsic motivation.

Extrinsic motivation depends on rewards such as pay and benefits, which are controlled by an external source whereas intrinsic motivation depends on rewards that flow naturally from work itself. Therefore, while it is important to keep in mind that money is not the only effective way to motivate behavior, and that money rewards will not always be the answer to motivation problems, it does not appear that monetary rewards run much risk of compromising intrinsic motivation in most work settings.

Another theory relevant to the study is the Equity Theory and Fairness, propounded by John Stacey Adams as Equity Theory but was later on advanced by Elaine Hatfield and her colleagues, which is now known as Equity Theory and Fairness. This theory which probably came as a result of continuous agitation for fair and equitable wages for all workers is the bedrock on which this study hinges. The theory which is divided into two suggests that people evaluate the fairness of their situations by comparing them with those of other people. According to this theory, a person (P) compares his/her own ratio of perceived outcomes (O = pay benefits, working conditions) to perceived inputs (I = effort, ability, experience) to the ratio of a comparison other (O) – external inequity pay. The main implication of this theory for managing employee compensation is that to a large extent, employees evaluate their pay by comparing it with what others are paid, thereby influencing their attitude to work by such comparisons.

V. IMPACT OF COMPENSATION ON EMPLOYEE PERFORMANCE

Compensation is the remuneration received by an employee in return for their contribution to the organization. It is an organized practice that involves balancing the work-employee relation by providing monetary and non-monetary benefits to employees. Compensation includes payments such as bonuses, profit sharing, overtime pay, recognition rewards and sales commission. Compensation weighs significantly in job performance. An organization's performance management system begins long before the employee reports for her first day on the job. Performance management starts with discussing the job duties, responsibilities and expectations with candidates during the recruitment and selection process. Ideally, a job posting should contain a summary of the job, the qualifications the company is looking for and what the company expects from employees in that particular role. Consequently, when a recruiter hands a job applicant the full job description, essentially saying, "This is what we expect from the person we hire to fill this position and if you accept this, we can move forward with the selection process."

Methods of employee compensation

Some of the most common methods of employee compensation which as impact on employee performance are as follows,

- **Individual incentives:**

Pay incentives are associated with increased performance and productivity. For example, employees receive a pay raise for reaching a certain level of performance. Bottom line increases in quantifiable productivity are associated with individual incentives; with studies showing increases on average of 30 percent when incentive programs are introduced.

- **Merit pay:**

This involves giving employees bonuses or other compensation when they perform well. It is the most widely used method for organizations. Research studies show that there is some support that merit pay is associated with increased performance, though many studies failed to demonstrate a definitive impact of this system on performance.

- **Profit sharing:**

This involves rewarding employees when profitability targets are met. Studies suggest that they do have an impact on performance. However, employees may be less motivated by this type of reward as compared to other reward systems, because they may not see the connection between their own efforts and increased profits. Profit sharing rewards are also often disseminated in the future (e.g., at retirement) and can therefore be less motivating than immediate rewards.

- **Stock plans:**

This involves offering employees the opportunity to buy stock in the company at a fixed rate. Studies investigating the impact of this approach for middle and upper management show positive results. However, this option has its issues — for example, when stock prices fall, this could impact employee motivation. It also opens the door for ethical and even criminal violations to occur.

- **Gain sharing:**

This involves rewarding employees based on group performance, accounting for the interdependent nature of jobs. Studies show that this approach is effective, and that it can result in high performance, teamwork, increased profits, and decreased losses.

Offering a variety of performance incentives is best. For example, some programs emphasize individual performance, while others reward group performance, and so it is best to offer a range to balance the benefits and risks of these, thereby avoiding unhealthy competition while maximizing motivation.

VI. IMPORTACE OF COMPENSATION ON EMPLOYEE PERFORMANCE

A well designed compensation and benefits plan helps to attract, motivate and retain talent in the organization. A well designed compensation & benefits plan will benefit in the following ways.

1. Job satisfaction: Employees would be happy with their jobs and would love to work for organization if they get fair rewards in exchange with their performance.

2. Motivation: We all have different kinds of needs. Some of us want money so they work for the company which gives them higher pay. Some value achievement more than money, they would associate themselves with firms which offer greater chances of promotion, learning and development. A compensation plan that hits workers' needs is more likely to motivate them to perform in the desired way.

3. Drive employee performance: The basic idea is that if an employee knows that his/her bonus depend on the occurrence of a specific event (or paid according to performance, or if a certain goal is achieved), then the employee will do whatever he/she can to secure this event (or improve their performance, or achieve the desired goal). In other words, the bonus is creating an incentive to improve business performance.

4. **Low Absenteeism:** It employees enjoy the office environment and are happy with the compensation. Their performance will be high and absenteeism will be very low.

5. Low Turnover: Would employees want to work for any other organization if working organization offers them fair rewards.

6. Peace of Mind: An organization offering of several types of insurances to workers relieves them from certain fears. Workers as a result now work with relaxed mind. They perform very well without any mental stress.

7**. Increases self-confidence**: Reward system helps to increase the self confidence of the employees. It helps to increase the performance of the employees in the organization.

VII. CONCLUSION

Today Humans are regarded as one of every company's assets so they need to be efficiently and effectively managed. One of the tools companies use to attract, retain and motivate its people is Compensation Management. With the behavioral science theories and evolution of labor and trade unions, employees started asking for their rights. Employees performance was being measured and apprised based on the organizational and individual performance. The compensation system was designed on the basis of job work and related proficiency of the employee.

Compensation helps in running an organization effectively and accomplishing its goals. Salary is just a part of the compensation system, the employees have other psychological and self-actualization needs to fulfill. The most competitive compensation will help the organization to attract and sustain the best talent. The compensation package should be as per industry standards. A good compensation package is important to motivate the employees to increase their performance and to increase organizational productivity.

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