Date: 26/3/2020

MBA Full Time (CBCS)

Compensation Planning (Fourth Semester)

Lecture 1 Notes

Dr.Swarna Parmar

Assistant Professor

SOS in Management Studies

Jiwaji University,Gwalior

Topics Covered

1. **Compensation:** Meaning,characteristics,system and Objectives of Compensation.
2. Importance of Compensation.
3. Factors affecting Employee Compensation.

Compensation: Meaning, System and Objectives of Compensation
The term compensation is used to indicate the employee's gross earnings in the form of financial rewards and benefits.

Compensation can also be defined as follows:
1. A system of rewards that can motivate the employees to perform.
2. A tool that is used to foster values and culture.
3. An instrument that enables an organization to achieve its objectives.

The management should ensure that compensation structure is designed after taking into account certain factors such as qualification, experience, attitude and prevailing rates in the markets. Compensation means the reward that is received by an employee for the work performed in an organization. It is an important function of human resource management. Employees may receive financial and non-financial compensations for the work performed by them.
Financial compensation includes salary, bonus, and all the benefits and incentives, whereas non-financial compensation includes awards, rewards, citation, praise, recognition, which can motivate the employees towards highest productivity.

Compensation System:
Compensation is a tool used by management for safeguarding the existence of the company. Compensation can be of two types—direct and indirect.

Direct Compensation:
1. Basic pay, dearness allowance, cash allowance.
2. Incentive pay, bonus, commission, profit sharing, stock option.

Indirect Compensation:
1. Legal requirement
a. Provident fund
b. Gravidity
c. Pension
d. Insurance
e. Medical leave
f. Accident benefits

g. Maturity leave
2. Optional sick leave
3. Casual leave
4. Travelling allowance
5. Telephone bills
6. Canteen allowance
7. Club membership

The main characteristics of the compensation system are as follows:

1. A hierarchy of pay levels
2. A hierarchy of jobs
3. A set of rules and procedures
4. Qualities required for movement from one level to other

An organization's compensation system usually consists of three separate components. Each element of the compensation package has a link with an individual need hierarchy. All allowance are linked to basic pay. In order to motivate the employees when they achieve objectives, rewards and incentives are incorporated along with basic pay. To retain the employees and to get long-term commitments, stock option plan, annual increments and promotion are provided.

Objectives of Compensation:

1.The compensation should be paid to each employee on the basis of their abilities and training.
2.Compensation should be in the form of package.
3.It should motivate the employees towards increasing productivity.
4.It should be capable of taking care of employees for safety and security needs also.
5.It should be flexible and clear.
6.It should not be excessive.
7. Compensation should be decided by the management as per the norms fixed by the legislations in consultation with the union.

Importance of compensation

Compensation is important for an organization to consider its mission and vision and its strategies and then devise the compensation system such that all these components are inter-linked and aligned with each other. Compensation comes under the parlance of human resource (HR) department of an organization. It is the tool that organizations use to manage and reward their employees, so that they perform efficiently. The compensation system that company follows should be an attracting one, and it should motivate its employees to work and justify the amenities provided to them by the company. The compensation system should also ensure that the turnover rate remains low and the employees remain motivated. Along with other non-monetary perks &

incentives, the company offers **compensation and benefits** to its employees. Companies have to devise a **compensation plan** based on the position, responsibility and qualification of an employee.

Factors Affecting Employee Compensation

Everything you need to know about the factors affecting employee compensation. Compensation is a very important issue in Human Resource Management (HRM) and affects the relations between management and workers.
Compensation is also one of the biggest reasons of dispute between employers and employees. Employees provide their services to the business; they devote their time, energy, skills, knowledge to the organisation. In consideration of this devotion, employer gives compensation to employees.
The compensation awarded to the employee is dependent on the volume of effort exerted, the nature of job and his skill. Besides, there are several other internal and external factors affecting the compensation.

The factors affecting employee compensation can be categorized into:-
1. Internal Factors and 2. External Factors.

Some of the external factors affecting employee compensation are:

1. Demand and Supply of Labour 2. Cost of Living 3. Economic Conditions 4. Prevailing Wage Level 5. Society 6. Government Control 7. Labour Unions 8. Legislation 9. Globalization 10. Cross Sector Mobility and 11. Compensation Survey.

Some of the internal factors affecting employee compensation are:

1. Compensation Policy of the Organization 2. Employer's Affordability 3. Worth of a Job 4. Employee's Worth 5. The Organizational Ability to Pay 6. Job Analysis and Job Description and 7. Employee Related Factors.

Factors Affecting Employee Compensation – External and Internal Determinants of Compensation
The compensation awarded to the employee is dependent on the volume of effort exerted, the nature of job and his skill. Besides, there are several other internal and external factors affecting the compensation.

I. External Determinants of Compensation:
1. Labour Market Conditions:

The forces of demand and supply of human resources, no doubt, play a role in compensation decision. Employees with rare skill sets and expertise gained through experience command higher wage and salary than the ones with ordinary skills abundantly available in the job market. But the higher supply of human resources for certain jobs may not lead to reduction of wages beyond a floor level due to Government's prescription of minimum wage levels and employee union's bargaining strength.

Similarly, this factor by itself does not result in lower pay if the vast majority of available resources are unemployable due to poor skill and low talent. Thus, it is clear that law of demand and supply applies to labour market only to a limited extent.

2. Economic Conditions:

Organizations having state-of-the-art technology in place, excellent productivity records, higher operational efficiency, a pool of skilled manpower, etc., can be better pay masters. Thus, compensation is the consequence of the level of competitiveness .prevailing in a given industry.

3. Prevailing Wage Level:

Most of the organizations fix their pay in keeping with the level for similar jobs in the industry. They frequently conduct wage survey and accordingly seek to keep their wage level for different jobs. If a particular firm keeps its pay level higher than those of others in the industry, its employee cost becomes heavier which may escalate the end cost of the products. This will affect the competitiveness of the firm. On the other hand, if a firm keeps its pay level lower than the prevailing rates, it may not recruit the skilled and competent manpower.

4. Government Control:

Government through various legislative enactments such as Minimum Wages Act, 1948, Payment of Wage Act, 1936, Equal Remuneration Act, 1976, Payment of Bonus Act, 1965, dealing with Provident Funds, Gratuity, Companies Act, etc., have a bearing on compensation decisions. Therefore, firms have to decide on salaries and wages in the light of the relevant Acts.

5.Cost of Living:

Increase in the cost of living, raise the cost of goods and services. It varies from area to area within a country and from country to country. The changes in compensation are based on consumer price index which measures the average change in the price of basic necessities like food, clothing, fuel, medical service, etc., over a period of time. Allowances like Dearness Allowance. City compensatory allowances are paid to meet the increasing cost of living and parity among employees posted at different geographies.

6. Union's Influence:

The collective bargaining strength of the trade unions also influence the wage levels. Trade unions enjoy an upper hand in certain industries like banking, insurance, transport and other public utilities. Therefore, wage structure in such industries and in such Union-active regions, salary and wage need to be fixed and revised in consultation with the unions for ensuring smooth industrial relation.

7. Globalization:

It has ushered in an era of higher compensation level in many sectors of the economy. The entry of multinational corporations and big corporates have triggered a massive change in the compensation structure of companies across sectors. There is a salary boom in sectors like information technology, hospitality, biotechnology, electronics, financial services and so on.

8. Cross Sector Mobility:

Contemporary companies find it difficult to benchmark the salaries of their staff with others in the industry thanks to mobility of talent across the sectors. For example, hospitality sector employees are hired by airlines, BPOs, healthcare companies and telecom companies.

II. Internal Determinants of Compensation:

1. Compensation Policy of the Organization:

Firm's policy regarding pay i.e., attitude to be an industry leader in pay or desire to pay the market rate determines its pay structure. The former can attract better talent and achieve lower cost per unit of labour than the ones that pay competitive pay.

2. Employer's Affordability:

Those organizations which earn high profit and have a larger market share, a large business conglomerate and multinational companies can afford to pay higher pay than others. Besides, company's ability to pay higher pay is impaired by sector- specific economic recession and acute competition.

3. Worth of a Job:

Organizations base their pay level on the worth of a job. The wages and salaries tend to be higher for jobs involving exercise of brain power, responsibility laden jobs, creativity-oriented jobs, technical jobs.

4. Employee's Worth:

In some organizations, time rates are granted to all employees irrespective of performance. In such cases, employees are rewarded for their mere physical presence on the job rather than for their performance. However many private sector organizations follow performance-linked pay system. They conduct performance appraisal more often than not which provides input for determining pay levels. It distinguishes the high-performer from the low-performer and the non-performer.

Factors Affecting Employee Compensation – 8 Important Factors: Supply and Demand for Employee Skills, Company's Business Strategy, Job's Worth and a Few Other Factors

Working out the compensation policy is a very difficult job for an organisation. Several factors play an important role.

Some of the important ones are explained as under:

Factor # 1. Supply and Demand for Employee Skills:

Though the commodity approach to labour is not completely correct, it is nevertheless true that a wage is a price for the services of a human being. The firm desires these services and it must pay a price that will bring forth the supply, which is controlled by the individual worker or by a group of workers acting together. The primary practical result of the operation of this law of supply and demand is the creation of the "going wage rate policy."

Even though practically it is not possible to draw demand and supply curves for each job in an organisation, but in general, if anything was to decrease the supply of labour, such as the restriction of particular labour unions, there will be a tendency to increase the compensation.

If anything works to increase the employers demand for labour, there will be a tendency to increase the compensation. The reverse of a situation is likely to result in a decrease in employee compensation.

Factor # 2. Company's Business Strategy:

The compensation method followed by an organisation depends to a large extent on the business strategy followed by them, such as an organisation following the aggressive strategy for rapid growth will maintain higher levels of compensation than their competitors.

As against this, business pursuing a defensive strategy will keep its remuneration levels at average or below average levels than the ones prevailing in the market.

Factor # 3. Job's Worth:

An organisation would like to pay their employees in terms of the worth of the job which they are going to perform for the organisation. The job's worth can be calculated by conducting a thorough job evaluation and comparing the job with other jobs in the organisation as well as with jobs in competitive organisations.

Factor # 4. Labour Unions:

They try to regulate the supply side of the labour. From time to time labour unions put pressure over the management for providing better work facilities, better wages, or service conditions for workers. At times they do resort to strike or lockout affecting the supply of labour to the industry.

So it becomes important for the employers to keep their labour happy and satisfied by compensating them well so that their union should not pose any problems to them.

Factor # 5. Ability to Pay:
The level of compensation being paid to the employees depends to a large extent on the paying ability of the organisation. In case the organisation is big and prosperous, its employees expect a better level of salary and better perks and facilities from the management.
Such organisations generally compensate their employees at higher levels than their competitors, while in case the firm is marginal and cannot afford to pay competitive rates its employees will always have a tendency to leave the organisation for better paying jobs.
Factor # 6. Productivity:
The employee's salary at times is directly related to their level of productivity. Every good management would try to bring equity between the results and rewards of an employee. Employee's productivity results in increasing turnover for the organisation resulting in better revenues and ultimately an increase in the salary of its employees.
Factor # 7. Cost of Living:
The consumer price index is widely accepted and followed by many employers and labour organisations for fixing the basic level of employee's salary. Cost of living adjustment of compensation does not provide any fundamental solution to the principle of equitable compensation to employees. It is useful as a stopgap device in times of inflation when labour is pressed to keep up with the rise in prices.
Factor # 8. Government Regulation:
Government plays a very important role in fixing the basic level of salary for employees. From time to time government has made various laws to protect the interest of employees at various levels. It is expected of every organisation to keep the various laws into account while fixing the compensation for employees so that they should not finally land into any legal trouble.

Factors Affecting Employee Compensation – Demand & Supply of Labour, Capacity to Pay, Cost of Living, Productivity of Workers, Trade Unions, Wage Laws & Wage Rates

The compensation to be paid to the different categories of workers depend upon the following factors:

(i) Demand for and Supply of Labour:
Wage is a price or compensation for the services rendered by a worker. The firm requires these services, and so it must pay a price that will bring forth the supply which is controlled by the individual worker or by a group of workers acting together through their unions. The primary result of the operation of the law of demand and supply is the creation of the "going-wage rate".

It is not practicable to draw demand and supply curves for each job in the organisation even though, theoretically, a separate curve exists for each job. But, in general, if anything works to decrease the supply of labour such as restriction by a particular labour union, there will be a tendency to increase the wage.

If anything works to increase the employer's demand for labour, there will be a tendency to increase the wage. The reverse of each situation is likely to result in a decrease in employee wage, provided other factors do not intervene.

(ii) Capacity to Pay:

Employer's capacity to pay is an important factor affecting wages not only for the individual firm, but also for the entire industry. This depends upon the financial position and profitability of the firm. However, the fundamental determinants of the wage rate for the individual firm emanate from supply and demand of labour.

If the firm is marginal and cannot afford to pay competitive wage rates, its employees will generally leave it for better paying jobs in other organisations.

(iii) Cost of Living:

Another important factor affecting the wage is the cost of living adjustment of wages. This tends to vary money wage depending upon the variations in the cost of living index following rise or fall in the general price level and consumer price index. It is an essential ingredient of long-term labour contract unless provision is made to reopen the wage clause periodically.

(iv) Productivity of Workers:

To achieve the best results from the worker and to motivate him to increase his efficiency, wages have to be productivity based. There has been a trend towards gearing wage increase to productivity increases. Productivity is the key factor in the operations of a company. Higher wages and lower costs are possible only when productivity increases appreciably.

(v) Trade Unions:

Organised labour is able to ensure better wages than the unorganised one. Higher wages may have to be paid by the firm to its workers under the pressure of trade unions, If the trade unions fail in their attempt to secure higher wages and other allowances through collective bargaining, they resort to strike and other methods whereby the supply of labour is restricted.

This exerts a kind of influence on the employers to concede at least partially the demands of the labour unions.

(vi) Wage Laws:

To protect the working class from the exploitation of powerful employers, the Government has enacted several laws. Laws on minimum wages, hours of work, equal pay for equal work, payment of dearness and other allowances, payment of bonus, etc., have been enacted and enforced to bring about a measure of fairness in compensating the working class.

Thus, the laws enacted and the labour policies framed by the Government have an important influence on wages and salaries paid by the employers. Wages and salaries can't be fixed below the minimum level prescribed by the Government.

(vii) Prevailing Wage Rates:

Wages in a firm are influenced by the general wage level or the wages paid for similar occupations in the industry, region and the economy as a whole. External alignment of wages is essential because if wages paid by a firm are lower than those paid by other firms, the firm will not be able to attract and retain efficient employees.

For instance, there is a wide difference between the pay packages offered by multinational and Indian companies. It is because of this difference that the multinational corporations are able to attract the most talented workforce.

The above factors exercise a kind of general influence on wage rates. In addition, there are several factors which do affect the individual differences in wage rates.

The most important factors which affect the individual differences in wage rates are:

(i) Worker's capacity.
(ii) Educational qualifications.
(iii) Work experience.
(iv) Hazards involved in work.
(v) Promotion possibilities.
(vi) Stability of employment.
(vii) Demand for special skills.
(viii) Profits or surplus earned by the organisation.

Factors Affecting Employee Compensation – Internal and External Factor Influencing the Compensation Package Payable to Employees

There are number of factors influencing the compensation package payable to employees.

They can be categorized into:

1. External factor
2. Internal factor

1. External Factors:

These are demand and supply of labour, cost of living, society, labour unions, legislation, economy and compensation survey.

(i) Demand and Supply of Labour:

Even in times of high employment, individuals with certain skills or abilities are in demand. This demand and supply of labour influences wage and salary fixation. Jobs in high demand frequently will receive premium wages, as in case of skilled labour.

However, if supply of labour exceeds the demand, then employers are willing to pay less. High remuneration to skilled labour is necessary to attract and retain it. But exploitation of unskilled labour, like, for instance, paying less wages because it is available in plenty, is unjustifiable. The Minimum Wages Act, 1948, is precisely meant to prevent this kind of exploitation.

The basic point of this approach is that firm pays its employees the “going rate” for the type of work they do. Going rate analysis is done by reviewing all job description and then collecting relevant salary market data through participating in national, regional, and local salary surveys and by third party survey administrators (generally human resources consulting firms).

Going rates are those that are paid by different units of an industry in a locality and by comparable units of the same industry located elsewhere. If the firm offers pay much below the going rate, it may be unable to attract and retain qualified workers. If it pays much more than the going rate, it may be unable to charge comparative prices for its product because its labour costs are too high.

Productivity of labour also influences wage fixation in labour market. Productivity can arise due to increased effort of the worker, or as a result of the factors beyond the control of the worker such as improved technology, better management etc. Greater effort of the worker is rewarded through piece – rate or other forms of incentive payments.

Productivity is the relationship between the input of labour measured in man-hours and its output in the form of money or physical terms. Productivity linked wages may help utilize human resources better and help determine fair wages.

(ii) Cost of Living:

The logic for using cost of living as a pay determinant is both simple and important. A pay increase must be roughly equivalent to the increased cost of living, if a person is to maintain a precious level of real wages. A rise in the cost of living is sought to be compensated by payment of dearness allowance, basic pay to remain undisturbed. Some firms even index pay increases to the inflation rate and sacrifice merit pay to provide across the board increases designed to offset the results of inflation.

(iii) Society:

Compensation paid to employees often affects pricing of the firms goods or services. For this reason, consumers may also become interested in compensation decisions. Businesses in a local labour market are also concerned with the pay practices of new firms locating in their area. The Supreme Court has been keeping social and ethical considerations in adjusting wage and salary disputes. It was also considered to keep the company wages in line with other wages in the community.

(iv) Labour Unions:

The presence or absence of labour organizations often determines the quantum of wages paid to employees. When union uses comparable pay as a standard in making compensation demands, the employer needs accurate labour market data. When a union emphasizes cost of living, it may pressure management into including a cost of living allowance. The employees of strongly unionized companies too, have no freedom in wage and salary fixation. They are forced to yield to the pressure of labour representation in determining and revising pay scales.

(v) Legislation:

There are numerous Legislation Acts which affect the compensation system. Equal employment legislation, including The Civil Rights Act, Family and Medical Leave Act, Payment of Wages Act, 1948; The Payment of Bonus Act, 1965; Equal Remuneration Act, 1976; Payment of Gratuity Act, 1972 etc. The Payment of Wages Act seeks to protect workers against irregularities in payment of wages and unauthorized deductions by the employer.

The Minimum Wages Act enables the Central and State Governments to fix minimum rates of wages payable to employees in sweated industries. The Equal Remuneration Act provides for payment of equal remuneration to men and women workers for same or similar work. The Equal Pay Act, 1963 prohibits an employer from paying an employee of one gender less money than an employee of the opposite gender, if both employees are performing same nature of job. (same skill, effort and responsibility).

In addition to legal enactments, there are wage boards, tribunals and fair wages committees which aim at providing a minimal standard of living to workers. Also there is the Companies Act, 1956, which checks the managerial remuneration.

(vi) The Economy:

The economy definitely affects financial compensation decisions. For example, a depressed economy generally increases the labour supply and lowers the market rate. On the other hand, a booming economy results in greater competition for workers and price of labour is driven upward.

Since the cost of living is commonly used as pay standard, the economy's health exerts a major impact upon pay decisions. Cost of living typically rises as the economy expands.

(vii) Compensation Survey:

A compensation survey strives to obtain data regarding what other firms are paying for specific jobs within a given labour market. The surveys may be either outsource to a consulting firm or conducted by the organization itself. In this, market rates remain the most important standard for determining pay.

Most big organizations provide low, high and average salary for a given position with the help of compensation survey. It provides information for establishing both direct and indirect compensation. A firm should take the determinants such as the geographical area of the survey and the specific firms to contact before conducting a compensation survey.

2. Internal Factors:

Among the internal factors that affect pay structure are the compensation policies, organizational ability to pay, job analysis, and job descriptions, employee, trade union’s bargaining power.

(i) Compensation Policies:

It provides general guidelines for making compensation decisions. The first thing employers should consider when developing compensation package is fairness. It should be vital and maintain internal and external equity. The policy should include the company’s philosophy related to the major components of incentive compensation, including the strengths and weaknesses of each and how the overall plan provides optional alignment of interest with shareowners.

The policy should provide broad guidelines by which the company will use alternative forms of compensation, and the relative weight in relation to overall compensation if “others” form of compensation will be utilized. An organization often, formally or informally, establishes compensation policies that determine whether it will be a pay leader, a pay follower, or strive for an average position in the labour market.

(a) Pay leaders – They are organizations that pay higher wages and salaries than competing firms. This helps to retain and attract high quality and productive employees.

(b) The market rate – These are the average pay that most employers provide for a similar job in a particular area or industry, it is also known as going rate.

(c) Pay followers – These are companies that choose to pay below the market rate because of poor financial condition or a belief that they simply do not require highly capable employees.

(ii) The Organizational Ability to Pay:

An organization’s ability to pay is also an important factor in determining compensation package. Companies that have good sales and, therefore, high profits tend to pay higher wages than those which running at a loss or earning low profits because of the high cost of production or low sales. However all employers, irrespective of their profits or losses, must pay no less than their competitors to attract and retain potential employees.

(iii) Job Analysis and Job Description:

It is found that the more difficult and challenging a job, the higher are the wages. For this, the particular job is analyzed and then the relative value of a job is determined. Job analysis is the systematic process of determining the skills and knowledge required for performing job.

(a) Determine what tasks must be accomplished by whom.

(b) Decide which job classifications should be exempt and which should be non-exempt.

(c) Develop model job descriptions for exempt and non-exempt positions and distribute the models to incumbents for reviews and comment; adjust job descriptions if necessary.
(d) Finalize and document all job descriptions.
(e) Evaluate jobs.
(f) Also a general task analysis is conducted by major departments to the jobs within each seniors, vice president's and manager's department and then rank jobs between and among departments.
(g) Verify ranking by comparing it to industry market data concerning the ranking and adjust if necessary.
(h) Prepare a matrix organizational review.
(i) Determine grades.
(j) Establish the number of levels – senior, junior, intermediate and beginner for each job family and assign a grade to each level.
(k) Determine the number of pay grades or monetary range of position at particular level and establish the salary range.

(iv) Employee Related:

In addition to all the above factors, employee related factors are also important in determining wage structure. These factors include performing on the job, seniority experience, and membership in the organization and their potential.

Trade Union's Bargaining Power:

The stronger and more powerful the trade union in any organization, the higher the wages. Trade union's bargaining powers are often measured in terms of its membership, its financial strength and the nature of its leadership.

Factors Affecting Employee Compensation – 13 Major Factors Affecting: Demand & Supply of Labour, Ability of Organisation to Pay, Prevailing Wage Rate and a Few Others

Compensation is a very important issue in Human Resource Management (HRM) and affects the relations between management and workers. Compensation is also one of the biggest reasons of dispute between employers and employees.

Employees provide their services to the business; they devote their time, energy, skills, knowledge to the organisation. In consideration of this devotion, employer gives compensation to employees.

Compensation includes wages, salary, benefits, allowances paid in cash or in kind or both, which the employer pays to the employees.

Wages are paid to blue collar workers daily, weekly or monthly for the jobs whose contribution to the output can be measured to some extent. For example, contribution of a production worker can be estimated.

Salary is paid to white collar workers monthly for the jobs whose contribution cannot be exactly measured. For example, contribution of a manager cannot be exactly measured.
The compensation paid to employees depends on many factors such as job requirements, prevailing wage rate, cost of living, etc.

A detailed description of the factors which affect compensation is given below:

Factor # 1. Demand and Supply of Labour:
Prices are determined according to interaction of demand and supply, the same happens with wage rate. Wage rate is the price paid to labourers for the services they render. Demand for labour depends on demand of goods (consumer goods & producer goods) and services. Supply of labour depends on that part of population which is willing to work.
The wage rate is determined at a level for which demand of labour equals supply of labour. If the demand of labour exceeds the supply of labour, the wage rate will increase. On the contrary, if the demand of labour is less than supply of labour, the wage rate will decrease.

Factor # 2. Ability of Organisation to Pay:
The compensation an organisation pays to its employees depends on its ability to pay. This factor is less important in short run because there is a minimum wage level which a company must pay. In long run, ability of organisation to pay can affect the compensation decision. In long run if ability to pay increases then company can pay higher salary, bonus and other benefits.

Factor # 3. Prevailing Wage Rate:
Prevailing wage rate is also known as ‘company wage’ or ‘going wage rate’. This criterion is most popular. In this, the compensation paid by organisation depends on compensation paid by other organisations of same industry. This criterion is widely used because, by using it competition can be avoided, trade unions accept this method and employees also remain satisfied.
If the firm pays higher compensation as compared to other firms, then a wage war will start which will be detrimental for all firms. On the other hand, if firm pays less compensation as compared to other firms then it will not be able to attract or retain employees.

Factor # 4. Cost of Living:

Cost of living is like a minimum limit. Cost of living index guides about the minimum amount which everyone should get in order to maintain a minimum standard of living. Cost of living index depends on general price level or consumer price index.

The compensation is related to price level and varies with variation in price level. Increase in price level should be followed by increase in compensation. Logically, compensation should decrease with decrease in price level but it does not happen usually.

Factor # 5. Living Wage:

According to this criterion the compensation paid to employees should be such that the employee can maintain a reasonable level of living standard for himself and his family. Employers don't usually use this criterion because compensation should be based on contribution of employee to the organisation rather than on his needs.

Factor # 6. Bargaining Power:

Bargaining power of trade unions or organised workers affects the wages. The stronger, more powerful the trade unions; the greater will be the effect on wages. Strength of trade union depends on the number of members in trade union, financial position and leadership qualities of leader. Trade unions have the weapons of strike, lock out or gherao to get their demands accepted.

Factor # 7. Job Requirements:

A job which requires more skills, more competence, compensation for that should be more as compared to others. Job details are analysed whenever relative value to two jobs is to be given and jobs are graded according to skills, energy, time, efforts, responsibility and job conditions.

Factor # 8. Productivity:

Wages can be related to productivity of workers as it is done in piece wage system. In piece wage system, the compensation is paid on the basis of work done by the worker.

Factor # 9. Legal Requirements:

There are some legislative acts which apply to compensation such as Minimum Wages Act 1948, Payment of Wages Act 1936, Equal Remuneration Act 1976, Payment of Bonus Act 1965, Contract Labour (Regulation and Abolition Act) 1970 and Factories Act 1948 etc. These acts give guidelines regarding hours of work, minimum compensation, bonus, allowances, etc.

These rules and regulations should be kept into mind while drafting a compensation policy.

Factor # 10. Attitude of Managers:
Attitude of managers has a decisive influence on the compensation decision. Thinking, experience, perception, etc., of manager affects this decision.
A manager may support higher wage policy to motivate employees, another may oppose higher wage policy because it can make employees lazy and lethargic.

Factor # 11. Labour Unions*:*
Organised labour, also known as industrial labour is able to get more compensation as compared to unorganised or craft labour. Workers' unions demand for the higher compensation, if they cannot get their demands completed; they resort to strikes and other methods through which labour supply is restricted.
Factor # 12. Organisational Policies:
Organisational factors like philosophy of management, compensation plan adopted in firms of same industry, mode of compensation, equity criterion, performance appraisal, etc., affect compensation decision.
Factor # 13. Employee Related:
Employee characteristics affect his remuneration.

Characteristics influencing remuneration include:
(a) **Performance-** Employees who perform more than the standards should be given rewards to motivate them so that good performance is repeated in future also.
(b) **Experience-** A person learns a lot through experience; experience of employees is useful for organisation also. So, it is generally rewarded.
(c) **Seniority-** Seniority is most objective criterion for pay increase. Senior employees should be paid more as compared to juniors.
(d) **Employee calibre-** Employees are paid for their potential also. Due to potential, competency and calibre, young employees are sometimes paid more than the senior and experienced employees.