Impact of Compensation Management on Firm’s Performance: A Theoretical Perspective

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ABSTRACT
The compensation management in enterprises can directly affect the firm’s performance. Compensation management is a core content in business management. Higher the staff’s compensation satisfaction is, the more obvious its incentive effect is. And the staff will work harder and often receive more praise from the management; consequently they will get higher compensation and create a greater value for the firm. Otherwise, a vicious circle is likely to occur. Compensation incentive is to fully encourage and exploit staff’s competence while ensuring their basic living expenses, and so as to improve the firm’s economic benefits and market competitiveness. Compensation strategy for increased firm’s performance involves the statistical analysis of employee, operational, financial, and marketplace data to determine the net effects of reward investments on human capital and business outcomes.

Keywords--- Compensation, Career, Employee and Performance

I. INTRODUCTION
As organizations continue to face mounting competitive pressures, they seek to do more with less and do it with better quality. As goals for sales volume, profits, innovation, and quality are raised, employment growth is often tightly controlled and in many cases, substantial cuts in employment have been made. To accomplish more with fewer employees, the employee compensation system, plays a major role in efforts to manage human resources better. Employee compensation plays such a key role because it is at the heart of the employment relationship, being of critical importance to both employees and employers. Employees typically depend on wages, salaries, and so forth to provide a large share of their income and on benefits to provide income and health security. For employers, compensation decisions influence their cost of doing business and thus, their ability to sell at a competitive price in the product market. In addition, compensation decisions influence the employer’s ability to compete for employees in the labor market (attract and retain), as well as their attitudes and behaviors while with the employer. The compensation management in enterprises can directly affect the firm’s performance. Compensation management is a core content in business management. Body and Salamin hold that compensation management plays an important role in staff recruiting, incentives and retaining, and is a key factor for an organization to gain competitive advantages. Higher the staff’s compensation satisfaction is, the more obvious its incentive effect is. And the staff will work harder and often receive more praise from the management; consequently they will get higher compensation and create a greater value for the firm. Otherwise, a vicious circle is likely to occur. Compensation incentive is to fully encourage and exploit staff’s competence while ensuring their basic living expenses, and so as to improve the firm’s economic benefits and market competitiveness.

II. PAY AND PERFORMANCE
The average employee of the firm faces decisions on the job: Should I work hard or not Work hard? Should I spend the extra time and effort required to use resources efficiently, or should I waste resources (paid for by my employer) to make my work easier? These problems are important in a world of positive transaction costs. The decisions employees ultimately make depend on the relative costs and benefits of available alternatives, and firms can change the structure of the decision problem by rewarding correct behavior. Employees will maximize firm value if they receive net increases in utility for such behavior, and the magnitude of the link between pay and performance is commonly interpreted as a measure of
these incentives. All else equal, increases in the magnitude of the pay–performance link imply decreased agency costs. A few authors examined the link between pay and performance for average employees. The profit-sharing literature finds significant links between firm performance and the structure of average employee compensation. For example, Bhargava (1994) examined the impact of a profit-sharing dummy variable on firm performance. This is interesting, but he only knows of the existence of one particular type of incentive pay. He has data on the level of profit-sharing pay in each firm, but he has no indication of other incentive measures which may be in effect.

Rayton examined the link between pay and market performance, and finds that average employee hourly compensation in U.S. manufacturing firms is characterized by a performance elasticity of approximately 0.1.

Smith and Watts (1992) find a positive relationship between firm growth and the use of incentive pay. They start from the premise that principal–agent models predict some sort of incentive pay arrangement for managers if managerial actions are not perfectly observable. Smith and Watts then argue that managerial actions are less readily observable if the firm has more investment opportunities due to increased difficulties of communicating information about investment options. Taken together, these ideas predict greater use of incentive pay as growth increases. By extension, increases in the complexity of the relationship between the work of non-managerial employees and firm performance should also be matched by an increased incidence of incentive pay arrangements.

Frye (2004) examined the relationship between equity based compensation and firm performance and found positive relationship between the two. He argued that for human capital intensive firms compensation plays a crucial role in attracting and retaining highly skilled employees.

III. IMPORTANCE OF COMPENSATION STRATEGY

Today’s competitive conditions make it more difficult for employers to acquire and retain experienced and productive talent. The growing awareness that finding, motivating, developing, and keeping employees is a key component of business success has raised expectations for human resource (HR) departments. Today, the HR function is being scrutinized more closely, with expectations that it will make a contribution to the business—just like finance, accounting, marketing, and sales. The reward programs that have been the traditional domain of HR (e.g., pay, benefits, and training) represent a significant and growing investment for an organization. In general, these programs have been managed discretely rather than as part of an overall strategy. As leadership looks to HR to support the organization’s business objectives and enhance profitability, some tough questions need to be answered:

• How can we attract and retain the right people?
• How do we motivate and develop employees?
• Do we know what skills, knowledge, experience, and behaviors we actually reward?
• How do we pay for performance?
• Are pay, benefits, and career investments aligned with each other—and with our business strategy?
• How do we measure the return on our investment in people?

A broader concept of rewards, and reward strategy, is needed to answer these questions effectively.

IV. ELEMENTS OF COMPENSATION STRATEGY

An individual’s evaluation of a job opportunity is based on more than just current pay. It also includes the benefits that a company might offer, as well as the opportunities for learning and advancement: the career which is otherwise called as elements of compensation. In assessing the rewards being offered by a company to its current and prospective employees, it is important to understand the relationship among these three important reward components (see Exhibit 1).

Exhibit 1: Elements of Compensation Strategy


1. Pay

Everyone, especially workers, knows the importance of pay. It includes base pay plus additional compensation in the form of incentives or bonus awards, stock options, and stock grants.

2. Benefits

Another key reward component is benefits, which, like pay, are measurable and can be valuable tools in attracting and retaining the right employees. But, the HR executive who looks exclusively at benefits, or only benefits and pay, may be short-changing his or her organization. Benefit plans have changed remarkably in
recent times as companies move away from traditional pension plans, seeking out account balance plan alternatives designed to attract and motivate a “21st-century” workforce, which is generally older and has shorter service expectations. Newer programs like flexible benefits—allowing employees to choose their own benefit choices—as well as casual dress and more flexible hours have become standard in some industries.

3. Careers

HR professionals, while trying to determine the right combination of pay and benefits, at times neglect an important component: careers. Careers represent the future value to employees of staying with an organization (i.e., what will they be paid and what jobs will they have). It is the opportunity to learn and grow; in many cases, employees forgo higher current salaries and better benefits for the prospect of career advancement (See exhibit 2).

Exhibit 2: Reward Strategy


V. COMPENSATION STRATEGY FOR INCREASED PERFORMANCE

Compensation strategy for increased firm’s performance involves the statistical analysis of employee, operational, financial, and marketplace data to determine the net effects of reward investments on human capital and business outcomes. The compilation, linkage, and analysis of data can save a company a lot of time, money, and headaches by evaluating reward choices before making the leap to a new reward strategy. The seven-step plan is detailed as follows:

1. Review the business environment. Understand the key factors outside the firm (economic, geographic, regulatory, political, labor, and supplier) that affect internal business and human capital decisions.
2. Assess the organization’s business design. Establish the business goals, context, and key performance drivers (see Exhibit 3).

Exhibit 3: Organisation Performance Model


3. Examine critical human capital implications. Articulate the role of people and workforce practices (including rewards, managerial structure, work processes, information and knowledge flows, and decision-making practices) in executing the business strategy (see Exhibit 4).

Exhibit 4: Human Capital Strategy Model


4. Measure internal human capital reality. Determine what is rewarded, by qualitatively and quantitatively evaluating current human capital practices (i.e., to find out both what executives and employees think is rewarded and what actually is rewarded) and the degree to which the marketplace influences the effectiveness of those practices.
5. Identify gaps and priorities for action. Look at human capital practices holistically to create the optimal rewards mix to motivate, develop, and in fact drive the workforce based on business objectives (e.g., pay the right people the right amount for the right reasons at the right time).
6. Develop an action plan. Evaluate the ROI, feasibility, and risks associated with rewards interventions to create a sustainable reward strategy that will both generate bottom-line results and support future business needs.
7. Implement and monitor results. Guide communication, administration, and other implementation activities to ensure consistent messaging and strategic alignment.
VI. CONCLUSION

The best performing firms have links between pay and performance than their lower performance counterparts. Compensation is a hot potato for the Human Resource Department. The motivation level of the employees to great extent lies in monetary rewards. A satisfied employee is a productive employee and care should be taken that they are fairly paid for their worth in the organization. If managers follow the aforesaid guidelines, their pay-related communication with employees will result in clarity and respect. In addition, they will avoid the misunderstanding and resentment that results from avoiding this critical issue. If paid well can generate results for the organization, failed can create problems. The major challenges what manager’s face today is retention of the man power and the major cause of it is that they are paid better in the other organizations.

REFERENCES