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IMPACT OF EMPLOYEE COMPENSATION ON ORGANISATIONAL EFFECTIVENESS

Dr. Sarika Suri,
Rohtak, 8950284008, sarikamakan138@gmail.com

ABSTRACT

In today's era, in order to sustain and be lucrative, an organization must be ambitious. Organizations achieve their objectives through their workforce. Human resources are the pivot of organizational effectiveness and the greatest asset that an organization can possess. In fact, employee compensation is the vital ingredient underlying organizational competitiveness. Compensation of an organization plays a key role in attracting and retaining high yielding employees. The purpose of this research is to provide insight into the impact of compensation on employee performance and productivity leading to organizational effectiveness. The study describes the relationship between compensation and employee satisfaction, motivation and performance. It was found that compensation has great impact on organizational effectiveness. The findings of the study suggest that in order to implement their strategies, organizations design and implement reward system to focus employees attention on the specific behaviors that are consistent with strategic goals. A compensation strategy that fulfills the employee requirements not only provides a competitive edge to the organization but also is an important determinant of their satisfaction and forthcoming performances. The study draws strong conclusions that compensation has significant effect on employees satisfaction, motivation and performance and that the pay and reward system of an organization impacts employee performance positively and boost organizational performance and profitability.

Keywords: Compensation, Motivation, Performance, Satisfaction.

INTRODUCTION

Employees are valuable asset of any organization. Currently, the main concern of organizations is labor productivity. Employees must be managed efficiently to ensure increased productivity. It is traditionally embraced that employees discover valuable source of competitive edge for firms. Compensation plays an important role in organizations that want to reach their objectives and goals. It is one of the most important and dynamic human resource practices. It involves design, development, implementation, communication and evaluation of the reward strategy and processes of the organization. It is the sum total of all forms of payments and rewards provided to employees for performing tasks to achieve organizational objectives.

Compensation is what employees receive in exchange for their contribution to the organization. Milkovich and Newman (1999) stated that, compensation refers to all forms of financial returns and tangible services and benefits employees receive as part of an employment relationship. The Journal of Global Business and Economics (2010) also defines compensation as "the combination of all cash incentives and the fringe benefits mix that an employee received from a company which constitutes an individual's total compensation."

According to DeNisi and Griffin (2001) compensation is a reward system that a company provide to individuals in return for their willingness to perform various jobs and tasks within organizations.

This paper discusses how compensation policies of an organization impact its profitability. The relationship between employers and their employees is expected to be mutually reciprocal. The employer expects employees to give their best performance while employees on the other hand also look up to the employer or management to provide fair compensation for the work they do. For an organization to be able to effectively manage compensation to have a positive influence on the performance of its employees, it must understand the various aspects of compensation as the driving force that motivates the employees and direct their behavior towards achieving the organizational objectives. It goes without saying that organizations which do not properly manage this aspect of human resource activity very well have a negative impact on the total performance of their employees and also on their productivity. As Maslow (1943, 1954) postulated in his hierarchy of needs, compensation motivate employee to give their best to influence performance positively depend on how much it addresses their need for status, security, and their survival. Mayson and Barret (2006) found that a firm’s ability to attract, motivate and retain employees by offering competitive salaries and appropriate rewards is linked to firm’s performance and growth. According to Barber and Bretz (2000), "pay is one of the most important job attributes to job seekers." Motivated people perform well. In this way they have impact on the productivity, and thus, profitability, of organizations.

It must also be noted that a good and successful compensation and incentive package is hinged on a number of factors which one may call indicators. The compensation package should be tied to the vision strategy, culture, business models and goals of the organization. A good communication system must exist to ensure there is a clear understanding of the organization’s future. Employees must understand the roles they place in achieving the objectives of the company and they must feel secure in performing those roles.

As alluded to above, compensation plans must be well defined at various levels of the organization and must be reviewed periodically to keep the motivational levels of employees at desired heights. Also promises made concerning compensation by both employees and management must be honored to ensure a fair relationship between the two parties. It can be guaranteed that if above given indicators of a good compensation system are given proper attention by the management or employers, they have the tendency of impacting on the attitudes and behaviors of employees positively hence sustaining their motivational levels to achieve corporate organizational goals.

TYPES OF COMPENSATION

Compensation can be classified into two main categories, financial and non-financial. Financial compensation can be of two types- direct or indirect.

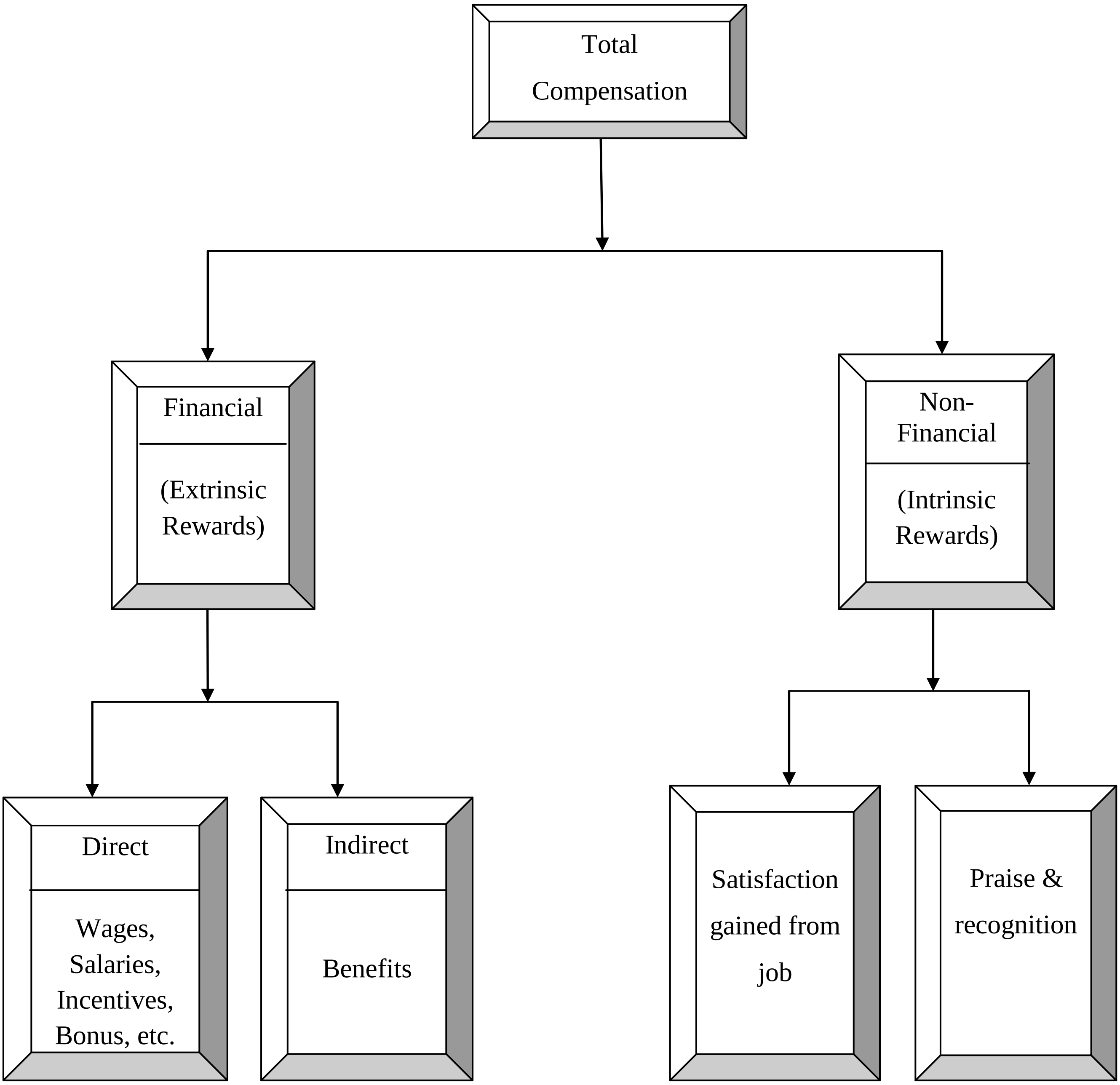
Financial Compensation

According to Cascio (2003), the objective of the design of compensation program is divided into two; direct and indirect forms of compensation. Direct compensation has to do with wage or salary aspect while indirect compensation is the fringe benefits a worker enjoys as a result of working in an organization. Integrating the two into a package that will encourage the achievement of an organizations goal is what compensation is all about (Odunlade, 2012).

Direct financial compensation: refer to monetary payments made to employees in exchange for work. These include basic wage or salary, bonus, incentives, merit increases, overtime payments, variable pay and commission.

Indirect financial compensation: includes benefits such as pensions, insurance, paid time work off, etc. These rewards are received by all employees on the basis of their membership in the organization. Instead of cash, the employees receive the tangible value of the reward.

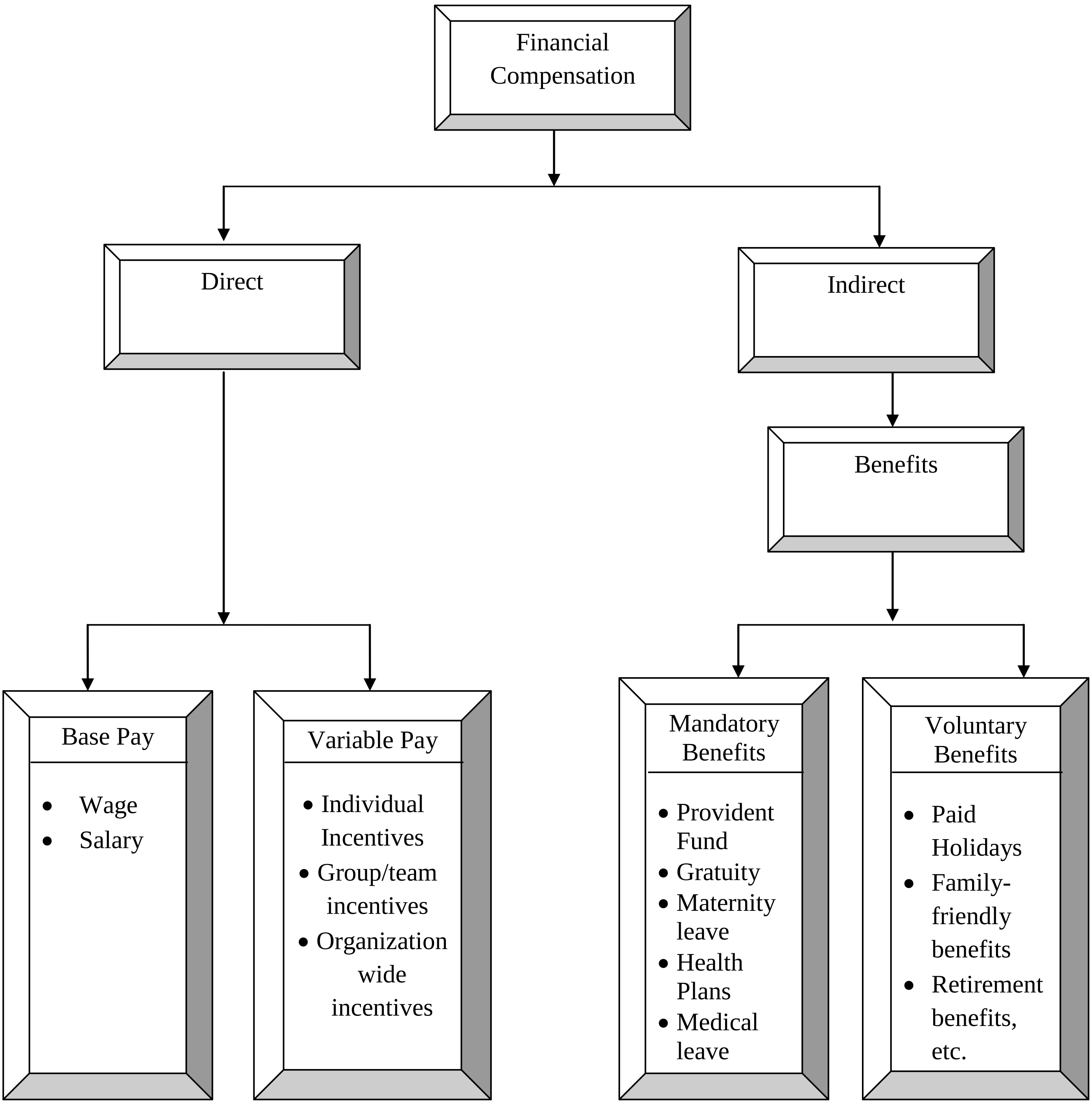
FIG: 1 TYPES OF COMPENSATION



Non-financial Compensation

Non-financial Compensation is the satisfaction that an individual derives from the job or from the environment in which he/she performs the job. If the job provides an individual variety, challenge, responsibility, etc. and allows him/her to close friendships with colleagues, it provides non-financial compensation to the employee.

FIG: 2 FINANCIAL COMPENSATION: CONSTITUENTS



The constituents of the financial aspect of a compensation programme are:

- Basic salary, or base pay, that is adjusted for length of service and for cost of living;

- Variable pay or incentives, that take the form of pay for performance; incentives may be individual or grouped; and
- Benefits, or employer-provided rewards, other than wages, salaries, or incentives.

COMPENSATION IMPACT ON ORGANIZATIONAL EFFECTIVENESS

“If you pick the right people and give them the opportunity to spread their wings - and put compensation and rewards as a carrier behind it - you almost don’t have to manage them.” ― Jack Welch

The most valuable asset of an organization is its human resource and therefore they must be managed efficiently to ensure increased productivity. Compensation has a great impact on productivity. To achieve effective work performance calls for job satisfaction among the workers. Compensation plays a significant role in influencing job satisfaction. It stimulates employees to work harder, thus increasing productivity and enhancing job performance. According to Salman et al., (2010), job satisfaction is directly linked with the motivation, involvement, organizational cooperation, and the job performance of employees Also, gratitude and rewards are essential factors to increase job satisfaction of employees and motivation, which are directly linked with the organization’s achievements (Jun, Cai, & Shin, 2006). The understanding of the employees’ needs and expectations at work signifies the base for their motivation.

Motivation is among the key concerns of organizations in the modern business environment, as it has been identified to be critical in achieving business goals and objectives. Motivated people perform well. In this way they have impact on the productivity, and thus, profitability, of organizations. A motivated work force is a vital component for a company’s survival. Employees are a valuable resource that may contribute in several different ways to a company's activities, provided that the company gives them an appropriate chance (Morgan, 1997). For a company to be successful, it needs the work force that can act strongly for the achievement of organizational goals and also have a strong urge to remain loyal to the company (Molander, 1996). For such devotion and dedication the key remains the motivation. Moreover, motivation is expected to accomplish work productivity and job satisfaction (Schultz and Schultz 1998). Anthony et al., (2000) defines compensation as mechanism that encourages and motivates managers to achieve organizational goals. Motivation is high willingness to make efforts for organizational goals, conditioned by ability to satisfy individual needs.

In today's globalized world, it is crucial for organization to strategize their competitive and benefits plans in order to attract and retain appropriate talent, maximize return on human capital and increase employees’ job satisfaction. Compensation is a powerful communicator of organizational goals and priorities and institutions that expect to be successful must make employees become partners in their success (Pam, 2007). An effective compensation management strikes a good balance between pay and work, thereby impacting organizational effectiveness.

(a) COMPENSATION AND JOB SATISFACTION

Today’s world is dynamic and ever-changing. In this environment, job satisfaction is an integral factor in motivating employees to accomplish organizational goals and objectives. Compensation plays an important role in determining employees’ job satisfaction. This is because of two reasons. First, money is an important instrument in fulfilling ones needs; and two; employees often see pay as a reflection of managements’ concern for them. Consequently, employees want a pay system, which is simple, fair and in line with their expectations. When pay is seen as fair, based on job demands, individual skill level, and community pay standards, satisfaction is likely to result. According to Bozeman & Gaughan (2011), the perception of being paid what one is worth predicts job satisfaction.

In today's globalized world, organizations are facing changes generated by increased competition, mergers and acquisitions, shifting markets and changing employee demographics. Therefore, it is crucial for organization to strategize their competitive and benefits plans in order to attract and retain appropriate talent, maximize return on human capital and increase employees' job satisfaction. Souza (2000) observes that compensation is a predictor of job satisfaction in that employees who are paid highly show a greater job satisfaction, a view also held by (Joanne, 1980). There is a correlation between compensation/reward and workers' job satisfaction (Nelson, 2008). According to the survey report conducted by the Society for Human Resource Management (2012), it was found that compensation and benefits are regularly among the top three factors affecting employee job satisfaction. The report further stated that as the economic climate continues to warm up and hiring rates increase, attractive compensation packages will be one of the strategies organizations competing for talent will use to recruit and retain the best employees. From here, it would seem that compensation and job satisfaction have a positive relationship. According to Armstrong and Murlis (1994) reward is a means through which various workers' needs are satisfied. The thus unsatisfied workers normally reduce workplace morale and lower productivity (Garrett, 1993). There are surveys that indicate compensation affects job satisfaction. It has impact on employee attitude and behavior. When employees are dissatisfied, (a) The quality of their work will become worse; (b) They tend to be late or do things other than their core tasks; and (c) The level of absenteeism and turnover is higher. These have negative impacts on organizational performance. Job's satisfaction could be enhanced by increasing autonomy, stress reduction and above all rises in compensation package (Whitt, 2006).

(b) COMPESATION AND MOTIVATION

In today's competitive economic environment, compensation is the most important motivation factor. Compensation is one of the key drivers of motivation. Humans are naturally inclined to perform better when they perceive that they will get sufficient payment or returns from their efforts (Campbell, 2007). This means giving close attention to how individuals can best be motivated to achieve objectives set for them. Motivation can be through incentives, rewards, and positions, all aimed at motivating people and obtaining their commitment and engagement (Amstrong 2008). Maintaining highly motivated employees is therefore a strategic move to keep employees committed to working hard and ultimately contributing their optimal capability towards achieving the organization's goals (Frey and Osterloh, 2002).

In the field of management, the key to understanding the process of having a satisfied work force lies in the meaning of the relationship among, needs, drives, and incentives. For as long as organizations have existed, compensation has been recognized as a major motivator of employees as well as an important tool and an expense for organizations. To use compensation as a motivator effectively, human resource managers must consider four major components of a pay structure in an organization (Popoola & Ayeni, 2007). The components include: job rate, fringed benefits, payment and personal or special allowances. Employees with high level of motivation tend to work hard and perform better in their work as compared to the employees with low level of motivation. The understanding of the employees' needs and expectations at work signifies the base for their motivation. In addition, the arrangement of the employees' work and the level of satisfaction with the job are important in order to increase the actual motivation and satisfaction with their work. The differences in this regard that what people want and actually perceive from their job are of significance. The strongest motivator is, according to Wiley (1997), something that people value, but lack. The awareness, for the organization, about those strong motivators is of great value and may serve as a starting point to re-design the work, in order to increase an employee's motivation and satisfaction.

As far back as 1911, Frederick Taylor and scientific management associate described money as the most important factor in motivating the industrial workers to achieve greater productivity (Waren, 1994). Taylor viewed compensation and performance based pay as one of the major tools management had at its disposal to motivate employees and increase their productivity and reduce turn over. In his work, Akitonye (2000) also emphasized that money remains the most important motivational strategy. According to Sinclair (2002), money possesses significant motivating power in as much as it symbolizes intangible goals like security, power, prestige, and a feeling of accomplishment and success. He also exhibits the motivational power of money with the process of job choice and expounds that money has the power to attract, retain, and motivate employees towards higher performance. Robbins (1991) suggested that motivation is: *".... The willingness to exert high levels effort toward organizational goals, conditioned by the effort's ability to satisfy some individual need".* Expectancy theory of Vroom (1964) says that employees will be motivated to make high level of effort when they are confident that these efforts will result in a good performance appraisal, good judgment will result in organizational rewards such as bonuses, and increase in employee benefits, or promotion and these awards will satisfy personal goals of employees. Results of research on compensation and motivation by Ghazanfar et al. (2011), Khan and Mufti (2012), Ingalens and Rousell (1999), and Rasheet (2010) reveal that compensation has significant effect on motivation. Employee motivation through compensation can be in several forms including salary raises, performance bonuses, commissions, profit sharing and other extra benefits such as vacations, cars and other tangible items that are used as rewards (Campbell, 2007). Highly motivated employees build advantages for its organization and lead it to its objectives (Rizal and Ali, 2010).

(c) STRATEGIC COMPESATION

In today's globalized world, organizations are facing changes generated by increased competition, mergers and acquisitions, shifting markets and changing employee demographics. Therefore, it is crucial for organization to strategize their competitive and benefits plans in order to attract and retain appropriate talent, maximize return on human capital and increase employees' job satisfaction. To have an effective compensation strategy, an organization should design jobs that:

1. Support a desired organizational structure that in turn ensures organizational effectiveness;
2. Are compatible with organizational culture and philosophy; and
3. Permit each jobholder to recognize the relationship between job activities and the common purpose of the organization.

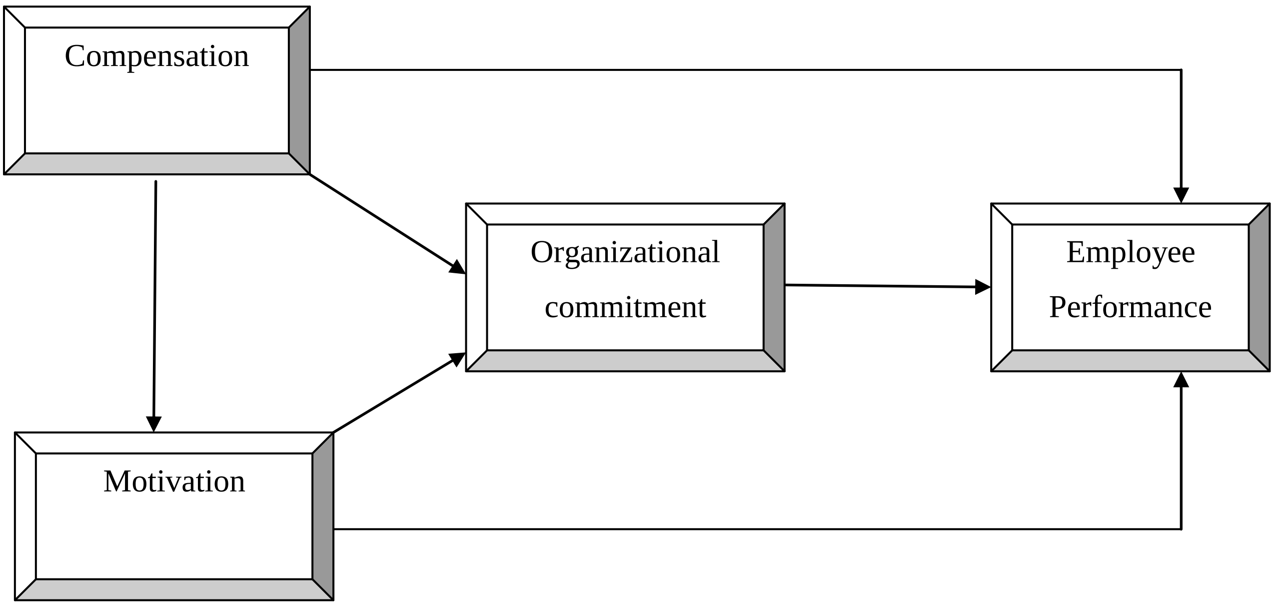
Since compensation impact on organizational effectiveness is a reality, it is only logical to optimize its potential by giving people fair and just compensation for works well done or to motivate employees to perform better. A fair compensation framework has the potential of making employees more satisfied. Since pay is one of the important attributes of work, employees will perform well for a fair pay. This, in turn, impacts on organizational performance and effectiveness. Thierry (1987) stated that the compensation systems to be effective depended on three perceived features, which are transparency, fairness and controllability. To develop and operate a compensation system that promotes fair treatment, an organization should consider the following compensation strategies:

1. Relating job worth to differences in job requirements.
2. Recognizing the worth and value of employee knowledge and skills.
3. Rewarding employee contributions and the results achieved.
4. Promoting continued employee acquisition and upgrading of knowledge and skills.
5. Supporting team and work unit cooperative efforts.
6. Designing compensation plans that successfully compete with established labour markets.
7. Aligning compensation of all employees with objectives and goals of the organization.
8. Providing a compensation package that enhances current lifestyles and provides long-term protection for employees and their dependents.

THE IMPORTANCE OF COMPENSATION MANAGEMENT ON EMPLOYEE PERFORMANCE

Employees are the assets of any organization. Organizational productivity depends on employee's performance. To have a positive influence on the performance of its employees, an organization must understand the various aspects of compensation as the driving force that motivates the employees and direct their behavior towards achieving the organizational objectives. An effective compensation system can stimulate employees to work harder, thus increasing their productivity and enhancing job performance. According to Baker (2002) the output or performance of an employee is a combination of effort, ability and an error margin, providing for all uncontrollable factors, at least from the employee's perspective. He stated that given the employee's private information *vis a vis* the employer, the employer must depend on performance measures in order to estimate the effort the employee has put in. Performance measures are selected based on two criteria: (a) alignment with the organizational objective and, (b) controllability by the employee as proposed by.

FIG: 3 LINK BETWEEN COMPENSATION AND EMPLOYEE PERFORMANCE



It has been found that there is a significant relationship between compensation and employee performance (Shin-Rong and Chin-Wei, 2012). From a strategic and tactical perspective, the quality and quantity of organizational output depend directly on the skill, interest, and the effort of the employees. Certainly, the more highly paid workers might be more critical contributors, but the productive efforts of all employees are essential. Mayson and Barret (2006) found that a firm's ability to attract, motivate and retain employees by offering competitive salaries and appropriate rewards is linked to firm performance and growth. Therefore, in an ever competitive business environment, many companies attempt to identify innovative compensation strategies that are directly linked to improving organizational performance (Denis and Michel, 2011).

Employee performance has a corresponding effect on the organization's performance. If the organizations wish to retain high-performers, they will have to focus on compensation strategies such as performance-based incentives. Performance-based compensation is the dominant human resource practice that firms use to evaluate and reward employees' efforts (Collins and Clark, 2003). Delery and Doty (1996) identified performance-based compensation as the single strongest predictor of firm performance. Both performance-based compensation and merit-based promotion can be viewed as ingredients in organizational incentive systems that encourage individual performance and retention (Cho et al., 2005). Moreover, Paul and Anantharaman (2003) found that compensation and incentives directly affect operational performance. To be effective, compensation practices and policies must be aligned with organizational objectives.

CONCLUSION

In today's globalized world, organizations are facing changes generated by increased competition, mergers and acquisitions, shifting markets and changing employee demographics. Therefore, it is crucial for organization to strategize their competitive and benefits plans in order to attract and retain appropriate talent, maximize return on human capital and increase employees' job satisfaction. Compensation is a powerful communicator of organizational goals and organizations reward employees for contributions that are consistent with organizational goals. Humans are naturally inclined to perform better when they perceive that they will get sufficient payment or returns from their efforts. The present study analyzed the link between compensation and employee satisfaction, motivation and performance. Through this, the impact of employee compensation on achieving organizational goals was worked out. The study highlights that an effective compensation management strikes a good balance between pay and work, thereby impacting organizational effectiveness.

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