

IMPACT OF COMPENSATION SYSTEM ON EMPLOYEE PERFORMANCE – A STUDY WITH SPECIAL REFERENCE TO SERVICE SECTOR

Dr. U. M. Premalatha*

Abstract:

Compensation is recompense or reward given by an organization to individuals in return to a work done, services rendered, or a contribution made towards the accomplishment of organizational goals. The objective of competent pay for performance is to attract capable applicants and by retaining current employees as strengths.

This study examines impact of compensation on the performances of employees and the extent to which compensation management can be used as a tool for improving organizational performance in the service sector. It is also aimed at finding out if efforts of the employees commensurate with compensation and ascertain the extent to which reform programmes of the sector have affected compensation policies and practices. In pursuance of the objectives of the study, the descriptive survey design is developed. Chi square-test is also employed to test the significance of the coefficient of correlation at 5% level of significance.

The topic is of particular interest to the researcher because employees who are involved in service sector are those who are commonly found to experience face-to-face interactions with customers and play an important role in ensuring that service quality is delivered.

In this context, there is a need for companies in the service sector to really focus on determining how they can encourage their employees to be dedicated and engaged with their work.

Key words: Compensation, Performance, Employee Turnover, Service sector, Promotion Practices.

* Chief Coordinator, School of Business, MBA Dept, Jain University, Bangalore

Introduction

In today's competitive environment, compensation system of the company has direct impact on its employee performance. Compensation is one of the physical needs that motivates which in turn will affect the employee performance. Job performance is influenced by many factors externally and internally.

Providing appropriate compensation within the meaning of fair and adequate to meet the requirements is one of the personnel department functions that are difficult to implement. Every organisation needs a strategic compensation system for its employees that address compensation, benefits, recognition and appreciation. Compensation includes the returns to the services rendered by employees as part of employment relationships. It has a big influence in the recruitment of employees, motivation, productivity and employee turnover. The level and magnitude of compensation should be of concern because the level of compensation will determine the lifestyle, self esteem, and the value of the company.

Objective of the study

The objective of the study is to find out the degree at which salary, incentives, benefits, promotion, self-development, and work environment collectively or individually have influence on employee performance.

The first part of the paper focus on compensation management identified with the different types, schemes, policies, procedures, instruments and strategies. Second part highlights definition and methods of performance management and performance appraisal. After the theoretical framework relationship between two areas of the study i.e., compensation and performance will be tested to draw the conclusions.

Sampling and research design

The purpose of this study is to examine the relationship between compensation system (monetary and non-monetary rewards) and employee's performance in banking sector. Analytical survey method was employed to collect information from 100 respondents (executives) in five different banking institutions, i.e. SBI, SBM, CANBANK, ICICI, VIJAYA Bank. Two monetary reward factors (basic pay, performance bonus) and three non-monetary reward factors (recognition, learning opportunity, and career advancement) were tested.

Review of literature:

The Influence of Reward System on Employees' Performance among Non-Academic Staffs in Master skill University College of Health Sciences concludes that employees' performance is influenced by both monetary reward and non-monetary reward at 57% and 69.8% respectively.

A Study of Relationship between Satisfaction with Compensation and Work Motivation remarks that work motivation in the organizations is influenced by the satisfaction of the employees with their compensation, which is offered by the organization. Study suggests that fixed pay can increase work motivation.

Impact of Compensation, Performance Evaluation and Promotion Practices on Government Employees Performance VS Private Employees Performance Results indicated that compensation and performance evaluation practices were significantly and positively associated with employee performance of both public and private sector organizations of Pakistan. On the other hand promotion practices were found to be insignificantly associated with employee performance of both public and private sector organizations.

Hypothesis Testing

The hypothesis was tested by using Chi Square. The reason for using Chi Square was the categorical nature of the data for which Chi Square is an appropriate test. Another justification for using Chi Square is based on the premise that it is most frequently used tool at .05 level of significance with 1 degree of freedom.

H0 = Compensation system influence and motivates effective performance.

H1 = Compensation system alone do not influence/motivates effective performance.

Data Processing

The filled questionnaire collected from the respondents was checked for incompleteness and for any inconsistencies. Editing detects errors and omissions, corrects them when possible, and certifies that minimum data quality standards have been achieved. Before the data are tabulated and analysis carried, the researcher is required to edit the same suitably to make it more meaningful. An initial screening should be carried out to determine if the responses are legible, consistent and complete. If the responses are not legible, a researcher may have to approach the respondent once again, or try to infer something about which a researcher is not clear or at the most discard the response altogether.

Theoretical framework

Performance effectiveness perspective is determined by the compensation system. The general purposes of the *compensation policy* covers:

- Valuing employees' performance.
- Maintaining a competitive labour market conditions.
- Uphold justice employee salaries.
- Motivating employee performance.
- Maintaining budget.
- Reducing employee turnover.

When employees are motivated, it is possible to achieve strategic goals for the organization. When the compensation scheme is based on positions or skills that are relevant to the position, the organization has a greater chance to attract, motivate and retain employees.

In *designing a compensation system* or a program, organisation can separate the salary or merit pay system from the main compensation system. Monetary rewards, especially those given on a regular basis like, bonuses, profit sharing, etc., should be tied to an employee's achievements and accomplishments and should be considered "pay at risk" in order to distance them from salary. By doing so, organisation can avoid a sense of entitlement on the part of the employee and ensure that the compensation emphasizes excellence or achievement rather than basic competency.

Common parameters while designing and developing *compensation program* may include:

- Identify company or group goals that the compensation program will support.
- Recognize desired employee performance or behaviours which will reinforce the company's goals.
- Determine key performance measurements.
- Design appropriate rewards.
- Communicate program to employees.

In order to reap the benefit of increasing productivity and profitability, organisation has to design a compensation program that identify company or group goals to be reached and the performance that will contribute to this.

Compensation practices can have far-reaching effects on its competitive advantage. As compensation expert Richard Henderson notes, "To develop a competitive advantage in a global

economy, the compensation program of the organization must support completely the strategic plans and actions of the organization.” Labour costs greatly affect competitive advantage because they represent a large portion of a company's operating budget. By effectively controlling these costs, a firm can achieve cost leadership. The impact of labour costs on competitive advantage is particularly strong in service and other labour-intensive organizations.

Compensation can be of two types like monetary and non monetary benefits. *Monetary compensation* consists of direct financial compensation and indirect financial compensation. Direct financial compensation includes salary, wages, bonuses, and commissions. The indirect financial compensations are also called benefits, which are all financial compensations not covered by the direct compensations. The *non monetary compensations* consist of employee satisfaction, such as responsibility, opportunities for growth and recognition, the chance of promotion, or from psychological and physical environment in which the employee works, such as a pleasant work environment, sound policies, a cafeteria, work sharing, compressed work week and the free time.

Michael and Harold determined the three forms of compensation like, material, social, and activities. Material compensation is not only the form of money, such as salaries, bonuses and commissions, but all forms of physical reinforcement, such as parking facilities, telephone and office space as well as various forms of benefits such as pensions, health insurance. Social compensation is closely linked to the needs of interaction with others, such as status, recognition as an expert in his field, the formation of groups of decision makers, and a special group formed to solve the problems of the company. Activity compensation provides employees an opportunity to work in an area that is not linked to his routine work. These three forms of compensation can motivate employees in the supervision, job performance and commitment to the company. Motivators of the three forms of compensation are control, achievement, involvement, membership, security, and personal development.

Employee Performance

The performance is defined as the achieved results of operations with the capabilities of the employee who acts in certain situations. It is a combined result of effort, ability, and perception of tasks. High performance is a step towards the achievement of organizational goals. Therefore, efforts are needed to improve employee performance.

Performance Measurement

The most difficult part of the performance appraisal process is to accurately and objectively measure the employee performance. Measuring the performance covers the evaluation of the main tasks completed and the accomplishments of the employee in a given time period in comparison with the goals set at the beginning of the period. Measuring also encompasses the quality of the accomplishments, the compliance with the desired standards, the costs involved and the time taken in achieving the results. In order to minimize subjectivity, the rating scales used to evaluate jobs must be clearly defined, and evaluators should be thoroughly trained on how to use them. Moreover, the evaluators should be provided with complete, accurate, and up-to-date job descriptions.

Table 1: Compensable Factors Used in the Point-Factor Method of Performance Measurement

Compensable Factor	Criteria
Competency: Knowledge Skill/know-how	Education Experience Knowledge
Efforts	Physical Effort Mental Effort
Responsibility and Accountability	Judgement/decision-making Internal business contacts Consequence of error Degree of influence Supervisory responsibilities Responsibility for independent action Responsibility for machinery/equipment Fiscal responsibility Responsibility for confidential information
Working environment	Risks Comfort Physical demands Personal demands

For the purpose of measuring employee performance, different input forms can be used for taking the feedback from the various sources like the superior, peers, customers, vendors and the employee himself. All the perspectives thus received should be combined in the appropriate manner and to get an overall, complete view of the employees' performance.

Data analysis and interpretation:

Relationship between Compensation and Employee Performance

One of the latest strategies being followed in all sectors throughout the world for retention and talent management is "linking compensation to performance". Commonly known as "Pay for Performance" or "Performance based pay", it links the compensation of the employees to their performance and their contribution to the organizational goals. Therefore, periodic performance reviews play a vital role and provide the basis of performance related pay.

Although compensation is not the only factor affecting the performance, but it is acknowledged that the compensation is a major factor for employee performance improvement. If employees feel that their effort is appreciated and the company offers a system of compensation in association with job evaluation, the employee's motivation and enthusiasm will improve and hence their performance.

Analysis 1

Non Parametric Test

"Compensation system motivates effective performance"

H0 = Compensation system influence and motivates effective performance.

H1 = Compensation system alone do not influence/motivates effective performance.

Table 2: Whether Compensation system influence and motivates effective performance

Parameters	Yes	No	Total
Compensation system	62	38	100
Effective performance	55	45	100
Total	117	83	=200

Computation of Expected values: $E = \frac{RT*CT}{GT}$ Where RT = Row Total

GT = Grand Total CT = Column Total

GT = Grand Total

$$E (72) = \frac{100*117}{200} = 58.5 = E (55)$$

$$E (28) = \frac{100*83}{200} = 41.50 = E (45)$$

Table 3: Computation of X^2 value to know whether Compensation system influence and motivates effective performance

O	62	38	55	45
E	59	42	59	42
(O-E) ²	9	16	16	9
(O-E) ² /E	.13	.50	.27	.28

$$X^2_{cal} = \sum (O-E)^2 / E = 1.18$$

$$\text{Degree of freedom (d.f)} = (r - 1) (c - 1) = (2 - 1) (2 - 1) = 1$$

Level of significance (α) = **0.05**

X²_{tab} Value at 5% level for 1 degree of freedom is **3.841**

Decision: Since X²_{cal} < X²_{tab}

i.e. 1.18 < 3.841;

Accept H₀

i.e Compensation system influence and motivates effective performance.

Analysis 2

Using Phi coefficient The phi coefficient is a measure of the degree of association between two binary variables. This measure is similar to the correlation coefficient in its interpretation.

Formula for the phi coefficient:

$$\phi = \frac{ad - bc}{\sqrt{efgh}}$$

Notice that Phi compares the product of the diagonal cells (a*d) to the product of the off-diagonal cells (b*c). The denominator is an adjustment that ensures that Phi is always between -1 and +1.

	X ⁻	X ⁺	Total
Y ⁻	a	b	e
Y ⁺	c	d	f
Total	g	h	n

Table 4: Strong association between work environment and employee performance.

	X ⁻	X ⁺	Total
Y ⁻	35 (a)	15 (b)	50 (e)

Y +	10 (c)	40 (d)	50 (f)
Total	45 (g)	55(h)	100

$$\phi = \frac{ad - bc}{\sqrt{efgh}}$$

$$\Phi = \frac{35 * 40 - 15 * 10}{\sqrt{50 * 50 * 45 * 55}}$$

$$= \frac{1400 - 150}{\sqrt{6187500}} = \frac{1250}{\sqrt{2487.47}} = .5025$$

Interpretation: As the value of Phi coefficient falls in between -1 and +1 i.e. **.5025** in the analysis, there exists a strong association between work environment and employee performance. Coefficient revealed that there is a positive significant relationship between these two.

Findings

The results show that compensation management has a direct impact on employee performance. The preferences of employees on compensation may change from position to position in the organisation irrespective of its size and nature. Study also shows that monetary rewards have to be supported with non monetary benefits to retain the talents in the long run.

Suggestions

Employee compensation and recognition programs are one method of motivating employees to change work habits and key behaviours to benefit organisation in the long run for its sustenance. Since compensation practices heavily influence recruitment, turnover, and employee productivity, it is important that both employer and employee view these practices in a favourable light.

Conclusion

Compensation doesn't only mean only salary but there many different ways to compensate competent employees. Performance evaluation practices helps to recognize the level of performance performed by employees. Performance appraisals should be devised in such a way that it must have all the elements and aspects. These activities must be done in a systematic and synchronized way. Employees should have a belief that their efforts will be recognized.

References:

- Asra Juziela, Md. Hashim (2011) The Influence of Reward System on Employees Performance among Non-Academic Staffs in Master skill University College of Health Sciences. Masters thesis, University Utara Malaysia.
- Belcher, D.W., & Atchison, T.J. Compensation Management, 2 nd Ed, Prentice- Hall.
- Compensation management as too for improving organisational performance in the public sectors: A study of the civil service of anambra state of Nigeria published in *Sacha Journal of Policy and Strategic Studies Volume 1 Number 1 (2011), pp. 109-120.*
- The Impact of Rewards on Employee Performance: Case Study of Organisations from Two Sectors in Nigeria.
- Lawler, E.E. & Porter, L.W. Antecedent attitudes of effective managerial performance, Organizational Behavior and Human Performance.
- Wiley, C., What motivates employees according to over 40 years of motivation surveys, International Journal of Manpower.

