

# The Impact of Indirect Compensation on Employee performance: an Overview

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## Abstract

"If you pick the right people and give them the opportunity to spread their wings and put compensation as a carrier behind it you almost don't have to manage them."(Jack Welch). Compensation management is one of the most important elements of personnel management. It includes economic rewards in shape of wages and salaries as well as in different forms of non-wage economic payment known as fringe benefits, indirect compensation or supplementary pay. The subject of Compensation and for that matter Indirect Compensation is of great importance because it affects the wellbeing of the individuals in the concerned organizations. According (Tsai, Yu, & Shih-Yi, 2005), Indirect compensation helps organizations to attract and retain highly competitive employees which are seen as strategic resources in getting competitive advantage. Therefore, this research work has been done to look at the impact of Indirect Compensation on the performance of employees. Organizations should pay the necessary attention to the Indirect Compensation, as this will help to boost the morale of employees which will in turn result in higher productivity.

**Keywords:** Compensation, Benefits, Performance, Indirect, Management

## 1. Introduction

Every organization must describe its mission and understand the circumstances in which it operates and formulate a strategy and structure for achieving its objectives. The human resources strategy it acquire must devote to its success and empower it to retain attract and motivate the employees essential for high levels of performance (Greene).

Compensation is an important matter which needs to be considered because it directly or indirectly impact effectiveness and competitiveness of a business as well as the well-being of employees. It is a significant instrument for employers in affecting employee attitudes such as perceptions of fairness and employee behavior including whether an employee is attracted to and remains with the employer and how employees effectively utilize their time at work. It has a major effect on employees' values of living and communicates to them the degree to which the employer values their contribution. The compensation package is normally differentiated into Direct and Indirect Compensation. These comprise financial and non-financial rewards (Noe, Hollenbeck, Gerhart, & Wright, 1996).

According to (Geringer & Frayne, 1990) Compensation involves those rewards financial and non-financial, direct and indirect which an organization exchanges for the participation of its employees; both job performance and personal contribution.

Harrison and Liska (2008) revealed that reward is the main element of the employment contract because it is the basic reason why people work. It involves all types of rewards, both intrinsic and extrinsic, that are gained as a result of employment by the organization.

Compensation management is one of the central pillars of human resources management (HRM). It is linked with the formulation and implementation of strategies and policies that aim to compensate people practically, justifiably and constantly in agreement with their worth to the organization (Armstrong, 2005).

Compensation Management as the name represent including a compensation structure in which best performer employee awarded more than average performer (Hewitt, 2009). This motivates the good performer to work hard and make competitive atmosphere in organization.

Brown and Armstrong (1998) suggest that compensation management is an essential part of HRM approach to achieve organizations objectives and manage the people and it is strategic because it is tackle relating to problem

like how people can achieve their objectives; it is therefore linked with other HRM functions, mostly linked with human resource development.

Compensation management is one of the most important elements of personnel management. It includes economic rewards in shape of wages and salaries as well as in different forms of non-wage economic payment known as fringe benefits, indirect compensation or supplementary pay. The subject of Compensation and for that matter Indirect Compensation is of great importance because it affects the well-being of the individuals in the concerned organizations. Therefore, this research work has been done to look at the impact of Indirect Compensation on the performance of employees.

## 2. Objectives of the Study

1. To analyze the impact of Indirect Compensation on employee performance
2. To explore the different types of Indirect Compensation.
3. To explore the recommendations that can make the Indirect Compensation programs more effective.

## 3. Literature Review

### 3.1 What is Compensation?

According to (Chhabra, 2001) Compensation is the combination of monetary and non-monetary rewards provided to employees for offering the services to the organization. It is given in the shape of wages, salaries and employee benefits like paid vacations, insurance, maternity leave, free traveling facility, retirement benefits, etc. He says that the terminology 'wage' is used to represent payment to workers doing manual or physical work. So, wages are provided to facilitate the unskilled workers for their services to the organization. Wages can be given on hourly, daily, weekly or on monthly bases. On the other side, According to (Chhabra, 2001) the term 'salary' is normally used to mean compensation to employee of the office, foremen, managers, professionals and technical staff. Salary is basically provided on weekly, monthly or yearly basis. The duration for which salaries are given is basically higher than wage payments. He furthermore added that salary is always based on the time spent on the job, while wages are either based on the number of units produced or the time spent on the job.

### 3.2 Indirect Compensation

According to (Dessler, 2011) Indirect Compensation is the indirect monetary and non-monetary remuneration employees get for continuing their job with the organization that is an essential element of every employee's compensation. Other terminologies used for indirect compensation are fringe benefits, employee services, supplementary compensation and supplementary pay.

According to (Chhabra, 2001), Indirect or Supplementary Compensation includes 'fringe benefits' rendered via several employee services and benefits like housing, financial assistance for food, medical allowance, daycare centers for children's and so on. In the organization rewards are given by organizations to employees for their membership, attendance or participation. Due to the continuous increase in the costs of fringe benefits, some people used the term 'hidden payroll' for them. Presently these benefits represent approximately 40 % of the total compensation costs for each employee of the organization. The basic objective of fringe benefits or indirect compensation is to attract, motivate and retain competent human resources in the organization.

### 3.3 Types of Indirect Compensation

Following are some of the types of famous indirect compensations offered by organizations Nowadays (Byars & Rue, 2008):

**a. Social Security:** It is an insurance system that is federally administrated. Both employer and employee must contribute into the system according to law, and up to a maximum limit a definite % of the employee's salary is provided. How much is contributed by employer and employee is decided on the average monthly wage. Its basic purpose is to provide employees financial assistance when they retire.

**b. Workers' Compensation:** worker compensation is given to employees to save them from loss of income and to fulfill extra cost related to job-related injuries or illness. The laws normally provided as a replacement of lost income, medical expenditure, and lump-sum disability payments and for some sort of reestablishment, and death benefits to survivors.

**c. Retirement Plans:** Retirement and pension plans that are a way of income to people who have retired. It is the money paid to them for past services. During the time of employment private plans are financed entirely by the organization or together by the organization and the employee. Defined-benefit plan is one famous form of

pension plan. In this, the employer promise to give a benefit decided by a definite formula at the time of employee's retirement. Defined contribution plan is another type of retirement plan; Instead of a known benefit it takes a fixed or known annual contribution.

**d. Paid Holidays:** It includes Christmas Day, New Year's Day, Independence Day, Labor Day, etc. Floating holiday is comparatively a new concept, which is observed on the choice of the employee or the employer. One more important new concept is known as personal time-off or personal days. In this concept, organizations provide employees a certain number of days with pay to deal with personal matters. Usually these days are taken at the discretion of the employee.

**e. Paid Vacations:** Before becoming eligible for paid vacation an employee must fulfill certain duration of service requirement normally. The time allowed for paid vacations is normally based on the employee's length of service. Vacations policies are different among class of employees unlike holiday policies which normally impact everyone in the same way, vacation. Many organizations permit employees to take vacation by the week or a day but not in units of less than a day.

**f. Other Benefits:** Organizations may also provide some other extra benefits that include food services, exercise facilities, health and first-aid services, financial and legal advice, and purchase discounts. The degree and inducement of these benefits is considerable different among organizations. E.g. purchase discounts are normally attractive to employees of an airline or retail store.

### *3.4 Impact of Indirect Compensation on Employee Performance*

According (Tsai, Yu, & Shih-Yi, 2005), Indirect compensation help organizations to attract and retain highly competitive employees which are seen as strategic resources in getting competitive advantage, One can expect that through benefits offerings the overall attractiveness of organization can be increased and the loyalty and satisfaction of that employee will also be increased. As a result, it will increase employee motivation and performance. In simple, higher indirect compensation may enhance organizational performance by attracting and retaining competitive labor. In another words, indirect compensation play a moderating role and increase the positive impact of labor input on an organization's output with the retention and recruitment of high quality employees.

According to (Bond & Galinsky, 2006) The fact that many small organization do, that give some, if not all, of these supplementary benefits to the lower-wage employees, it demonstrate that they view the investments valuable for purposes of enhancing recruitment, performance, and retention. It indicates how important it is for organizations to give their employees with appropriate fringe benefits (in addition to salaries and wages) and make sure that the elements of their Conditions of Service are properly implemented. This will increase employee morale and make the quality of goods and services better at low prices and also increase profit. According to (De Nissi & Griffin, 2001) Performance is an economic measure of effectiveness which summarizes and indicates the amount of the outcome produced by an individual, organization, industry or economic system comparative to the amount of the inputs used to produce them. Organizations all around the world have identified the importance of performance to compete and also to survive in the market. Moreover, actual performance improvement takes an important comprehensive approach which relies on the employees, it is important to provide them with the essential supplementary benefits to encourage them to perform their best. To increase employee morale, performance and productivity, Hodgetts said organization should adopt the following steps:

- Provide value to the people as human beings and define rules and procedures to deal with employees fairly.
- Design a support system for identifying and rewarding good performance.
- Develop an environment of trust and indicate that management has confidence on the employees.
- Develop a natural, fun (recreation centers or club houses), collaborative friendly atmosphere (end of year parties) which foster innovation.

People are the most essential elements of the organizations. They demand high respect by their organizations, be provided with necessary recognition and good environment for work. Once the above steps are taken by organizations, the goal of high performance and high quality would be achieved and this will help the organization to achieve success.

### *3.5 Recommendations to make the compensation programmes more effective*

According to (Aswathappa, 2007) these five steps need to be taken by organization whiles developing indirect compensation.

**(1) Developing the objectives of employee benefits:** No benefit plan is properly developed unless it does not meet the employer's objectives. Managers should make sure that the organizations have clearly defined written objectives that have been recommended by the board of directors or by the owners of the firm. These objectives are different for each organization, on the basis of these factors such as size, location, industry, the results of collective bargaining and the ideology of the employer. The objectives will help the organization in developing the types of indirect compensation they must provide to employees and make decisions in this respect.

**(2) Assessment of the environmental factors:** Both internal and external factors have an impact on organization's indirect compensation programme. External factors include government taxes rules, regulations and policies, unions and economic factors. Internal factors include organizational strategies, policies and objectives, employee preferences and demographics. Assessment of these factors is important for Managers to develop useful indirect compensation programmes.

**(3) Assessment of competitiveness:** It means how organization compares its benefits to the competitors. Managers should ensure that their organization is offering benefits to match with benefits offered by competitors. The benefit packages of competitors could be assessed from market surveys which are conducted by professional consultants and associations.

**(4) Communicating information about benefits to employees:** The Benefit of these programmes can be communicated to employees via booklets, brochures, presentations and regular employee meetings. A useful technique is to use employee calendars that may communicate the total salary components. The calendar of the month will show the company employee receiving a benefit, for example one month calendar may show a photo of an employee building a new home that becomes possible through the company's savings plan. Communication helps to increase employees (and of employers too) knowledge about indirect compensation. Moreover, organization may be able to increase the performance and the advantages of good supplementary compensation by informing employees about what the company does for them which does not appear on their pay slips.

**(5) Monitoring employee benefit cost and evaluation:** One method of determining the effectiveness of fringes benefits is to discover how much the indirect financial schemes have really benefited the employees. In this point Managers need to determine whether the income of employees have improved or not, benefits are capable to attract and retain high quality people and if the morale of employees has increased or not.

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