Unit IV: Wages & Salary Administration

Concept & objectives of wages & salary administration, Principles of wages & salary administration, components of remuneration, Theories of wages:- (Subsistence Theory, Wage fund theory, Bargaining theory, comparative advantage theory) factors affecting wage & salary level.

CONCEPT OF WAGES AND SALARY ADMINISTRATION

In simple words wages means reward for the labourer for his services rendered to the industry. These can be paid on per unit, per hour, daily, fortnightly, weekly, or monthly basis. Labourers render services of both types i.e. mental and physical.

According to Prof. Straitoff, "Wages is the reward of that labour which creates utility."

As per the ILO, "Wages refer to the payment which is made by the employer to the labourer for his services hired on the conditions of payment per hour, per day, per week, or per fortnight."

In the words of Jaod, "Wages are the income that an employee gets for his services."

According to Benham, "Wages are a sum of money paid under contract by an employer to a worker for services rendered."

'Wage and Salary Administration' refers to the establishment and implementation of sound policies and practices of employee compensation. The basic purpose of wage and salary administration is to establish and maintain an equitable wage and salary structure. Wages and salaries are often one of the largest components of cost of production and such have serious implications for growth and profitability of the company. On the other hand, they are the only source of workers' income

PRINCIPLES OF WAGES AND SALARY ADMINISTRATION

The following principles should be followed for an effective wage and salary administration ;

- Wage policy should be developed keeping in view the interests of all concerned parties viz., employer, employees, the consumers and the society.
- Wage and salary plans should be sufficiently flexible or responsive to changes in internal and external conditions of the organization.
- Efforts should be made to ensure that differences in pay for jobs are based on variations in job requirements such as skill, responsibility, efforts and mental and physical requirements.
- Wage and salary administration plans must always be consistent with overall organizational plans and programmes.
- Wage and Salary administration plans must always be in conformity with the social and economic objectives of the country like attainment of equality in income distribution and controlling inflation, etc.
- These plans and programmes should be responsive to the changing local and national conditions.
- Wage and salary plans should expedite and simplify administrative process.
- Workers should be associated, as far as possible, in formulation and implementation of wage policy.
- An adequate data base and a proper organizational set up should be developed for compensation determination and administration.
- The general level of wages and salaries should be reasonably in line with that prevailing in the labor market.
- There should be a clearly established procedure for hearing and adjusting wage complaints. This may be integrated with the regular grievance procedure, if it exists.
- The workers should receive a guaranteed minimum wage to protect them against conditions beyond their control.
- Prompt and correct payments to the employees should be ensured and arrears of payment should not accumulate.
- The wage and salary payments must fulfill a wide variety of human needs including the need for self-actualization.

- Wage policy and programme should be reviewed and revised periodically in conformity with changing needs. For revision of wages, a wage committee should also be preferred to the individual judgement however unbiased of a manager.

COMPONENTS OF REMUNERATION

An average employee in the organized sector is entitled to several benefits — both financial as well as non-financial. To be specific, typical remuneration of an employee comprises—wages and salary, incentives, fringe benefits, perquisites, and non-monetary benefits.

WAGES AND SALARY

Wages represent hourly rates of pay, and salary refers to the monthly rate of pay, irrespective of the number of hours put in by an employee. Wages and salaries are subject to annual increments. They differ from employee to employee, and depend upon the nature of job, seniority, and merit.

Incentives

Also called 'payments by results', incentives are paid in addition to wages and salaries. Incentives depend upon productivity, sales, profit, or cost reduction efforts.

There are:
1) individual incentive schemes and
2) group incentive programmes.

Individual incentives are applicable to specific employee performance. Where a given task demands group effort for completion, incentives are paid to the group as a whole. The amount is later divided among group members on an equitable basis.

Fringe Benefits

These include such employee benefits as provident fund, gratuity, medical care, hospitalization, accident relief, health and group insurance, canteen, uniform, recreation and me like.

Perquisites

These are allowed to executives and include company car, club membership, paid holidays, furnished house, stock option schemes and the like- Perquisites are offered to retain competent executives.

Non-monetary Benefits

These include challenging job responsibilities, recognition of merit, growth prospects, competent supervision, comfortable working conditions, job sharing, and flexitime.

THEORIES OF WAGES:- SUBSISTENCE THEORY

The theory was formulated by physiocrats. According to them wages would be equal to the amount just sufficient for subsistence. Lassale, a German economist developed this theory. According to this theory, wages are determined by the cost of production of labour or subsistence level. The wages so determined will remain fixed.

It actual wages are higher than the subsistence level, then population will increase leading to an increase in labour supply and lower wages. If on the other hand, the actual wages fall below the subsistence level, population will decrease resulting in a decline in labour supply and rise in wages. Since there is a tendency for the wages to remain fixed at the subsistence level, it is called as Iron Law of Wages or Brazen Law of Wages.

This theory is based on two assumptions:

1. Food production is subject to the law of diminishing returns, i.e., there is a limit to expansion of food production.

2. Population increases at an increasing rate.

Criticisms:

This theory is almost completely out-dated and has no such practical application, especially in advanced countries. The theory was based on the Malthusian Theory of Population. It is inappropriate to say that every increase in wages must inevitably be followed by an increase in birth rate. An increase in wages may be followed by a higher standard of living.

1. Ricardo was one of the exponents of the subsistence theory. He stressed the influence of custom and habit in determining what was necessary for the workers. But habits and customs change over time.

Hence, the theory cannot hold good for a longer period of time, especially of a world characterised by fast changing habits. Ricardo, therefore, admitted that wages might rise above the subsistence level for an indefinite period in an improving society.

2. The subsistence theory of wages explains wages from the supply side and ignores the demand side.

3. If all labourers must get the bare necessaries of life, all must get equal wages. But there are many differences in wages. Thus this theory ignores wage differences.

4. This theory asserts that wages are fixed at the subsistence level. Therefore, it assumes that the trade unions are powerless in increasing the wages. This is a wrong notion.

5. This theory is based on the Malthusian theory of population according to which a rise in wages above the subsistence level will lead to rapid increase in population.

But experience shows that a rise in wages leads to higher standard of living and not increase in population.

6. This theory is pessimistic because it excludes all possibility of improvement in the conditions of labour either through increased efficiency or due to general economic progress.

B) WAGE FUND THEORY

This theory was developed by J.S.Mill. According to him, the employers set apart a certain amount of capital to pay wages for labourers. This is fixed and constant. This is called as wages fund. Wage is determined by the amount of wages fund and the total number of labourers.

According to J.S.Mill, “wages depend upon the demand and supply of labour or as it is often expressed as proportion between population and capital. By population is here meant the number only of the laboring classes or rather of those who work for hire and by capital, only circulating capital……….. “.

Wage rate=Wage fund / Number of labourers

An increase in wage rate is possible only by an increase in wage fund or by a reduction in the number of labourers. Thus there exists a direct relation between wage rate and wages fund and inverse relation between wage rate and number of labourers. This theory also states that trade unions are powerless in rising the general wage rate.

Criticisms:

1. Wage fund theory states that the wage rate is found by dividing the wage fund by the number of workers. But it does not tell us about the sources of wages fund and the method of estimating it.

2. Wage fund theory is unscientific and illogical because it first decides the wages fund and then determines wages. But in reality, wages should be found first and from that wage fund should be calculated. This theory neglects the quality and

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4. This theory assumes that wages can increase only at the expense of profit. This is not correct. The operation of the law of increasing returns will lead to a great increase in total output which may be sufficient to raise both wages and profits.

5. The wages fund theory has been criticized by the trade unions for its assumption that wages cannot be increased through bargaining.

6. Wages fund theory has failed to explain the differences in wage rate.

7. This theory believes that wages are paid out of circulating capital. But when the process of production is short, wages are paid out of current production. When the process of production is long, wages are paid out of capital.

BARGAINING THEORY

The bargaining theory of wages holds that wages, hours, and working conditions are determined by the relative bargaining strength of the parties to the agreement. Smith hinted at such a theory when he noted that employers had greater bargaining strength than employees. Employers were in a better position to unify their opposition to employee demands, and employers were also able to withstand the loss of income for a longer period than could the employees. This idea was developed to a considerable extent by John Davidson, who proposed in The Bargain Theory of Wages (1898) that the determination of wages is an extremely complicated process involving numerous influences that interact to establish the relative bargaining strength of the parties.

This theory argues that no one factor or single combination of factors determines wages and that no one rate of pay necessarily prevails. Instead, there is a range of rates, any of which may exist simultaneously. The upper limit of the range represents the rate beyond which the employer refuses to hire certain workers. This rate can be influenced by many factors, including the productivity of the workers, the competitive situation, the size of the investment, and the employer’s estimate of future business conditions. The lower limit of the range defines the rate below which the workers will not offer their services to the employer. Influences on this rate include minimum wage legislation, the workers’ standard of living, their appraisal of the employment situation, and their knowledge of rates paid to others. Neither the upper nor the lower limit is fixed, and either may move upward or downward. The rate or rates within the range are determined by relative bargaining power.

The bargaining theory is very attractive to labour organizations, for, contrary to the subsistence and wages-fund theories, it provides a very cogent reason for the existence of unions: simply put, the bargaining strength of a union is much greater than that of individuals. It should be observed, however, that historically labourers were capable of improving their situations without the help of labour organizations. This indicates that factors other than the relative bargaining strength of the parties must have been at work. Although the bargaining theory can explain wage rates in short-run situations (such as the existence of certain wage differentials), over the long run it has failed to explain the changes that are observed in the average levels of wages.

COMPARITIVE ADVANTAGE THEORY

Comparative advantage refers to a company's ability to produce goods and services at a lower cost than anyone else. It often occurs when a country produces something at a lower cost than you could produce it in your own country. For example, many companies outsource their call centers to other countries because it is so much cheaper than locating it in their own country. While the employees in the other country may not speak English as clearly, the savings is enough to make the trade-off worth the loss of quality.

The theory of comparative advantage was created by economist David Ricardo. He claimed that a country gained the most economic growth by focusing on the industries in which it had the greatest comparative advantage. He developed the theory to argue against trade restrictions on imported wheat in England. He argued that England shouldn't place restrictions on low-cost and high-quality wheat from other countries and that it would, instead, gain greater value by exporting products that required machinery and skilled labor.

While comparative advantages generally occur in goods, telecommunication technology is making it easier to export services, such as call centers, entertainment and banking.

Advantages of comparative advantage

There are a few advantages of comparative advantage, including:

1. Lower opportunity costs and higher profit margins: Nations—or companies—that have a comparative advantage can focus their labor, capital and resources on production that requires a lower opportunity cost and therefore achieve higher profit margins.

2. Increased efficiency: Companies choose to specialize their production on goods or services that they can make more efficiently and then purchase what they cannot efficiently create from trading partners.

3. Absolute and competitive advantages: Companies that engage in commerce do so to capitalize on advantages. In doing so, they may gain a competitive or even absolute advantage.

Disadvantages of comparative advantage

There are some arguments against comparative advantage.

1. Government may restrict trade: If a country removes itself from an international trade agreement or a government imposes tariffs, it could create complications for the companies that were relying on those countries for resources.

2. Transport cost may outweigh the comparative advantage: While the cost of materials and labor overseas may be cheaper than manufacturing them in the same country, the savings may not be enough to outweigh the cost of transport. In some cases, transportation costs may outweigh any comparative advantage.

3. Increased specialization may make scaling difficult: If your products and services require specialized skills, it may be difficult to increase the organizational size or output, as employees with those specialized skills can be difficult to find.

4. Opportunity cost is key to comparative advantage. Opportunity cost is the benefit that someone loses by choosing one option over another. In the case of comparative advantage, the benefit that has been given up—the trade-off—is lower for one company than it is for another. The company with the lower opportunity cost has a comparative advantage.

FACTORS AFFECTING WAGE AND SALARY LEVEL

The wage payment is an important factor influencing labour and management relations. Workers are very much concerned with the rates of wages as their standard of living is connected with the amount of remuneration they get. Managements, generally, do not come forward to pay higher wages because cost of production will go up and profits will decrease to the extent.

Following factors influence the determination of wage rate:

1. **Ability to Pay**: The ability of an industry to pay will influence wage rate to be paid, if the concern is running into losses, then it may not be able to pay higher wage rates. A profitable enterprise may pay more to attract good workers. During the period of prosperity, workers are paid higher wages because management wants to share the profits with labour.

2. **Demand and Supply**: The labour market conditions or demand and supply forces to operate at the national and local levels and determine the wage rates. When the demand for a particular type of skilled labour is more and supply is less

than the wages will be more. One the other hand, if supply is more demand on the other hand, is less then persons will be available at lower wage rates also. According to Mescon," the supply and demand compensation criterion is very closely related to the prevailing pay comparable wage and on-going wage concepts since, in essence to all these remuneration standards are determined by immediate market forces and factors.

3. **Prevailing Market Rates**: No enterprise can ignore prevailing wage rates. The wage rates paid in the industry or other concerns at the same place will form a base for fixing wage rates. If a unit or concern pays low rates then workers leave their jobs whenever they get a job somewhere else. It will not be possible to retain good workers for long periods.

4. **Cost of Living**: In many industries wages are linked to enterprise cost of living which ensures a fair wages to workers. The wage rates are directly influenced by cost of living of a place. The workers will accept a wage which may ensure them a minimum standard of living.
Wages will also be adjusted according to price index number. The increase in price index will erode the purchasing power of workers and they will demand higher wages. When the prices are stable, then frequent wage increases may not be required

5. **Bargaining of Trade Unions**: The wage rates are also influenced by the bargaining power of trade unions. Stronger the trade union, higher will be the wage rates. The strength of a trade union is judged by its membership, financial position and type of leadership.

6. **Productivity**: Productivity is the contribution of the workers in order to increase output. It also measures the contribution of other factors of production like machines, materials, and management .Wage increase is sometimes associated with increase in productivity. Workers may also be offered additional bonus, etc., if productivity increases beyond a certain level. It is common practice to issue productivity bonus in industrial units.

7. **Government Regulations**: To improve the working conditions of workers, government may pass legislation for fixing minimum wages of workers. This may

ensure them, a minimum level of living. In under developed countries bargaining power of labour is weak and employers try to exploit workers by paying them low wages. In India, Minimum Wages Act, 1948 was passed empower government to fix minimum wages of workers. Similarly, many other important legislation passed by government help to improve the wage structure.

8**. Cost of Training**: In determining, the wages of the workers, in different occupations, allowances must be made for all the exercises incurred on training and time devoted for it.