

# COMPENSATION MANAGEMENT IN INDIAN CENTRAL PUBLIC SECTOR ENTERPRISES: TOWARDS PERFORMANCE RELATED PAY

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## **Abstract**

Central Public Sector Enterprises in India have realized the importance of attracting, motivating and retaining talent and hence are bring in massive change in its attitude towards managing people. CPSEs are geared up to establish a performance oriented culture by making their compensation competitive and by integrating performance and compensation management systems in their organizations. The latest 2nd pay revision for CPSEs in India calls for an implementation of the concept of Cost to Company, performance related pay (PRP), Performance management system and cafeteria type benefit plan. The paper attempts to study the steps taken by CPSEs in the context of 2nd pay revision in terms of establish of transparent and robust Performance Management System. It also tries to explore the link of various motivational theories and its implication to PRP. The paper also highlights the determinants of PRP in CPSEs and the challenges before CPSEs.

**Key Words:** Central Public Sector Enterprises, India, Performance Management System, Performance Related Pay.

## **Compensation Management in Indian CPSEs: Towards Performance Related Pay**

The field of compensation has grown in both scope and complexities in recent years. Organizations are continually in search of ways to motivate and reward its employees in order to increase their motivation & performance. One primary HR tool that is used to affect motivation and performance is compensation. Compensation is also an important tool for attracting and retaining talent. An excellent example in this regard is the Central Public Sector Enterprises which are losing their rare talents to the Private enterprises on the grounds of compensation. The country is witnessing the emergence of Private sector participation in every economic activity, many of which had been the sole preserve of the Indian Public Sector. The skills, talent and experience required for manning the mushrooming private companies will be available as a readymade product in the CPSEs and they will be the main target for talent poaching. Though the entry level salaries are

by and large comparable in the India Public Sector and the Private Sector Enterprises, the reluctance of bright talent to get into CPSEs is because of the known limitations in the increase in remuneration through periodic pay revisions and the long gestation time in the growth path.

"Compensation refers to all forms of financial returns and tangible services and benefits employees receive as part of an employment relationship." (Milkovich & Newman, 2005) The phrase "financial returns" refers to an individual's base salary, as well as short- and long-term incentives. "Tangible services and benefits" are such things as insurance, paid vacation and sick days, pension plans, and employee discounts.

CPSEs have realized the importance of attracting, motivating and retaining talent and hence are bring in massive change in its attitude towards managing people. It is talking about performance oriented culture and is ready to differentiate performers and non-performers in the organization and reward them accordingly. The 2nd pay revision calls for an implementation of the concept of CTC, performance related pay (PRP), Performance management system and cafeteria type benefit plan. It is clearly evident that CPSEs are geared up to establish a performance oriented culture by making their compensation competitive and by integrating performance and compensation management systems in their organizations. The paper attempts to study the steps taken by CPSEs in the context of 2nd pay revision in terms of establish of transparent and robust Performance Management System. It also tries to explore the link of various motivational theories and its implication to PRP. The paper also highlights the determinants of PRP in CPSEs and the challenges before CPSEs.

## **Factors influencing compensation:**

In the present competitive world where PSEs are competing with other private sector employers, compensation mix should depend on factors such as (i) Affordability or Capacity to pay, (ii) Job content, managed through an evaluation of positions in CPSEs, (iii) Cost of living, (iv) Market benchmarks

for Pay and Benefits in comparable companies,(v) Individual performance or contribution and (vi) Qualifications and Competencies. To recruit the top in the job market, companies must understand the local salary market and what companies are offering Indian recruits to ensure competitive salary levels. As the demand for talent continues to increase, the companies which do not offer competitive salary packages risk losing talent.

**2nd pay revision: Steps towards Performance Related Pay in Central Public Sector Enterprises.**

Among the three P's of compensation, that is, pay for Position, Pay for Person and Pay for Performance. CPSEs have been following the concept of Pay for Position. Having realized the importance of differentiating and recognizing performers, it has adopted the concept of Pay for performance in the form of PRP and has linked PRP to individual level performance, departmental/group level and at organizational level.

While salaries are the primary motive and a compensation factor for any employee, the pay structure is crucial for instigating performance. The concept of CTC, variable pay component, fitment benefit, increments, allowances etc. could make the difference. The bell - curve approach in the pay revision is a method of categorizing employees on the basis of performance and establishes a mechanism of linking pay with performance.

**Prerequisites for PRP implementation in CPSEs:**

Department of Public Enterprise (DPE) guidelines on implementing PRP (Office memorandum No.2(70)/80-DPE-WC) dt: 26 November, 2008. The committee proposed to change the current pattern of compensation and bring in the component of variable pay as part of the total compensation. The variable component is relatively low for lower level executives and progressively increases to as high as to 200% of the basic pay at the level of the CEOs. The variable component is what is referred to as Performance Related Pay and will be linked to individual, group, business-unit and company performance.

PRP in the case of CPSEs will be based on the physical and financial performance and will come out of the profits of the CPSE. 60 % of the PRP will be given with the ceiling of 3% of profit before tax (PBT) and 40% of the PRP will come from 10% of the incremental profit. The total PRP however will be limited to 5% of the year's PBT, which will be for

both executives and non-unionized supervisors.

Performance related pay (PRP) 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. It is because of this reason that the CPSEs have all implemented a transparent and robust PMS in line with the second pay revision which recommends for a balanced scorecard approach.

In the above context it is important to study the PMS of Public sector enterprises to know whether their PMS process can support the performance related pay programme or not as it is evident from literature that the implementation of PRP requires a transparent and robust PMS in place. In the above context the PMS of the following companies are studied and compiled. The table below is indicative of the fact that Public are taking a conscious effort of shifting from ACR concept to contemporary method of performance management.

**Table: 1**

**PRP as a motivational tool**

Employers want employees to perform in ways that lead to better performance. There is growing evidence that employee performance depends on three general factors.

Employee Performance = f (SKM), where, S = Skill and ability to perform task, K= Knowledge of facts, rules, principles, and procedures and M = motivation to perform.

Motivation involves three elements: 1. what's important to a person, Maslow's and Herzberg theory answers this question.2. Exchange between company and employees, expectancy theory and equity theory focus less on need and more on the second element of motivation that is the nature of exchange. Hence there is a need for fair exchange. 3. The third element of motivation is desired behavior. Identifying desired behaviors, and goal setting to flow from these behavior, is emphasized in goal setting research.

**Table2**

**Determinants of PRP in CPSEs:**

The determinants of PRP in CPSEs are based on the following parameters.

1. Profit of CPSE
2. Grade of Executives (E0 - 40% to CMD (A) 200%)
3. MoU rating of CPSE (Excellent - 100% to poor - 0%)
4. PAR rating of Executive (Excellent - 100% to poor - 0% in a system based on PMS)

## 5. Remuneration Committee

1. Profit of CPSEs: PRP will come out of profits of the CPSE, 60% of the PRP will be within ceiling of 3% of Profit before Tax (PBT) and 40% of PRP from 10% of incremental profit as compared to previous year's profit. The total PRP, however, will be limited to 5% of the year's PBT, both for executives and non unionized supervisors. The PRP for the year will be calculated latest by December of the following year, based on the CPSE's performance as per audited accounts.

2. Grade of Executives (E0 - 40% to CMD (A) 200%)

### Table 3

3. MoU rating of CPSE (Excellent - 100% to poor - 0%): The PRP would be payable at 100% eligibility levels in case the Company achieves its Memorandum of Understanding (MoU) rating as "Excellent". If the Company's MoU is rated "Very Good" the eligibility of PRP would be 80%. In respect of "Good" and "Fair" ratings, the eligibility levels would be 60% and 40% respectively. However, there will be no PRP irrespective of the profitability of the CPSE, in case it is rated as "Poor"/Below Par.

4. PAR rating of Executive (Excellent - 100% to poor - 0% in a system based on PMS): Maximum PRP payable to the eligible officials at different levels based on the PAR rating for the year shall be:

### Table 4

5. Remuneration Committee: Each CPSE should have Professional Boards with Independent Directors. CPSE should also constitute a Remuneration Committee headed by an Independent Director. The company will not be eligible for PRP, if there are no Independent Director on the Board of the CPSE. Remuneration Committee will decide the annual bonus/variable pay pool and policy for its distribution across Executives and Non Unionized Supervisors. Performance Appraisal System for E8 and above in CPSEs:

### Table 5

## Challenges ahead

The concept of variable pay, CTC, PRP, bell curve approaches are concept if implemented in true sense will bring a change in the culture of the CPSEs as a whole. A study regarding the implementation, acceptance and the impact needs to be conducted to discuss the effectiveness of variable pay in CPSEs in India. Few apprehensions raised in some of the recent studies are as follows: 1. The concept of CTC is new to PSEs and this has to drive them to attract talent from educational campuses. Due to lack of

precedence and in the absence of suitable guidelines and standards on how to monetize individual perks and allowances, there is a possibility that different PSEs adopt different valuations and thereby arrive at different CTC numbers, as observed by the Ernst and Young Associates (2008). 2. What is also questioned is the fact that if Bell curve approach is used to differentiate the employees into various category and is only linked with pay and not promotion will not be able to bring the real change in term of attracting and retaining talent which the public sector intends to do. 3. Salary survey proves that though the entry level salary in CPSEs is competitive or in some ways better than their counterparts in the private sector, the same cannot be said for top level compensation. According to an ET analysis, the chairman & managing director (CMD) of a public sector oil major earns a respectable Rs 5, 76,000 per month, factoring in a 200% performance-related bonus. It may be noted that despite the hugeness of public sector entities in terms of profitability potential, market capitalization and access to national resources, and despite the revision recommended, the gap between public and private sector pay levels at the top level still persist. 4. The concept of linking performance with pay will not bring the change CPSEs are looking for unless otherwise it is making a conscious effort of linking performance with pay and career advancement both.

## Conclusion:

It is interesting to witness the change in approach of CPSEs towards valuating its Human Capital. The shift from Annual Confidential Report (ACR) to a transparent and robust PMS is a reflection of CPSEs commitment to establish a performance oriented culture. The DPE guidelines on HRM and the initiatives of integrating performance with compensation will definitely bring in positive changes in this direction. CPSEs are facing a number of challenges in the implementation of PRP and the employees are apprehensive about the bell-curve approach. The implementation and more so the institutionalization of such progressive concept will definitely give rise to a performance oriented culture in CPSEs in India. Most of the CPSEs have introduced performance related pay, hence there is a scope to study the implementation and impact of performance related pay in Indian CPSEs.

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**Table: 1 - Performance Management System of Select CPSEs in India**

Name of the company	Performance Management System Details
Coal India Limited	Executive Evaluation Report based on Balanced Scorecard Method.
NMDC Ltd.	Performance appraisal report consisting of Key Responsibility Areas, Professional Attributes Rating, Suggested Development Plan and comments by Reporting, Reviewing & Accepting Officer.
NTPC Ltd.	Five stage PMS system which includes: Performance planning midyear review annual assessment normalization feedback, coaching and counseling
ONGC Ltd.	Online PMS system based on 'Forced Distribution' using Bell Curve approach, Standard <i>KRAs / KPIs</i> derived from Job Descriptions
SAIL	Executive Performance Management system based on Online 360 degree appraisal and feedback system
BHEL	Online PMS known as Moving Ahead through Performance (MAP) which is based on Balanced Scorecard Method.
Airport Authority of India Limited	KPA based Performance Appraisal System is applicable to all executives of AAI (E1-E7) Performance Planning Mid Year Review Annual Assessment Normalization Feedback, Coaching and Counseling

**Table2: - Motivational Theories and its implication for Performance Related Pay**

Theory	Essential Features	Predictions about Performance-Based pay	Implications
Maslow's need hierarchy	<p>People are motivated by inner needs. Needs form a hierarchy from most basic (food and shelter) to higher-order (e.g., self-esteem, love, self-actualization). Needs are never fully met; they operate cyclically.</p> <p>Higher-order needs become motivating after lower-order needs have been met.</p> <p>When needs are not met, they become frustrating.</p>	<p>Base pay must be set high enough to provide individuals with the economic means to meet their basic living needs.</p> <p>An at-risk program will not be motivating since It restricts employees' ability to meet lower-order needs.</p> <p>Success-Sharing plans may be motivating to the extent they help employees pursue higher-order needs</p>	<p>Performance-based pay may be demotivating if it impinges upon employees' capacity to meet daily living needs.</p> <p>Incentive pay is motivating to the extent it is attached to achievement, recognition, or approval.</p>
Herzberg's two-factor theory	<p>Employees are motivated by two types of motivator: hygiene factors and satisfiers.</p> <p>Hygiene, or maintenance, factors in their absence prevent behaviors, but in their presence cannot motivate performance.</p> <p>They are related to basic living needs, security, and fair treatment.</p> <p>Satisfiers, such as recognition, promotion, and achievement, motivate performance.</p>	<p>Base pay must be set high enough to provide individuals with the economic means to meet hygiene needs, but it cannot motivate performance.</p> <p>Performance is obtained through rewards-payments in excess of that required to meet basic needs.</p> <p>Performance-based pay is motivating to the extent it is connected with meeting employees' needs for recognition, pleasure, attainment, achievement, and the like.</p> <p>Other factors such as Interpersonal atmosphere, Responsibility, type of work, and working conditions influence the efficacy of Performance-based pay.</p>	<p>Pay level is important---must meet minimum requirements before performance-based Pay can operate as motivator.</p> <p>Security plans will induce minimum, but not extra, performance. Success Sharing plans will be Motivating. At risk plans will be demotivating.</p> <p>Other conditions in the Working relationship Influence the effectiveness of performance-based pay.</p>

<p>Expectancy</p>	<p>Motivation is the product of three perceptions: expectancy, instrumentality, and valence.          Expectancy is employees' assessment of their Ability to perform required job tasks.           Instrumentality is employees' beliefs that requisite job performance will be rewarded by the organization.           Valence is the value employees attach to the organization rewards offered for satisfactory job performance.</p>	<p>Job tasks and responsibilities          Should be clearly defined.           The pay-performance link is Critical.           Performance-based pay Returns must be large enough to be seen as rewards.           People choose the behavior that leads to the greatest rewards.</p>	<p>Large incentive payments are better than smaller ones.           Line of sight is critical – employees must believe they can influence performance targets.           Employee assessments of their own ability are important- organizations should be aware of training and resource needs required to perform at target levels.</p>
<p>Equity</p>	<p>Employees are motivated when perceived Outputs (i.e., pay) are equal to perceived Inputs (e.g., effort, work behaviors).           A disequilibrium in the output-to-input balance causes.           If employees perceive that others are paid more for the same effort, they will react negatively (e.g., shirk) to correct the output-to-input balance</p>	<p>The pay-performance link is critical; increases in Performance must be matched by commensurate increases in pay.           Performance inputs and expected outputs must be clearly defined and identified.           Employees evaluate the Adequacy of their pay via Comparisons with other Employees.</p>	<p>Performance measures must be clearly defined, and Employee must be able to affect them through work behaviors.           If payouts do not match expectations, employees will react negatively.           Fairness and consistency of Performance-based pay across employees in an organization is important.           Since employees evaluate their pay-effort balance in comparison to other employees, relative pay matters.</p>

<p>Goal Setting</p>	<p>Challenging performance goals influence greater intensity and duration in employee performance. Goals serve as feedback standards to which employees can compare their performance. Individuals are motivated to the extent that goal achievement is combined with receiving valued rewards</p>	<p>Performance based pay must be contingent upon achievement of important performance goals. Performance goals should be challenging and specific. The amount of the incentive reward should match the goal difficulty.</p>	<p>Line of sight is important; employees must believe they can influence performance targets. Performance targets should be communicated in terms of specific, difficult goals. Feedback about performance is important. Performance based payouts should be contingent upon goal achievement.</p>
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Source: Milkovich, George. & Newman, Jerry (2005), compensation, McGraw Hills

**Table 3 : PRP as percentage of Basic Pay (source DPE: 2nd pay revision)**

Grade	% of basic pay
E0 – E3	40
E4 – E5	50
E6 – E7	60
E8 – E9	70
Dir ( C&D)	100
Dir (A & B)	150
CMD (C&D)	150
CMD (A&B)	200

**Table 4: PRP payable to the eligible officials at different levels based on the PAR**

Level / Post	PRP as a percentage of Basic Pay	%age of PRP as per the individual performance appraisal rating				
		Outstanding	Very Good	Good	Fair	Below Par
E-0 to E-3	40	100% of col. 2	80% of col. 2	60% of col. 2	40% of col. 2	No PRP
E-4 & E-5	50	100% of col. 2	80% of col. 2	60% of col. 2	40% of col. 2	No PRP
E-6 & E-7	60	100% of col. 2	80% of col. 2	60% of col. 2	40% of col. 2	No PRP
E-8 & E-9	70	100% of col. 2	80% of col. 2	60% of col. 2	40% of col. 2	No PRP

**Table 5: PMS weightage of E8 and above in CPSEs**

	Weightage			
	MoU target	Individual target flowing from MoU targets	Personal attributes and functional competencies	Total
What is being assessed	Company	Unit	Individual	
Designation				
Chief Executive	75		25	100
Function Director	40	35	25	100
EDs ( E9) & GMs (E8)	25	50	25	100