CASE STUDY

COMPENSATION CRISES

SYNOPSIS: Ajay Malhotra, the 45-year-old vice-president (human resources and organisational development) of the Rs 300-crore automobile ancillary, Cooks Industries (Cooks), was thoroughly confused. A benchmarking project he had commissioned had revealed that the compensation Cooks offered at every level of the company was much lower than the average in its industry as well as a representative sample of other industries too. There were other disturbing findings as well: Cooks had too many designations, which translated into a surfeit of hierarchical levels. Its salaries had a high level of tax-free cash reimbursements, which was at variance with the prevailing corporate trend. And there were perceived disparities between the pay-packages of the various functions in the company. What Malhotra was still not clear about, however, was how he should transform Cooks' organisational and compensation structures. While Cadbury India's G. Sridhar, Cerebrus Consultants' Anita Ramachandran, and Sandoz' Rajen Mehrotra all agree that Cooks needs to do so, they differ about how Malhotra should go about it. Which of them would you agree with?

FOR THE UMPTEENTH TIME THAT DAY, AJAY Malhotra stared at the bulky report on his table. And sighed deeply—much too deeply, in fact, visibly startling his secretary who was sitting right across the table. Ever since the findings of Amam Consultants' (Amam) compensation benchmarking project had reached Malhotra, the 45-year-old vice-president (human resources and organisational development) of the Rs 300-crore Cooks Industries (Cooks), he had studied it ad nauseam. Invariably, the report generated contradictory feelings each time: clarity, on the one hand, and confusion on the other.

A Pune-based automobile ancillary firm, Cooks produced key engine parts—pistons, piston rings, engine valves, fuel pumps, carburettors, and bi-metal bearings—for the majors in the automobile industry. Set up in 1985, the company had been promoted by two technocrats, Ram Prakash, 45, and Shantanu Kamble, 44, who had grown Cooks into a profitable entity that had reported net profits of Rs 35 crore in 1995-96 on sales of Rs 275 crore. Its success was partly due to a clear delineation of responsibilities between the two promoters, who had first met as students at the Indian Institute of Technology at Kanpur. While Prakash was the expert in metallurgy and mechanical engineering operations, the cutting-edge was provided by Kamble, who had also done his masters in business administration from the Indian Institute of Management at Ahmedabad.

Five years ago, from the proceeds of a Rs 30-crore public issue, Cooks had undertaken a major upgradation of its technology, modernising its plant and machinery. And, at present, it employed 450 workmen, who operated in three shifts, as well as 100 managers. In a market dominated by a number of regional units, Cooks had become one of the few automobile ancillaries in the country with a national presence. Of course, the company had been helped by the resurgence in the automobile market, which had grown at the average rate of more than 25 per cent in the last three years due to the entry of a large number of transnationals, leading to an upswing in the fortunes of the ancillaries too. In fact, their growth, at about 33 per cent last year, had outpaced that of the industry that had spawned them. The reason: in addition to the Original Equipment Manufacturing segment, the ancillaries also catered to the requirements of the replacement market, which accounted for 60 per cent of the demand for automobile parts.

Two additional factors had placed the automobile ancillary manufacturers on a sound footing. One, they were all driven by owner-technocrats, who had once worked for automobile-making firms and possessed high degrees of hands-on engineering skills. Secondly, many of their customers had floated joint ventures with foreign manufacturers with well-structured vendor development policies. So, they too actively supported firms, like Cooks, with finance and technology, inviting them to tie up with their global vendors. No wonder the subject of our case study had been riding the crest of a wave of commercial success over the last three years.

But every lining had its clouds. In 1996, Cooks' employee turnover rate crossed 15 per cent—shooting up from between 2 per cent and 3 per cent in the early 1990s. In particular, the expertise required to manage the production function was becoming rare. Most engineers were chucking their jobs up to seek greener pastures abroad, particularly in West Asia and Australia. Many were also setting up their own units within the country. Both Prakash and Kamble were concerned at what they initially thought was a blip, but had become a trend. More than 30 front-line engineers had left Cooks since mid-1995, and even the service functions—like finance—had had their share of departures.

That's when Malhotra—who, after an earlier stint as the head of personnel for a pharmaceuticals transnational, had joined Cooks as general manager (human resources) five years ago—came into the picture. When Prakash asked him to examine the issues involved, Malhotra had been quick to point out that one of the reasons for Cooks' high employee turnover was low managerial compensation. "The grade structure at Cooks, as it has evolved over the years, is archaic and needs to be improved," he argued. Prakash agreed: "If we have been out of touch with the trends in managerial compensation, let us set the situation right."

Which is why Malhotra quickly commissioned Amam to

Case Study

ıdertake a salary benchmarking study for Cooks in Novem-
ɜr, 1996. In all, the survey covered 32 firms: 11 from the auto-
ɔbile ancillary sector, six from automobiles, four each from
ɔnsumer products and infotech, two from pharmaceuticals,
ree from financial services, and the other two were multi-
oduct companies in the engineering sector. Of these firms,
ne were transnationals, four were family-managed, and the
maining 19 were public limited companies in the private
ctor. Amam's survey provided extensive data—no less than
)0 pages—on compensation trends and salary structures
:ross various levels of the corporate hierarchy in all these
ms. And the analysis had, of course, been carried out both
vel-wise and industry-wise.

Moreover, at each stage, there were comparisons high-
ghting Cook' ranking vis-a-vis the other companies on para-
ıeters like total employee cost to company, vari-
ɔle pay, and basic salary. Apart from competitive
enchmarking—comparisons with its direct com-
etitors in the same industry—Malhotra had
pecifically asked for generic benchmarking, or
omparisons with similar players in other indus-
ies. After all, Cooks had lost technical talent to
ne heavy engineering sector too. And there had
lso been instances in the past where Malhotra
ıad tried to recruit professionals for the service
unctions, but had been unable to attract any
alent. The reason: Cooks' inability to offer salaries
ıt par with what they were already earning in these
ectors. As he flipped the pages of the report,
Malhotra tried to cull the highlights from the
ɔlethora of information in front of him.

Based on the total cost to company, the Amam
Report placed Cooks at No. 29 at the lowest level
of Grade 10, and 23rd at the highest level of
Grade 1. The basic issue was that Malhotra needed
to upgrade the pay packages that Cooks offered
its managers at every level of its hierarchy. But
this was the easy part as the report was quite
insightful at this level. It pointed out, in unam-
biguous terms, where Cooks stood on each
element of managerial compensation in relation
to its contemporaries. This data had enabled
Malhotra to understand, for the first time, Cooks'
position both in terms of competitive as well
as generic benchmarking.

But, at another level, Malhotra was clueless since he could not find a handle to start formulating an action plan. The more he analysed the report for directions on his future course of action, the more complicated the issues seemed to be. Even as he grappled for a common point of reference, he felt that the survey confronted him with five fundamental dilemmas:

DESIGNATIONS: There were also some hard decisions to be taken regarding designations, which had always been a tricky issue at Cooks. Malhotra recalled how, six months ago, he had tried recruiting a manufacturing head for a product group at the Pune plant. After an extensive head-hunting exercise spanning six months, Cooks had found the right candidate for the job: Anjan Kumar Saxena. Employed with a heavy engineering firm in Mumbai, Saxena was willing to make the move to Pune on a marginal increase in salary because the city happened to be his home-town. The only snag: he had already been designated general manager by the organisation he worked for. Ideally, Cooks would only offer him the designation of deputy general manager in Grade 2 which, of course, was quite unacceptable to him.

Rather than lose a good man, Malhotra had taken an on-the-spot decision to by-pass company policy and offer Saxena the designation of general manager. While this had clinched the deal, it had also resulted in upsetting all of Cooks' other general managers. Such instances were fairly frequent in the company, and Malhotra knew that he had to do something about bringing Cooks' designations in line with those in the industry. However, the very thought of doing so was quite distasteful to him. Because, together with Prakash and Kamble, Malhotra firmly believed that a designation must strictly represent the nature of a job. He was wary of those who viewed designation as a matter of status. While the Amam Report showed that the rest of the corporate world was liberal in designating any functional head as a vice-president, Malhotra thought that Cooks' conservative approach was bound to make it unattractive to potential prospects.

HIERARCHIES: The Amam Report also revealed that Cooks had far too many hierarchy levels. A 10-grade structure was unnecessary as the survey showed that the industry norm had

COOKS INDUSTRIES' GRADE AND

Grade	Designation		Pay-Scale (Rs)
	Corporate Office	Factory	
10	Assistant Officer	Asst Engineer/ Trainee	2,500-65–3,150-70–3,850-75–4,600-80–5,400-85–6,250
9	Officer/ Mgmt Trainee	Engineer	3,500-100–4,100-125–4,850-150–5,750-175–6,800-200–8,000
8	Executive	Senior Engineer	3,800-125–4,550-150–5,450-175–6,500-200–7,700-225–9,050
7	Senior Executive	Section In Charge	5,000-150–5,900-175–6,950-200–8,150-225–9,500-250–11,000
6	Assistant Manager	Assistant Manager	5,000-175–7,000-200–8,200-225–9,000-250–11,000-275–12,750
5	Deputy Manager	Deputy Manager	7,500-225–8,850-275–10,500-325–12,450-375–14,700-425–17,250
4	Manager	Manager	9,000-300–10,800-350–12,900-400–15,300-450–18,000-500–21,000
3	Senior Manager	Senior Manager	10,000-350–12,100-400–14,500-450–17,200-500–20,200-550–23,500
2	Deputy General Manager	Deputy General Manager	13,000-425–15,500-500–18,550-575–22,000-650–25,900-725–30,250
1	General Manager	General Manager	16,000-500–19,000-600–22,600-700–26,800-800–31,600-900–37,000

*Driver Allowance: Rs 2,000 PF: Provident Fund LTA: Leave Travel Allowance

become four or five levels. For the last one year or so, Malhotra had been toying with the idea of cutting down the levels to a lesser number. However, he was only too aware of the fact that this would create frustration and disgruntlement in managers as a flat structure would, obviously, reduce their opportunities for quick promotions.

Malhotra recalled a number of companies—particularly Darshan India, a consumer products company based in Mumbai which had squashed its hierarchies five years ago, and had to then cope with a managerial exodus of scary proportions—which were facing problems in retaining key managers for want of growth avenues within the organisation. Privately, Malhotra did not agree with the concept of a flat organisation. However, trends indicated that there was a move to reduce organisational levels to five or six—the average level benchmarked by the survey. Shouldn't Cooks too fall in line by reducing its hierarchical levels?

COMPENSATION STRUCTURE

HRA (% of Basic)	Monthly Allowances (Rs)			Annual Benefits (% of Basic)			
	Conveyance	Education	Periodicals	Bonus	LTA	Medical	PF
30%	750	100	—	20%	8.33%	10%	10%
30%	1,000	100	—	20%	8.33%	10%	10%
35%	1,250	130	—	20%	8.33%	10%	10%
35%	1,500	150	50	20%	8.33%	10%	10%
40%	1,750	150	50	20%	8.33%	10%	10%
40%	2,000	150	50	20%	8.33%	10%	10%
40%	2,250	300	100	20%	8.33%	10%	10%
40%	2,500	400	150	20%	8.33%	10%	10%
50%	Car (non-AC)	500	200	20%	8.33%	10%	10%
50%	Car (AC)*	750	300	20%	8.33%	10%	10%

SALARIES: Whenever there was a need to recruit technical people, Cooks had, traditionally, looked within the engineering industry. Of course, this was not so in the case of non-technical personnel—maintenance, finance, and human resources—for whom there were no barriers for mobility across industries. And this was one of the reasons why Malhotra had designed the survey to cover a representative sample of sectors rather than sticking to the engineering industry alone.

But this had generated another set of issues in terms of the internal parity of salaries. For instance, in a number of companies covered by the survey, professionals in staff functions received higher gross salaries than the technocrats who were, after all, the life-line of an engineering business. Malhotra did not miss out the unstated point of the survey: every technocrat worth his salt viewed this as unfair. Wasn't there a way of creating internal parity between the various functions within Cooks' organisational structure?

TAXATION POLICIES: Cooks' salary structure incorporated a high level of cash reimbursements, paying out cash against the vouchers submitted by its employees under heads such as conveyance, education, and periodicals. Employees found that attractive, and it was also a well-accepted practice in corporate India. However, the Amam Report showed that there was a discernible trend towards a lesser proportion of salaries being paid as cash reimbursements.

Increasingly, it was becoming common for companies—particularly transnationals—to resort to a consolidated salary rather than breaking it up into various kinds of allowances. And the tax-burden would then be borne by individual employees themselves. However, how would Cooks' employees react to a lower level of cash reimbursement—and a higher incidence of taxation even though income tax rates were falling?

LEADER-FOLLOWER: Since the Amam Report indicated that the salaries at Cooks ranked 29th at the lowest levels, and 23rd at the highest, there was no doubt that Cooks had to undertake a complete and radical upgradation of managerial remuneration. Which raised a new question: should Cooks turn into a leader in the remuneration game and offer the highest packages in the industry? Or should it stay a follower?

Of course, the answer was linked to the capacity to pay—another issue that merited scrutiny by its top managers. No doubt, Cooks had been generating attractive margins, and would, hopefully, continue to do so in future. Being a leader in the market for its products, it did make sense for Cooks to project the image of a premium paymaster in the employment market as well. But Malhotra was not sure where Cooks should position itself at the top.

So, should Cooks offer the highest pay-packages in the industry and create a high-wage island so that people would find it difficult to leave the company? Left to himself, Malhotra felt that he would follow the average trend in the industry, and position the company as a slightly above-average paymaster. Or should he continue to peg Cooks' salary structure as slightly below average, attracting and retaining people on the basis of the excellent business processes that the company was already known for? It wasn't easy for Malhotra—or Prakash and Kamble—to decide.

■ Case Study By ANEETA MADHOK, Professor (Organisational Development), Narsee Monjee Institute of Management Studies. Refereed by the BUSINESS TODAY Panel of Referees

CASE STUDY

Solution A

G. SRIDHAR
Director (Human Resources), Cadbury India

I BELIEVE THAT COOKS should hold the Amam Report in abeyance for the moment. Far too often, companies bring about changes in the elements of their HR infrastructure, such as designations, grades, salaries *et al*, without articulating the assumptions driving the need for such a change and, more importantly, without taking the view of the customer—in this case, the individual employee—into account.

More fundamentally, as part of evolving an action plan, Malhotra should reflect on the role of the HR function at Cooks. Does HR have a strategic role to play? Is it perceived as a critical success factor? Is it a regenerative process? Or is it merely a system maintenance function? Equally, what is the core aspiration of Cooks in upgrading salaries: retaining people, attracting talent, or what? Should the company evolve its own pay-for-performance plan? In the larger context, Malhotra's approach must be governed by a holistic view of using HR as a tool for building Cooks into an institution.

Specifically, the consultant's report has been helpful, but Malhotra should undertake an Employee Satisfaction Survey in order to understand its employees' perceptions before taking any decision on the various posers. Such a survey will no doubt confirm Amam's findings as far as compensation is concerned. But if the survey throws up a fairly high satisfaction level among Cooks' managers on the prevalent designations and hierarchies, there is little reason for change. In any case, these decisions must stem from the company's own business strategy rather than with a view to keeping up with the competition. For instance, the strategic objective of getting closer to the customer provides its own compelling reasons for delayering.

Since Amam's report has projected the company's compensation levels in poor light, the need to upgrade salaries is beyond question. But there is little merit, even when the company can afford it, in aiming to be the trend-setter in compensation levels. Securing leadership in areas which directly impact business—marketshare, technology, product innovation, skill levels of people—is a far more worthwhile objective. At the same time, a company cannot afford to be out of line with contemporary trends in compensation levels. Clearly, the benchmarking study has shown that Cooks is out of line. Malhotra should, therefore, quickly work towards positioning the company in the median range. I feel that the positioning should be implemented at two levels: between the 12th and the 16th rank among the 32 companies benchmarked in the survey, and between the 3rd and the 4th rank in its own industry segment. And that should meet Cooks' objectives.

Solution B

ANITA RAMACHANDRAN
CEO, Cerebrus Consultants

COOKS IS A LOW salary-paying company which is trying to understand the new trends in compensation and, in the process, coming to terms with the need to upgrade its salaries. This is a classic dilemma amongst corporates today. My advice is that Cooks should first get its priorities right. Instead of dealing with several issues at one go, it should focus only on its key concerns.

One: becoming competitive in its industry segment. Evidently, this means that Cooks should analyse itself as a potential employer at a wider level rather than just looking at mere compensation. First, in the light of the Amam survey, where should Cooks position its compensation levels? This is tricky in the Indian context where compensation is not entirely job-based, and the salary variations across industries are wide. But, for a company like Cooks, the comparisons should be lateral with the automobile and engineering industries. Thus, Malhotra should not worry about industries like consumer goods or infotech, notwithstanding the propensity among professionals in non-technical functions to move across industries.

A related question: should Cooks position itself as the top-paying firm in its segment? It is important to bear in mind that while low compensation spurs managerial mobility, high compensation is no guarantee for either low employee turnover or high morale. Employees view compensation only as a threshold factor beyond which a number of other considerations come into play: the financial health of the industry and of the company; the potential for personal growth; perceived market value of the experience in the company; the working environment *et al*. Similarly, a company need not take a blanket position at all levels. Depending on the company's strategy and recruitment needs, salaries at both entry- and middle-levels may be positioned differently. This is where the need for prioritisation becomes important.

This brings me to the second issue. Should a company continually worry about exceptional salaries in the market? No, it need not worry unless it is a target company because of its special image, training, or the quality of its managers. Companies pay exceptional salaries for several reasons. One reason

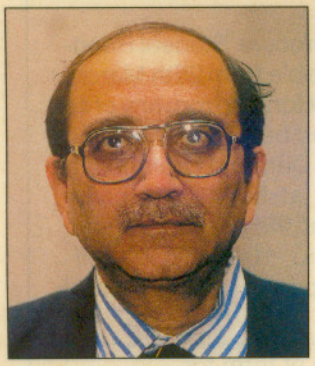
is the cushion effect: high salaries may often mask more serious problems in the organisation. Or it could be better management practices that enable manpower rationalisation and operational efficiency to, together, enhance the affordability to pay. That is why Malhotra should view the issue well beyond the numbers. To my mind, it is enough if Cooks tracks salaries in its own industry segment and keeps itself abreast at that level.

Third, Cooks is clearly at the bottom of the rung. It should upgrade its salaries. But it need not bother about all the non-technical staff. For the limited number of managers it may need in non-technical functions, Cooks should fix its job-related salaries as per market trends. The alternative is to compromise on the quality of managers. The choice is largely situational, and is linked to the overall strategy. One option, which I would recommend, is to identify its key managers and pay them top-of-the-market salaries. Care must be taken to incorporate an appropriate performance linkage. In fact, Cooks must factor in a large component of compensation for performance. It is a mistake to take key performers for granted, and pay a discounted salary on the assumption that emotional issues such as bonding will hold them back. Employees are bound to lose their self-worth and move on.

On the issue of crashing levels and flatter structures, there is merit in broad-banding. There is no easy answer to the issue of psychological stagnation arising out of the lack of promotional avenues. Multiple designations within a single grade is one approach. But it is important to bear in mind that, in the long term, unless a company grows and provides for the personal growth of its managers—both in terms of compensation as well as individual development—it cannot hold on to its managers in any case.

Another issue that needs to be considered in this context is whether the crashing of grades will help achieve objectives such as the flexibility to pay more for certain jobs even while maintaining relative grade parity. The risk is that the company might rationalise the wrong jobs due to a low grade structure, which would only aggravate the problem of retention. As far as designations at Cooks are concerned, they do not seem to be out of line with the engineering industry. Designations are important in this country as a hiring ploy. But they lose their appeal in a company that has the potential for both organisational and personal growth.

Solution C



RAJEN MEHROTRA
Vice-President,
Sandoz (India)

REIMBURSEMENT against cash vouchers should not form part of the monthly salary of managerial personnel. All reimbursements should be against actual expenses incurred for the conduct of the company's business. For instance, the tax benefit on education allowance in the event of an employee's child studying in school or college is quite clear. But it must be noted that the tax benefit is only marginal. Equally, offering tax-free monthly benefits on conveyance allowances and the reimbursement of expenses incurred on buying periodicals are both grey areas. Malhotra should recommend that these must be discontinued. The practice of giving House Rent Allowance (HRA) can, however, be retained.

The monthly remuneration should be the total of three components: basic, HRA, and a composite allowance, which tots up all the allowances currently being paid in cash. The composite allowance, which should be taxable, would be a percentage of the basic salary applicable to a particular grade and must not vary, as it does at present, with individual employees. One fall-out of this will be an increase—even if marginal—in the cost to company of an employee. It also leaves the option of tax planning to the individual. Here, individual employees can claim tax reliefs on, say, HRA provided they are incurring that expenditure by paying a monthly rent for their accommodation.

As far as designations are concerned, Malhotra should examine the need for some number-crunching. The total number of managerial personnel is 100, and it is likely that there is scope for reduction here. An exercise on the rationalisation of designations must be undertaken. This can best be facilitated by reducing the prevailing 10-grade structure to five or six grades. A lesser number of grades will help in rationalising designations too. There has been a lot of designation inflation in the corporate sector, and Cooks should be wary of jumping onto this bandwagon. Designations should be a reflection of job descriptions and the functions performed. The broad categories should be officer, executive, manager, and vice-president, with some slabs, in particular, in the manager category.

Amam's findings indicate that the salary structure at Cooks needs revision too. Three factors need to be kept in mind. First, Cooks should compare the salary structure of its technical people with those of the six heavy engineering units, and of the people in its service functions, like HRD, finance, and maintenance, with those of the 11 units in its own industry benchmarked in the study. It would be foolhardy to use the financial services sector as a guide to the salary structure in the finance division.

Second, Cooks should analyse the quartile value of the salary from the benchmarking data and ascertain the additional cost to the company in the event of a revision. Based on the quartile value, the salary structure could be worked out keeping in mind the capacity of the company to bear the additional cost, not only now, but, more importantly, in the future too. Third, Malhotra should identify the key jobs that carry a premium, either because of the skill-levels they embody or due to a shortage of people. And the market adjustment of salaries should be done only for those key jobs.