



A STUDY ON WAGE DIFFERENTIALS TO MAINTAIN INTERNAL & EXTERNAL EQUITY

S. KIRANMAI

Department of
management
studies

Sri Vasavi Engineering
College

Tadepalligudem

Andhra Pradesh.

Y. CHERISHMA

Department of
management
studies

Sri Vasavi Engineering
College

Tadepalligudem

Andhra Pradesh.

A. PAVANI

Department of management
studies

Sri Vasavi Engineering
College

Tadepalligudem

Andhra Pradesh.

Abstract

Wage payment is one of the largest cost centres for a company that results in the firm acquiring, maintaining and compensating the talent that achieves the firm's objectives. It is then an important step for a firm to develop and implement proper, fair and consistent wage differentiation in their compensation policies to maintain both internal and external equity in the long term and create a work-oriented environment that can reduce resource wastage in the organization.

Keywords: Wage, Discrimination, Compensation, Pay and Employee

INTRODUCTION

Wage is the compensation received by an employee for their services to the firm and for a firm, managing the compensation they pay to their employees is critical as it is one of the cost centres that can affect their bottom line at the end of the day. In this study, we will attempt to decipher the ways the companies can manage their pay to their employees and its importance.

NEED FOR THE STUDY

Employees work for the compensation or pay they receive in return and for an organization, differentiating pay can create a pay structure that does not over burden their financials while retaining and satisfying their employee.

OBJECTIVES OF THE STUDY

1. To understand wage differentials in Compensation management
2. To identify the various wage differential criteria in the organizations
3. To know the significance of wage differentials

SCOPE OF THE STUDY

The study is limited to conceptual understanding of Wage Differentials, the criteria for developing the wage differentials to maintain internal and external equity.

RESEARCH METHODOLOGY

The study was done by examining the various secondary sources on wage differentials from the various research papers authored by different authors and web. Through which we attempt to understand the concept of wage differentials.

THEORETICAL FRAMEWORK

Wage Differential is defined by Collins Dictionary as “the difference in wages between workers with different skills in the same industry or between those with comparable skills in different industries or localities” and as such through the study of wage differentials we can understand how the organizations implement their compensation policies to control their costs while improving their profitability.

Richard I. Henderson and Charles R. Henderson - Authors of "Compensation Management: Rewarding Performance" defined Compensation management as “the art and science of arriving at the wages and salary rates for various jobs in an organization. It involves balancing the internal and external equity considerations with the overall corporate objectives.”

Criteria for Wage Differentials

Some of the common criteria for implementing the wage differentials are,

- **Education and Skills:** Formal education and specialized training significantly impact an individual's productivity and efficiency in work. Higher degrees lead to skilled career options, technical knowledge, and higher salaries.
- **Experience:** Experienced workers are valuable to companies due to their awareness of job responsibilities, industry standards, and potential difficulties. This leads to increased productivity and efficiency, justifying higher remuneration.
- **Occupational Demands:** Certain industries may experience skilled labour shortages due to complicated job requirements or specialized qualifications, with industries like engineering, technology, and healthcare paying higher salaries.
- **Labour Market Conditions:** Employers may raise wages to attract talent in competitive, low-unemployment markets, while wage growth may plateau or slow during economic downturns or high unemployment.
- **Location:** Wage levels often correlate with local cost of living, with higher wages offered in expensive housing and remote areas to compensate for workers' living expenses.
- **Unionization:** Labour unions negotiate collectively with employers to improve pay, benefits, and working conditions, resulting in higher earnings for unionized workers.



Types of Wage Differentials

There are several ways to implement Wage Differentials based on the above criteria,

A. Based on Employee Characteristics:

Employee character can be described as personality that matches the job, including the type of work, level of ability and knowledge, working attitude, and degree of independence. Some of the ways to classify here are – Skill-Based Differentiation, Gender-Based Differentiation and Experience-Based Differentiation to name a few.

B. Based on Region:

Disparities in compensation in industries are influenced by living and working standards, labour availability, supply-demand balance, and economic growth. Compensation also varies based on state or region's standard of living. Some of the examples are State Based Differentiation, Country Based Differentiation and Geographic Based Differentiation.

C. Based on Industry:

Inter-industries and intra-industry compensation differentials arise when employees with similar occupations and locations receive different pay scales from businesses in the same area. These differences depend on factors like work quality, labour quality, market imperfections, and plant effectiveness.

Significance of Wage Differentials

1. Wage differentials play a vital role in efficiently allocating labour resources across various industries and occupations, ensuring that the demand for specific skills is met, and fostering labour market efficiency.
2. By offering higher wages in certain occupations, wage differentials serve as powerful incentives for individuals to invest in education, training, and skill development, leading to a more skilled and competitive workforce.
3. The existence of wage differentials motivates employees to increase their productivity and performance, as the prospect of higher earnings encourages greater effort and innovation.
4. Organizations that carefully consider wage differentials can enhance employee retention and reduce turnover rates, as competitive compensation packages attract and retain top talent.
5. Wage differentials can address income inequality by providing better financial support to individuals in low-income or essential roles, promoting a more equitable society.
6. Well-designed wage differentials contribute to economic growth and productivity, as higher wages stimulate consumer spending and improve the standard of living for workers.

7. Companies that use wage differentials effectively can boost their organizational performance, as higher pay for top-performing employees attracts and retains valuable talent, ultimately leading to increased competitiveness.
8. Wage differentials direct individuals toward industries and occupations crucial for technological advancements and economic development, fostering innovation and progress.
9. Aligning individuals' skills with wage levels through differentials results in better job fit and increased productivity, benefiting both workers and employers.

REVIEW OF LITERATURE

Shouyong Shi (2006), The paper examines a large labour market with homogeneous firms posting wages to find workers with different productivity levels. The model reveals a unique equilibrium where the wage differential depends on the workers' productivity differential only when large. When small, high-productivity workers receive lower wages, even when the differential shrinks to zero. The equilibrium is socially efficient, with high-productivity workers receiving employment priority and higher expected wages. Conventional measures may incorrectly identify discrimination in the model.

Sonu Madan (2019), The paper investigates wage differentials in Haryana's manufacturing and service sectors, focusing on worker-specific and firm-specific factors. Worker-specific factors like education, work experience, gender, and marital status explain half of wage variation, while firm-specific factors like nature, size, type, and location explain only a small proportion. The study emphasizes the importance of human capital in raising workers' income levels and achieving development goals.

Nidhi Sharma (2021), post-reforms saw faster employment in the organized manufacturing sector, with growth momentum larger than output growth. Since 2000, real wages of workers increased faster, while the percentage share of income wages in value added declined. This global phenomenon affects wage disparity, with increased labour productivity increasing average real wages and capital labour ratios. The study also shows that average wage rates rise and wage disparity falls across Indian states.

Robert L. Clark, Naohiro Ogawa, Norma Mansor, Shigeyuki Abe, Mohd Uzir Mahidin (2021), The study analyses earnings differentials between the public and private sectors in Malaysia, focusing on gender and ethnic wage differences. Results show that public employees receive higher wages than private sector employees, and gender and ethnic wage differentials have declined in recent years. Additionally, both gender and ethnic wage differences are smaller in the public sector.

Suresh Narayanan (2021), The paper argues that public sector earnings are generally higher than private sector earnings, but there is no theoretical framework to guide this. Fogel and Lewin's 1974 work suggests that discretion in decision making and the political process in wage setting provide upward-biased wage rates for most government jobs. This suggests that public sector wages will be higher than private sector wages for most job descriptions.

FINDINGS

1. Fairness and consistency are necessary in effective implementation of wage differentials.
2. Wage Differentials are a critical component in Controlling HR Cost.
3. Employee and organization related factors can affect Wage Differentiation.
4. The Organization can differentiate wages on several criteria

SUGGESTIONS

1. Organizations need to develop compensation policies that emphasise fairness.
2. Wage differentials must be implemented properly to control HR Costs related to Compensation.

3. Compensation policy should account for employee and organization concerns while developing and implementing Wage differentials.
4. Differentiation must be done based on criteria that suits the organization goals.

REFERENCES

- [1] Shi, Shouyong. (2006). Wage differentials, discrimination and efficiency. *European Economic Review*. 50. 849-875. 10.1016/S0573-8555(05)75004-5.
- [2] Madan, S. Wage Differentials Among Workers: An Empirical Analysis of the Manufacturing and Service Sectors. *Ind. J. Labour Econ.* 62, 731–747 (2019). <https://doi.org/10.1007/s41027-019-00195-4>
- [3] Sharma, N. Interstate Wage Differentials in Organized Manufacturing Industries. *Ind. J. Labour Econ.* 64, 961–979 (2021). <https://doi.org/10.1007/s41027-021-00338-6>
- [4] Robert L. Clark, Naohiro Ogawa, Norma Mansor, Shigeyuki Abe, Mohd Uzir Mahidin; Wage Differentials in Malaysia: Public Employment, Gender, and Ethnicity. *Asian Economic Papers* 2021; 20 (3): 16–34. doi: https://doi.org/10.1162/asep_a_00840
- [5] Suresh Narayanan Comment on Wage Differentials in Malaysia: Public Employment, Gender, and Ethnicity. *Asian Economic Papers* 2021; 20 (3): 35–39. doi: https://doi.org/10.1162/asep_a_00841
- [6] Wage differential definition and meaning | Collins English Dictionary. (2023). In Collins Dictionaries. <https://www.collinsdictionary.com/dictionary/english/wage-differential>

