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Reward: an introduction

Introduces the basics of reward, which includes pay and benefits, and outlines the UK legal position

Introduction

Pay and benefits are important in attracting, retaining and engaging employees. A range of options is available to reward people and recognise their contribution, each with their own opportunities and risks. The most effective reward packages meets the needs of its staff, the business, and the organisation's purpose, culture and performance, in a fair and responsible way.

This factsheet explores the purpose of reward and how employee responses may vary depending on different contexts. It introduces pay structures and levels, considerations surrounding pay awards and factors affecting pay progression. It also describes variable pay – from cash bonuses to incentives – as well as outlining some UK legal issues. Finally, it looks at the role of employee benefits, non-financial rewards and total reward.

See the **[full A-Z list of all CIPD factsheets](#)**.

Explore our viewpoint on [low pay and financial wellbeing](#) and [executive pay](#) in more detail, along with actions for government and recommendations for employers.

What is reward?

The term 'reward' generally covers all financial provisions made to employees, including cash pay, and the wider benefits package (such as pensions or private medical insurance). It can also include wider provisions for employees, with the term 'total reward' sometimes used to encompass non-pay benefits, such as flexible working opportunities.

Pay may be divided into two categories:

- **Fixed (or base) pay** is a guaranteed cash wage or salary paid to employees for doing their work for a contracted time period, such as a 37-hour week. This can include

location allowances and other associated guaranteed payments.

- **Variable pay** is not guaranteed. It can include bonus, incentives and overtime payments.

Pay definitions vary. For example, some employers might treat location allowances as part of fixed pay, while others may see it as variable.

Other terms may also be used. 'Compensation' for example is usually taken to mean just pay (both fixed and variable) while 'remuneration' might be used interchangeably with 'reward' to mean the wider benefits package, such as the value of employer pension contributions.

Reward is an area of specialist knowledge in our [Profession Map](#).

Reward during the cost of living crisis

A [CIPD report](#) shows that the business case for supporting employees' financial wellbeing is clear: those who experience money worries are more prone to absence from work. Financial distress can also lead to presenteeism, in which employees attend work but, because of health problems or other personal issues, don't perform to their usual standards.

During the existing cost of living crisis, pay and benefit professionals should consider whether their organisation's reward approach is fit for purpose by exploring questions such as:

- What's happening to workplace financial wellbeing?
- Are we paying our workers a liveable wage?
- Are the organisations in our supply chain paying their workers enough?
- If we can't increase pay for our employees by as much as the cost of living, what else can we do to reduce the impact of inflation on earnings?
- Can we offer opportunities for low-waged workers to increase their skills and experience so they can take on higher-paid roles?
- Should we invest in the HR technology needed to investigate whether our people are paid fairly?
- Are certain groups of workers, such as female, black, or disabled staff, being affected disproportionately by inflation? If so, what can we do to support them?
- What can we do to protect people from financial scams, such as around pensions?
- How does our benefits package support employee financial wellbeing?
- Should we change how we communicate with employees about pay and benefits?

- Are we directing employees needing help to sources of [regulated financial information and guidance](#)?
- Are we clearly communicating our financial wellbeing policy to employees?

The answers to these and other questions, such as what ways are there to improve employee productivity and reduce our cost base, will help employers to better support their people and reduce the impact of poor financial wellbeing for both employers and their workers. Our 2022 [Reward management survey](#) explores the impact that the rise in the cost of living is having on employee financial wellbeing and in-work poverty. There's lots more on what employers can be doing in our '[Tackling in work poverty hub](#)'.

Managing reward

The main reason for offering pay and benefits is to influence employee behaviour so they want to join and stay with an employer and to do their best in the job. Traditionally, salaries were used to attract people to an organisation, benefits helped retain them, and bonus and incentive schemes motivated them in their work. However, the thinking about which parts of reward are best suited for recruitment, retention and motivation has changed. Listen to our [podcast on the changing landscape of reward](#).

Individuals are attracted, retained and engaged by a whole range of financial and non-financial rewards, which can change over time depending on personal circumstances. In some situations, individuals may not consider the financial elements of a package particularly important. For instance, people at the beginning of their career may be more interested in gaining access to training and career development. Similarly, individuals may be willing to work for lower pay rates (or even volunteer) if they have a strong attachment to an organisation's purpose.

Employers should find out what attracts, keeps and inspires their current and future people, and explore how best they can meet these needs - as well as meeting the requirements of the business within the appropriate legal and regulatory environment. When creating a reward package, it's also important that organisations integrate the various reward elements so that they support, rather than contradict, one another, such as the factors used to increase salaries and award bonuses.

Behavioural science has offered up useful insights about how individuals may respond to various aspects of reward. Employers should use the lessons from behavioural science when designing, implementing, and communicating their reward packages. Find out more in our report [Show me the money! The behavioural science of reward](#). Our [Employee engagement - definitions, measures and outcomes](#) report also shows the impact reward and recognition practices can have on the level of commitment employees feel to their

organisations.

Because there are various elements to reward, it's important to think about the appropriate mix of base to variable pay, fixed to flexible benefits, and financial to non-financial rewards to meet the needs of both the organisation and its employees.

When making decisions about how to reward and recognise contribution, it's crucial to recognise the people risks involved. Employers operating overseas should also consider whether to set reward centrally or allow each region or subsidiary develop its own approach.

Organisations should establish a reward strategy that clearly articulates the aims of the various reward elements and how they are integrated. A reward strategy reflects the organisation's purpose and values, so it's critical that appropriate communications explain to staff what behaviours and performances the organisation is rewarding, how, why, and when. This may include employee education so that staff understand the benefits on offer. It's important to think about the implications for other parts of HR, such as the training and development line managers might need so they can communicate effectively about the rewards on offer. Employers also need to have measures and systems in place to assess the impact of their reward strategy on people and performance.

Determining base pay and total earnings

Pay structures

Pay structures provide a framework for valuing jobs and understanding how they relate to one another both within the organisation and to the external labour market. Our Reward management surveys show that a wide range of pay structures exist linked to varying organisational needs and objectives.

Pay structures may also need to allow for certain additional elements other than basic pay rates, for example location allowances. Find out more in our pay structures factsheet.

Pay levels

There are various approaches to setting pay levels or ranges for jobs. For example, job evaluation is an important tool for setting pay rates among public sector employers, whereas market pricing tends to be more influential in the private sector. Where market rates are used, employers need to determine where to pitch in-house rates (for example, at the median or upper quartile). See more in our factsheet on job evaluation and market

pricing.

Pay awards

Key factors when setting the overall pay review budget for annual pay increases - which often includes performance-based pay rises as well as general pay structure movement (often known as the annual pay award or cost of living uplift) - include:

- ability to pay
- inflation
- market rate changes
- stakeholder perspectives, such as those of customers, employees or investors.

There are variations by sector. For instance, in the public sector the government's pay policy is key, sometimes together with union pressure, whereas the latter is rarely an issue for many private sector companies. Our quarterly [Labour Market Outlook](#) reports look at pay forecasts for the coming year.

Pay progression

Individual performance, competency and skills are commonly used factors for moving individuals along salary bands or ranges. A hybrid approach that bases progression on more than one factor is typical. It might involve assessing individual employee's achievements against the backdrop of the wider labour market. Find out more in our [factsheet on pay progression](#).

Many organisations expect 'satisfactory' performers to progress to a target point in their pay range. Among private sector service employers, the target is often the mid-point in the range, while in the public sector it tends to be close to the top of the salary scale. In the voluntary, manufacturing and production sectors, employers tend to be more split on where the target is. Read more in our [performance-related pay factsheet](#).

Variable pay: cash bonuses and incentives

Our [Reward management surveys](#) show widespread use of bonus and incentive awards, either to encourage future performance (incentives) or to recognise past performance (bonuses). However, there are again variations by industry, with such schemes more widespread in the private sector. Employers often have more than one bonus or incentive scheme with senior staff usually on a different arrangement.

Among those employers offering a performance-related reward scheme, the most common individual performance-related variable schemes are individual bonuses and

sales commission, while profit-sharing and gain-sharing are the most common group performance-related plans. See more in our [factsheet on bonuses and incentives](#).

The advantage of variable pay schemes is that they can link earnings closely to desired performance and, in theory, only pay out when there is reason to do so. Variable elements of pay do not generally feed through into other elements, such as overtime or pension contributions, and so create no additional on-costs. However, the success of these kinds of financial rewards depends on several factors, namely how performance goals are set; the type of tasks being encouraged; how fairly employees view the process and outcomes; and the approaches used to allocate rewards, see our report [Incentives and recognition: an evidence review](#) for more detail.

Fair pay and the UK legal position

In all pay and reward policies, UK employers must meet legal requirements, for example, on equal pay and the National Minimum Wage, as well as reporting on the organisation's gender pay gap and chief executive pay ratio. Find out more in our factsheet on [pay fairness and reporting](#).

The [National Minimum Wage](#) applies to all workers aged 16 and over. There are currently four categories covering apprentices, workers aged under 18, those aged 18 to 20, and those aged between 21 and 22. The [National Living Wage](#) currently applies to those aged 23 or over, with a target to lower it to age 21 or over by 2024.

While not a legal requirement, almost 9,000 organisations employing over 300,000 workers have signed up to the voluntary [Living Wage](#).

Equal pay is an aspect of sex discrimination law giving the right for men and women to be paid the same for the same, or equivalent, work. However, despite legislation, there are still significant gender pay differences. Large employers are required to report annually the size of their [gender pay gap](#).

People professionals need to be aware of the [regulatory background and corporate governance standards](#) when setting rewards for senior employees, including the requirement for large, listed UK businesses to publish and explain their chief executive pay ratios from the start of 2020.

We commissioned research examining CEO reward from a behavioural science viewpoint and its impact on the rest of the workforce. Read our reports [The power and pitfalls of executive reward: a behavioural perspective](#) and [The view from below: what employees really think about their CEO's pay packet](#).

Our [RemCo reform](#) report explores how executive remuneration governance could be improved by broadening the remuneration committee's remit to look at the outcomes of how people are managed, developed, rewarded and recognised. We recently examined the extent to which employee issues have an impact on [performance-related pay for CEOs in the FTSE 100](#).

UK law also requires employers to provide certain workplace benefits, such as a pension scheme or paid leave.

The role of employee benefits

Many employers offer a wide range of benefits, from traditional items such as paid leave and occupational pensions, to newer elements such as paid time off to adopt a pet or set your own pay.

Benefits are provided for a variety of reasons including to match market practice, give some measure of health or disability security, or retain employees. Some benefits are required by law or are tax efficient.

There are various ways of offering benefits. For instance, flexible benefits schemes (also known as 'cafeteria benefits' or 'flex plans') allow employees to vary their benefits package to meet their individual needs.

Other issues to consider include how the benefits offered support the needs of the organisation and its employees, and how to communicate what benefits are on offer.

Read more in our [employee benefits factsheet](#).

Non-financial rewards and total reward

While pay and benefits are important, and getting them wrong can have adverse consequences, and they are not the only rewards that employers should consider. Research shows that non-financial rewards can be just as important. These include:

- Good performance management.
- Opportunities for personal and career development.
- Flexible working.
- Being involved in decisions that affect how and when people do their work.
- Recognition, such as through an 'employee of the month' award or team-based events.

Reward strategies that mix non-financial provisions with pay and benefits are often known as total reward approaches. Read more in our [factsheet on strategic reward and total reward](#).

Useful contacts and further reading

Contacts

[Acas - Pay and wages](#)

[GOV.UK - PAYE and payroll for employers](#)

Books and reports

ARMSTRONG, M. (2019) *Armstrong's handbook of reward management practice: improving performance through reward*. 6th ed. London: Kogan Page.

LIVING WAGE COMMISSION (2016) *Closing the gap: a living wage that means families don't go short: the final report of the Living Wage Commission*.

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ROSE, M. (2018) *Reward management: a practical introduction*. 3rd ed. HR Fundamentals. London: CIPD and Kogan Page.

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Journal articles

BASKA, M. (2019) [Government rejects key recommendations on curbing executive pay](#). *People Management* (online). 17 June.

COTTON, C. (2020) [CEO pay: complex solutions for complex problems](#). *CIPD Voice*. Issue 26, 16 November.

HOWLETT, E. (2019) [Two decades on, has the minimum wage worked?](#) *People Management* (online). 28 September.

PISSARIS, S., HEAVEY, A. and GOLDEN, P. (2017) Executive pay matters: looking beyond the CEO to explore implications of pay disparity on non-CEO executive turnover and firm performance. *Human Resource Management*. March-April, Vol 56, No 2. pp307-327. Reviewed in [*In a Nutshell*, issue 67](#).

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