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Reward and pay

Introduces the basics of pay and reward, including staff benefits, and outlines the UK legal position

Introduction

Pay and benefits are important factors in the process of attracting, retaining and engaging employees. There's a range of options available for organisations to reward their staff and recognise their contribution, each with their own opportunities and risks, but the most effective reward packages will be aligned with the business and staff needs, and reflect the organisation's purpose and performance.

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

Explore our stance on [low pay and financial well-being](#) and [excessive 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 (pensions, paid leave and so on). It can also include wider provisions for employees, with the term 'total reward' encompassing non-pay benefits.

Pay may be divided into two categories:

- **base (or fixed) pay** – guaranteed cash wage or salary paid to employees for doing their work for a contracted period of time
- **total earnings** – base pay plus additional variable earnings such as bonus payments

or overtime earnings.

Pay definitions vary. For example, some employers might treat certain location allowances as part of base pay, while others may see it as variable pay and exclude it from base pay.

Other terminology may also be used. 'Compensation' for example is usually taken to refer just to financial rewards (base pay and earnings) while 'remuneration' might be used interchangeably with 'reward' to mean the wider benefits package.

Managing reward

The main reason to offer pay and benefits is to attract, keep and influence staff. Traditionally, salaries were used to attract people to an organisation, while benefits helped keep them there, and bonus and incentive schemes motivated them in their work. However, 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](#).

Recent research indicates that individuals are attracted, retained and engaged by a whole range of financial and non-financial rewards and that these can change over time depending on personal circumstances. In certain 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 the mission of an organisation, such as a political party or a charity. Our [Employee Outlook: Focus on employee attitudes to pay and pensions](#) survey report examines UK employees' opinions and attitudes towards salaries and bonuses.

Employers should find out what attracts, retains and inspires individuals 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 elements so that they support, rather than contradict, one another.

Recently, behavioural science has offered up useful insights about how individuals may respond to various financial and non-financial rewards. Employers should use the lessons from behavioural science when designing, implementing and communicating its reward package. Find out more in our report [Show me the money! The behavioural science of reward](#).

When making decisions about how to reward and recognise individual and collective contribution it is important 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 - see our factsheet on [international and expatriate reward](#).

Organisations should establish a [reward strategy](#) that clearly articulates the aims of the various reward elements and how they are integrated. The strategy should be complemented by appropriate communications to explain to staff what behaviours and performances the organisation is rewarding, how, why and when. Employers also need to have measures 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 within the organisation and to the external labour market.

Our [Reward management](#) surveys illustrate that a wide range of different types of pay structures exist, linked to varying organisational needs and objectives, including:

- individual pay rates, ranges or 'spot' salaries
- narrow graded pay structures
- broadbands.

Pay structures may also need to allow for certain additional elements other than basic pay rates, for example the inclusion of location allowances. Find out more in our [pay structures factsheet](#).

Pay levels

There are various approaches to setting pay levels or ranges. 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 market pricing and job evaluation](#).

Pay awards

When setting the size of the overall pay review budget for annual pay increases - which often includes performance-based pay rises as well as general pay structure movement (commonly known as the annual pay award or cost of living uplift) - the key considerations

include:

- ability to pay
- inflation
- market rate changes.

There are variations by sector. For instance, in the public sector the key factor is the government's pay policy sometimes together with union pressure, whereas the latter factor is rarely an issue for many private sector companies. Our report [Megatrends: have we seen the end of pay rise?](#) looked at UK pay and inflation trends, while 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 which bases progression on more than one factor is typical. It might involve an assessment of what is achieved by individual employees against the backdrop of what is happening in 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 point 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 and manufacturing and production sectors, employers tend to be more evenly split as to whether the target is at the mid-point or towards the top end. Read more in our [performance-related pay factsheet](#).

Variable pay: cash bonuses and incentives

Our [Reward management surveys](#) show the 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. Many employers have more than one bonus or incentive scheme.

Among those employers offering a performance-related reward scheme, the most common individual performance-related variable schemes are individual bonuses and sales commission, while the most common group performance-related plans are profit-sharing and gain-sharing. 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 does not generally feed through into other elements, such as overtime or pension contributions, and so creates no additional on-costs.

The UK legal position

In all pay and reward policies, UK employers must meet legal requirements, for example, provisions on equal pay and the National Minimum 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 gaps.

From the start of 2020, large listed businesses must also report and explain their chief executive pay ratios.

The National Minimum Wage applies to all workers age 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 24. In April 2016, a new rate (the National Living Wage) was introduced for those aged 25 or over. Our report Weighing up the wage floor: employer responses to the National Living Wage examined the expected responses between small and large employers, and across different sectors of the economy. The Summer 2017 issue of our Labour Market Outlook found that the main response from employers to the National Living Wage was to absorb the cost.

While not a legal requirement, around over 5,600 organisations employing 180,000 workers have signed up to the voluntary Living Wage.

The UK tax position on staff benefits, for example tax relief on pension contributions, can change. For up-to-date information, see the HMRC website.

Executive pay

HR professionals need to be aware of the regulatory background and corporate governance standards when setting rewards for senior employees, including the requirement in the UK to publish chief executive pay ratios from the start of 2020.

Our most recent report on Executive pay in the FTSE 100 looks at what the UK's largest firms pays their CEOs. It finds that there's been a significant fall in CEO remuneration, but it would still take a UK full-time worker on median full-time earnings 117 years to earn what the median FTSE 100 CEO gets paid in just one year. Listen to our podcast exploring executive pay and what motivates top earners.

We've also produced 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 report on [RemCo reform](#) explores how the governance around executive remuneration could be improved, through the replacement of the Remuneration Committee by a People and Culture Committee, which would look at the outcomes of how people are managed, developed, rewarded and recognised.

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 concierge services.

There are various reasons why benefits are offered, including to: match market practice, provide workers with some measure of health or disability security, or retain employees. Some benefits, can be tax-efficient methods of remuneration via salary sacrifice provisions. Share schemes are one specific option for attracting, retaining or motivating senior managers as well as employees.

Flexible benefits schemes (also known as 'cafeteria benefits' or 'flex plans') allow employees to vary their pay and benefits package in order to satisfy their personal requirements.

Voluntary benefits (where employers arrange for the purchase of goods and services, often at a discount, by employees) are more widespread than flexible benefits, partly as they have no cost to employers beyond set-up and administrative costs.

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, 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 and appraisals
- opportunities for personal and career development
- flexible working (such as working from home)
- 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 - Help for small firms: Handling pay and wages](#)

[GOV.UK - Running your business' payroll](#)

Books and reports

ARMSTRONG, M. (2015) *Armstrong's handbook of reward management practice: improving performance through reward*. 5th 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*.

PERKINS, S.J. and WHITE, G. (2016) *Reward management: alternatives, consequences and contexts*. 3rd ed. London: Chartered Institute of Personnel and Development.

ROSE, M. (2018) *Reward management: a practical introduction*. 2nd ed. HR Fundamentals. London: CIPD and Kogan Page.

Visit the [CIPD and Kogan Page Bookshop](#) to see all our priced publications currently in print.

Journal articles

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

COTTON, C. (2019) [Who is feeding the Fat Cats – and should that change?](#) *CIPD Voice*. Issue 17, 7 March.

OLSEN, S. (2018) Why fair pay is a potent weapon in the war for talent. *Strategy + Business*, Issue 90, Spring. Reviewed in [In a Nutshell](#), issue 75.

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.

SIMMS, J. (2015) We can make you work for less: the psychology of pay. *People Management* (online). 27 October.

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This factsheet was last updated by Charles Cotton.