



Guide
January 2011

The pay review process

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Foreword

The amount of money spent on pay and employee benefits can often account for the largest part of organisational expenditure. In service, knowledge and innovation-based organisations the paybill can account for most of the total expenditure. Therefore, given the significance of the reward bill, it is surprising that there has not been that much research around the pay or salary review process, arguably for many employers one of their most important business processes.

Get it wrong and employers may find it difficult to recruit and retain the talent they need. Get it wrong and it may send out the wrong messages about what the organisation values in terms of employee behaviours, skills, values and performance.

Instead, research in this area has tended to focus on the outcomes of the pay review, such as how much salaries have increased by or the size of the bonuses, rather than on how these decisions were arrived at. This study attempts to rectify this deficit by examining the various stages of this business process within various organisational and business contexts to help HR and reward professionals plan their pay review process or examine their existing approach.

The reward philosophy of an individual organisation – whether explicit or implicit – is the driving force for the development and review of operational-level reward management practices including, as a key central strand, the pay review process. Put simply, most organisations aim to be externally competitive and internally fair when setting pay levels across their workforces. Achieving those aims, however, is not invariably straightforward in practice.

Strategic approaches to the design and implementation of reward systems aim to align the determination of pay awards closely with business strategy. But pay is not the sole driver of employee

behaviour – and reward policies need to be placed firmly in a context of complementary HR strategy if they are to effectively support and promote high levels of employee engagement and performance.

A central message from our research into arrangements for conducting the salary review process is that there is no single ‘one-size-fits-all’ approach that works most effectively. Rather, each individual organisation needs to draw on its own reward philosophy – taking account of business needs, employee aspirations and organisational culture – and develop pay review procedures to support that philosophy.

The pay review can be crucial in helping the organisation create and sustain a culture that is resilient and agile. However, the extent to which it can will depend on reward and HR professionals developing insight and foresight around what possible business, organisational and contextual developments are on the horizon and how best they can take advantage of these. The danger is that if insight and foresight are not developed then the organisation will focus on doing what it is already doing and the only insight it gains will be the hindsight of failure.

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1 Overview

While the pay review process is a business procedure designed to help each organisation achieve its aims and objectives, the role of HR/reward is critical in managing and supporting the process. This CIPD guide aims to help reward practitioners review and evaluate procedures for handling the process in their own organisations.

The guide focuses on the aim of aligning pay awards closely with business requirements in the context of the wider HR/reward strategy and organisational culture – as well as looking at how procedures can be developed to operate in as timely and effective a manner as possible.

Drawing on the experiences and insights of senior reward specialists across a range of employment sectors contacted for our research, the guide identifies ten central messages:

1 Pay review policies and practices should be firmly linked with HR processes to support business needs.

The pay review process should be treated as one aspect of the overall employee ‘value proposition’, firmly linked with other HR processes such as culture and values, performance management and talent or succession planning.

2 Effective planning is essential – especially liaison with finance.

Planning should commence well in advance of pay review implementation dates, with a specific emphasis on effective liaison between the reward/HR function and finance/the business at all times – as the latter are likely to have primary responsibility for employee costs.

3 Gathering and interpreting data is critical.

Collating and interpreting data on issues such as inflationary pressures and market pay rates is a critical part of the planning process, with this often forming

the most difficult or time-consuming aspect among the case study employers in our research.

Access to better or more tailored data would be helpful for many of our case study employers and – in addition to drawing on published sources such as government data or privately produced salary surveys – it may be helpful to conduct bespoke research.

4 Keep processes as simple as possible.

While care and diligence should be taken in matching the salary review process as closely as possible with business needs, individual aspects of the process should be kept as clear and simple as possible – particularly if there is only a small pot to distribute.

5 Management tools can support decision-making.

The use of appropriate management tools and technical back-up can help support the decision-making process. Some useful software packages are available, although these can be expensive – while less costly solutions may be sufficient to meet the needs of some organisations (especially where the pay review process is fairly simple).

6 Learning the lessons of previous reviews is essential.

Following each review, it is important to complete discussions and reach conclusions on learning the lessons of that review – including the implications of any changes required by corporate governance and regulators together with identified design changes.

7 Ensure that roles and responsibilities are clearly defined.

Clarity in the definitions of roles and responsibilities is essential, as many problems start where these roles are not clear: who proposes, endorses and approves awards and the respective roles of line managers, matrix managers, remuneration committees and HR/reward.

8 Minimise the risk of 'crowding out' other initiatives.

While there is a danger that the salary review process can 'crowd out' other important reward initiatives, this effect may be minimised or avoided through clear advance planning of the year ahead for the reward function's workload.

9 The process can act as a positive vehicle for change.

Salary review arrangements can support broader reward management changes if used as a vehicle for particular reward initiatives (such as pensions reforms) or to capitalise on wider benefits such as the opportunity to reinforce employer branding when communicating the pay award.

10 Effective review procedures help foster business success.

While acknowledging the time-consuming nature of the process, there is a sense among the reward practitioners in our study that the time and efforts expended are well spent – given that the effective undertaking of the salary review process is deemed essential to the success and well-being of the business and its employees.

Research background

Despite the critical role of the pay review process for employers, relatively little research has been undertaken into current arrangements for handling the process and there are few guidance sources to draw on for practitioners seeking to review the effectiveness of their own procedures.

This CIPD research project aims to meet this gap in knowledge by looking at how employers across a range of employment sectors carry out the process.

Conducted between July and November 2010, our research programme incorporated telephone interviews and responses to email questionnaires – in addition to analysis of company documentation where available – and input from expert reward commentators.

Aims of the guide

This guide is aimed at:

- reward and HR professionals looking to review their existing pay review process
- reward and HR practitioners new to the profession who need to find out about how the pay review process takes place and why
- recently promoted senior HR managers or directors who now have reward reporting to them.

2 Pay review flowchart

The arrangements and timetables for reviewing pay vary widely between employers depending on a range of factors, including the degree of complexity of pay structures and pay progression arrangements. It is often helpful to draw up a flowchart or table setting out roles and responsibilities, usually with dates/deadlines included at each stage.

An example flowchart is set out in Figure 1. This illustration reflects a non-unionised system where line managers have a major role in determining individual pay rises.

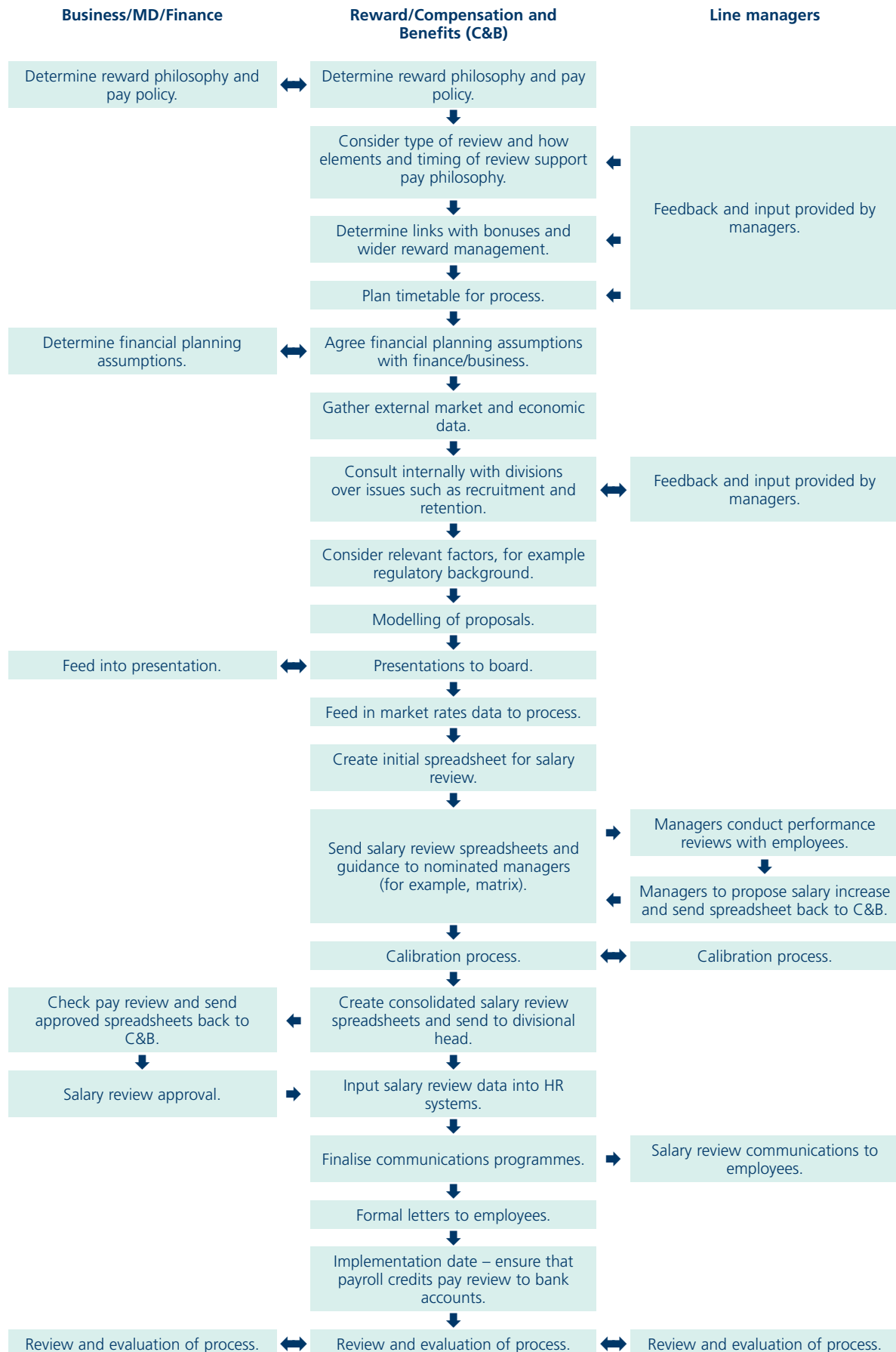
Our definition of a pay review is that its process to set an overall pay bill budget and to determine individual pay rises within that budget, typically on annual basis.

The process involves a number of key stages, some of which may overlap:

- planning /setting a pay bill budget
- determining individual pay rises within the overall budget – which may be based on internal factors (such as employee performance) and/or external factors (for example, a comparison with pay rates in similar organisations)
- communicating outcomes to employees
- reviewing and evaluating the outcomes of the process.

These stages are explored in more detail in the guide.

Figure 1: Pay review flowchart



3 The role of reward philosophy

The pay review process aims to deliver business imperatives through people, with employers needing to draw on their organisational reward philosophy in designing procedures to support this aim. For example, is the aim to reflect inflation, movement in market rates, the going rate of pay increases, employee performance, employee potential or organisational success (or some combination of these factors)?

While reward philosophies vary widely between organisations, a number of common factors need to be considered when structuring salary reviews to support business strategy, including the following examples.

Collective vs individual approaches

Pay awards may be set on a collective level, with an across-the-board pay rise awarded across all employees within a pay group or on a more individualised basis that allows factors such as performance to be taken into account in setting varying pay increases for individual employees. Different approaches might be deemed appropriate for different employee groups, for example the former approach may be appropriate for a large group of relatively low-skilled workers undertaking very similar work (such as supermarket cashiers) while higher-level roles might be rewarded in a more individualised manner.

Base pay vs total earning

A range of approaches are possible to achieve the right mix between base pay (guaranteed basic salary levels) and total earnings (including elements such as bonuses or market supplements), with the use of the latter generally intended to incentivise higher performance levels or assist with recruitment and retention needs.

Links with benefits packages

The financial impact of salary setting needs to be considered alongside the full benefits package – for example, pensions and other benefits.

Total reward

The broader total reward environment – covering aspects such as flexible working opportunities and high-quality training provisions – also needs to be taken into account when considering appropriate levels of pay.

Pay policy

Employers need to decide their pay policy in terms of competing in the labour market and meeting organisational objectives. For example, many charities aim to pitch salaries at the median for the voluntary sector or below median for the economy, while banks might aim for the upper quartile level (either base pay or total earnings) for certain key staff. However, while boosting pay rates in the latter way may well yield an immediate return on recruitment, it may have more mixed results in respect of retention – for example, by potentially locking in staff who are disengaged.

Internal vs external equity

A number of tensions may arise between approaches based on internal and external perspectives. For instance, the market rates for some jobs may be higher than rated by internal job evaluation procedures. Solutions need to be considered where such tensions arise (for instance the use of non-consolidated market supplements to boost pay temporarily).

Equality issues

The review process should be fair and equitable – and perceived as such by employees, supported by an effective communications programme – while principles of equality in areas such as gender and age must be considered both in respect of legislative requirements and good practice.

Design of pay structures

Options in pay management are governed in part at least by the pay structures and progression arrangements in place – for example narrow bands versus broad bands. The former tend to ensure clear and formal progression arrangements whereas the latter aim to foster greater flexibility in pay setting.

Segmenting pay

There may be a need for segmentation of pay structures and awards – often designed to help recruit and retain sought-after employees in a particular occupational group, such as specialist IT staff. For example, under ‘job family’ grading structures, different occupational groups (or ‘families’) are covered by distinct structures – enabling higher pay levels to be set across a particular occupational group where necessary to meet demand for specialist staff.

4 Planning/setting a pay review budget

For reward practitioners embarking upon the salary review process, effective planning – including obtaining relevant data and starting to build the business case for the pay outcome – is an essential first step.

Liaison with finance department/business

'The pay review is the responsibility of the business and, while HR/reward manages the process, the budget and allocation of increases is substantially a business decision – hence there is a need to get them to take responsibility for the budget, allocation and any variances.' This is the view of one senior reward practitioner contacted as part of our research programme.

As the finance function is likely to make some paybill growth assumptions for, say, one to three years ahead, the business case usually needs to be set against an existing assumption about the budget available.

Hence it is critical early on for HR to attain some influence over this budget assumption, or at least to understand the degree to which the business would be able to vary budgets if market conditions subsequently suggest this is necessary. Planning must be a partnership with finance – as, according to the commentator quoted above, *'too often HR is too late in getting to the process, or ignored'*.

Establishing a close working relationship early in the planning process with the finance function should help ensure that not only are key financial metrics correctly stated but that eventual proposals fall within the budgets set in the corporate business plan.

Another point to consider at this stage is the potential for differentiation within the business about allocation of the budget – for instance, should a high-growth, key business have the same level of increase as a business that is being sold off or closed down?

Finally, it is important to liaise effectively and clearly with other relevant functions where appropriate, such as the payroll or communications department – this should also take place at an early or ongoing stage of the process, particularly where any major changes are planned.

Planning timetables

Formal or informal timetables are commonly used by employers to govern, or at least guide, the salary review process – often commencing several months prior to the effective date of the pay rise – which ideally should clearly set out the responsibilities of all interested parties from the planning to the review stage.

John Lewis Partnership (JLP)

The organisation usually starts detailed pay research, analysis and provisional costing work in October and consultation with personnel management/business partners follows through November. In early December the pay review budget proposals are presented to the divisional boards for approval. Communication with line management takes place in January and February; pay review input takes place in February and March; communication with employees about their new rate of pay takes place during March and the pay review takes effect from 1 April.

Collating data: influences on level of award

The most obvious influence on the pay review is employer ability to pay – determined largely by company performance in the private sector or by government policy in the case of public sector organisations.

Table 1: Key influences on size of pay reviews

1	Ability to pay
2	Inflation
3	Movement in market pay rates
4	Recruitment and retention issues
5	The 'going rate' of pay awards elsewhere
6	Level of government funding/pay guidelines
7	Union/staff pressures

Source: CIPD annual Reward Management survey 2010

As illustrated by the CIPD's annual [Reward Management survey](#), the key factors used to determine the size of the overall pay review among employers are as set out in Table 1.

Practitioners will need to gather robust and relevant data on some or all of the factors listed in Table 1 in order to inform the pay reviews in their own organisations.

TUI Travel

At TUI Travel, the main influences on the salary review process in terms of internal data are financial affordability and profitability, while the company also draws on a number of external sources such as government data and privately produced salary surveys and publications examining wage trends.

1 Ability to pay

This is likely to be closely linked to organisational performance and, when making this assessment, data from a range of internal sources may be relevant, such as:

- most obviously, profit levels
- possibly, also more qualitative measures such as customer satisfaction levels
- issues of corporate governance, including how results are achieved as well as absolute performance versus target.

2 Inflation

For external influences on pay, including inflationary pressures, practitioners can get up-to-date information

from a range of official (government) and non-official sources. A wealth of official data is freely available via the UK Statistics Authority website (see [Resources](#) section), which gives trends in the various measures of inflation, as well as other relevant indicators (earnings, unemployment, GDP and so on).

Employers need to consider which of the following measures of inflation is most appropriate as an influence on the salary review process in their organisations:

- the **Retail Prices Index measure of inflation (RPI)** – known as the 'headline' rate of inflation, this measure is traditionally used in pay negotiations (particularly where trade unions are recognised)
- the **underlying inflation (RPIX)** measure – that is, RPI excluding the cost of mortgage interest payments
- the **Consumer Prices Index (CPI)** – the official measure of inflation in the UK, which excludes housing costs, and tends to result in a lower rate of inflation than RPI.

3 Movement in market pay rates

Employers wishing to take account of external labour market pressures and trends when reviewing salaries often find it helpful to make use of the wide range of salary surveys that are available from commercial producers, consultants and other organisations. Information about putting the data gleaned on market rates to use can be found in section 6 of this guide, while a checklist on choosing and using salary surveys is set out in Annex 6.

4 Recruitment and retention issues

There is a need to identify any recruitment and retention difficulties to assess if reward policy can help to resolve any such issues. This may involve means such as analysis of labour turnover figures and consultations with divisional managers.

5 The 'going rate' of pay awards elsewhere

Data on wage trends and forecasts are available from several commercial providers, including IDS and Xpert HR (see [Resources](#) section for more information).

6 Level of government funding/pay guidelines

For public sector organisations, central policy is inevitably the pre-eminent consideration in reviewing pay. For example, in 2010, a public sector pay freeze was announced to cover a two-year period (other than for

employees earning below a threshold set at £21,000 per annum). More information on issues specifically affecting public sector employers can be found in Annex 1.

7 Union/staff pressure

Union influence, albeit on the wane in recent decades, continues to play a significant role in pay-setting in certain sectors of the economy – notably the public (and privatised) sectors as well as parts of private manufacturing, retail and finance. Further information on reviews in unionised environments can be found in Annex 2.

Challenges of data-gathering

Several case study employers identify the collation and interpretation of data as the most time-consuming or difficult part of the pay review process. The Oxfam case study included in Annex 5 illustrates in more depth some of the issues involved when gathering data.

However – even given the wide array of extensive published data on offer – a number of practitioners report inadequacies with some of the data available in terms of quality or coverage. These issues may be overcome in part at least by the undertaking of bespoke research where necessary, such as participation in pay clubs or more informal research.

Sainsbury's

The retailer identifies particular constraints in obtaining reliable salary benchmark data for certain specialist positions. To alleviate this, the company typically undertakes its own market research, as appropriate, such as via contacts with other similar employers.

Another approach is to turn to recent recruits or those about to leave the organisation for information on their previous or expected pay rates – one strand of the approach adopted at JLP. In order to gather more useful information, exit interviews should (if practicable) be conducted some time after the individual has left the organisation as responses are likely to be more honest.

For some organisations, it may be also possible to share data and capitalise on economies of scale when clubbing together to purchase good benchmarking data.

The ultimate challenge is to draw together information from so many differing strands into a coherent pay strategy.

Royal Bank of Scotland (RBS)

While business performance is the key internal driver of paybill growth at RBS, there are also important external influences: the economic outlook – critical in particular when considering the differing environments in various countries where the organisation operates – including wage inflation, together with market rates as measured by salary surveys – all underpinned by the influence of the legislative/regulatory environment.

Forecasting trends

When gathering all this data, practitioners need to consider whether they wish to focus on recent developments and/or to also take account of forecasts of future trends. For example, they may decide to use actual 'point in time' inflation prior to pay reviews for a particular month or look at average inflation over a recent period – or they may choose to take into account predicted trends in inflation levels during the months or year ahead. Similarly, it is possible to make use of predictions of market movements in salaries in addition to a more retrospective exercise. The use of forecasts should, though, be undertaken with some caution given that their accuracy can be variable.

However diligent the process of data-gathering and forecasting, difficulties may still arise in practice, for example if salaries end up some way behind market rates, hence some companies allow for, say, a 0.5–1% budget pot in preparation for the smoothing of any anomalies that may ultimately arise (although this may be less of an issue during times of recession).

Presenting the information

Once adequate data has been collated, an important step is likely to be the presentation of recommendations in respect of the budget and the details of its planned distribution, perhaps to the board or some other level of internal management.

5 Timing of reviews

As part of the salary review planning or evaluation process, employers may want to consider the timing of the salary review process (and whether any adjustment is necessary).

Many pay reviews take place in either January or April, typically in order to follow the financial, tax or calendar year. There has also been an increase in the proportion of October reviews in recent years in certain relatively low-paying sectors, such as retail and hospitality, linked to the desire to tie in with annual changes in the National Minimum Wage.

Specsavers

The salary review implementation date of June at Specsavers is considered advantageous in respect of data collation and analysis – as it comes at the end of the busy pay-setting period for many other employers during January to April and at a time when certain other financial and economic indicators are available. Externally, the company looks at practice among other employers using information sources including salary surveys and at the wider economic background – with actual and forecast measures of the headline RPI indicator used as a guide for cost-of-living changes. The company also draws on a range of internal data sources – most significantly consultations and discussions with finance and the board.

A position needs to be adopted on whether to use the same review date for all staff or to operate a rolling review process based for example on each employee's anniversary of joining.

During difficult economic times in particular, there may also be an argument for flexible timings of individual pay increases according to performance. Under such arrangements, the standard review date stays the same but the effective pay increase date for top performers can be brought forward (but using a lower rate of increase) while poor performers would have a delayed increase. This can over time significantly improve the

pay benefit for top performers (for example, by giving the equivalent of four increases in a three-year period). However, the use of differing salary review dates inevitably brings with it an additional level of complexity.

In exceptionally difficult times, of course, some employers will defer the effective pay review date for the entire workforce or freeze pay levels altogether.

Pay pauses and freezes

Given the challenging economic climate prevailing at the time this research was conducted, it is not surprising that several of the case study companies had in recent pay reviews held back from giving pay rises at the normal date. The main options open to employers in this respect are:

- **Pay freezes** – traditionally defined as the maintenance of pre-existing pay rates over the full 12-month period normally covered by a review, a pay freeze might extend beyond a year. The implementation of a pay freeze means that, as well as keeping overall wage costs frozen at existing levels, savings are attained in respect of any on-costs linked to basic pay.
- **Pay pauses** – that is, delaying a pay rise by one or more months beyond the usual effective date (for example, a three-month pay pause would mean that a rise due on 1 April would be implemented to take effect on 1 July). This approach has the advantage of reducing the overall cost to the employer over the year while reducing the adverse impact on employees in areas such as engagement or retention. While it is possible for companies to put back the timing of reviews to save money in a financial year, it is considered best to pay bonuses in the tax year they are earned (see section 7 on bonuses) in case the bonus does not reflect subsequent employee performance.
- **Pay reductions** – in the most extreme cases, pay rates may be reduced to lower than pre-existing levels. This could be achieved either via a direct cut to basic hourly rates or by the use of short-time working (reducing the number of hours worked each week, hence cutting the overall wage bill costs).

6 Determining collective and individual pay increases

Within the overall pay review budget, there needs to be some means for determining collective or individual employees' pay rises.

Collective awards

Clearly, no special mechanism for distribution is needed in organisations that award a collective across-the-board increase giving each employee an identical percentage pay rise. Such arrangements are more common in unionised environments, or where the bulk of the workforce works in similar or relatively low-skilled occupations.

Further information on union-negotiated pay reviews can be found in Annex 2.

Individual or group awards

In general, however, there is a growing focus on the desire to ensure that the behaviours, attitudes, performances and values the organisation needs are recognised and rewarded by the pay review process. There is also often a need to pitch individual salaries at the appropriate level to support the recruitment and retention needs of the organisation – and even during an economic downturn certain occupations will still be in high demand.

There are other considerations too. It is necessary to consider appropriate approaches to pay determination for individuals who change roles during the course of the year. There is also the issue of employee potential or value to be considered – for example an individual may receive a rise even if rates are frozen for others because the organisation cannot afford to lose that individual.

Set against this background, pay rises for individual employees may vary according to both internal and/or external factors:

- **Internal factors** – these may include some measure of individual or group employee performance or contribution and/or length of service (and salary budgets may also be distributed to different units according to their respective performance).
- **External factors** – most notably, these include salary levels for comparable employees in competitor organisations.

Internal influences on pay: performance

In organisations where assessments of employee performance or contribution are linked to the level of salary increases, it is usual to hold review meetings between line managers and individual employees, often involving the use of formal assessment criteria and documentation.

One significant impact of the increased individualisation of pay in recent years is the increasing influence of the line manager – bringing with it challenges of ensuring that line managers have the training, time and skills to effectively assist in reviewing individual employee performance and setting pay levels.

McDonald's

The performance-driven culture at McDonald's is the central focus of the company's annual pay review process, which has an end-December implementation date. Performance rankings for employees range through 1 (unacceptable) and 2 (some improvement required) to 3 (significant performance) and 4 (exceptional performance). No pay rise is awarded for employees whose performance is rated at level 1 – while a higher percentage increase is given for those rated 4 compared with that awarded for employees rated at 3 or 2.

Enforcing distribution curves

Some employers choose to set specific distribution patterns for performance ratings when linking performance to pay in order to help ensure consistency and/or stay within budget. For example, each divisional head is restricted to ranking a specified proportion of employees as 'outstanding'. Under such arrangements, there may also need to be a 'calibration' stage to ensure the correct proportion of employees end up in each category. It is also possible to set a budget for the increase per manager or division.

Forced ranking, calibration or allocation guidelines will also vary with overall business performance.

McDonald's

The 'calibration' process at McDonald's is designed to ensure the company's required distribution curve within each operating unit – with 20% of employees in the highest performance category (4), 70% in the next banding (3) and 10% across the two lowest bands (1 or 2). This is enforced as a 'hard-and-fast' rule for salaried employees and, increasingly, is used as a best practice guideline for hourly paid staff. The policy of enforced performance distributions is fairly well bedded down now, although it accounted for much time during 'calibration' discussions between HR and line managers at the company when first introduced. As our interviewee from the company explains to line management colleagues: *'It's a little bit like the Premiership in football – one year a team can be relegated with 40 points while another year it can survive on 36 points... it's all relative, not absolute.'* This approach is thought to assist in the company's high-performance culture, as it should never be perceived that any level of performance is 'just enough'.

'A degree of common sense and flexibility should be exercised in using distribution curves, particularly for smaller departments, as this process often causes considerable tension and friction,' as observed by one reward expert participating in our research.

Alternatively, or in addition, some employers create a 'merit matrix' that gives a guideline increase to the line manager, depending on an individual's performance/position in pay range (possibly in combination with an assessment of external rates – see below for more information on using a matrix).

According to another reward expert: *'The usual challenge is whether to allow line managers wide discretion in allocating the budget at the expense of consistency of approach or to permit only limited discretion – which may be seen as a straitjacket.'* A robust system is needed for tracking spend versus budget in this respect and for dealing with disputes among managers competing for funds. This should be backed with adequate governance to ensure the right people review and approve at the right time together with a clear audit trail. An example of a performance distribution curve is illustrated in Figure 2.

Links with development programmes

Employers need to consider a number of issues when linking pay and performance, such as whether to keep the salary review process separate from the development review or to integrate the two processes.

McDonald's

A balanced approach is taken at McDonald's with, on the one hand, a clearly defined strategy for linking pay awards to performance and the distribution of such awards – complemented by a separate performance review process where the focus is specifically on employees' support and development needs and how these can effectively be addressed.

More information on assessing the performance of individuals or teams can be found in our [factsheets](#).

Internal influences on pay: length of service

In the UK, length of service is generally declining in influence as a factor affecting individual pay rises. However, it retains a stronghold in parts of the public (and voluntary) sectors – albeit within certain limits to avoid concerns over potential age or sex discrimination (see Annex 1 for more information on issues affecting the public sector).

External influences on pay: market rates

The use of salary surveys has already been noted as a key source when gathering external market data, while Annex 6 sets out some guidelines on choosing and using salary surveys.

HR or reward specialists need to allow adequate time and resources – which can be substantial – for involvement in such surveys (especially as participants). The workload encompasses everything from completion of questionnaires to the analysis of survey results – although the latter in particular may be helped by the use of specialist software or the services of consultants.

When linking pay with market rates – as well as choosing an appropriate salary survey – practitioners need to consider more specifically how to feed the data into the pay-setting process in their own organisation. They may need to define a reference point specifying which external market rate(s) are to be used to help determine internal pay levels. This might well be the median when compared with competitor organisations.

However, it is sometimes argued by HR that there is a need to maintain internal pay rates at, say, the upper quartile level with the aim of recruiting and retaining higher-quality staff for certain occupations.

Moreover, as noted by a reward specialist who participated in our research: *‘It is important to remember that surveys are not infallible and unerringly accurate sources of information – equally important is having a firm reward strategy and policies to guide pay decision-making.’*

In making comparisons with the external labour market, there is also a need to distinguish between percentage increases and absolute rates of pay because, if salaries in an organisation are ahead of or behind the market, the ‘percentage game’ will exacerbate rather than address this.

Royal Bank of Scotland (RBS)

The pay review strategy is drawn up in conjunction with finance, with pay driven primarily by performance – including measures of business performance, performance against personal objectives and outcomes versus budget. There is a need to draw together internal and external data in particular from three key sources – internally, the impact of business and personal performance and, externally, the economic environment and market rates as charted by salary surveys. All this information must be balanced carefully to ensure the effective implementation of pay review decisions.

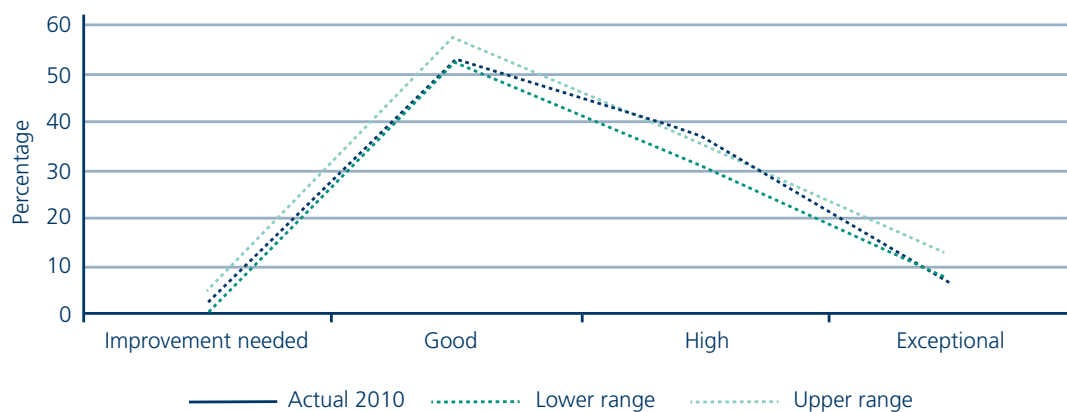
Using a matrix

As noted above, employers may have to devise some mechanism to allow them to take into account a combination of factors when determining individual salary increases, for example, individual employee performance as well as external market rates for comparable employees.

HR practitioners may therefore need to draw up a matrix, combining factors such as ratings of employee performance together with reference points extracted from external salary survey data, in order to determine individual salary rises. The distribution often also takes into account employees’ current salary position relative to market or target rates of pay, with those below market rate receiving proportionately more (assuming their performance reaches the required level).

Figure 2: Example of a performance distribution curve

- The following is an example of a performance distribution curve with the flexibility of a 5% range for each performance criteria.
- The graph illustrates the actual 2010 performance distribution by comparison to the desired range.



Rating	Improvement needed (%)	Good (%)	High (%)	Exceptional (%)
Desired performance	2.5	55	32.5	10
Range	0–5	52.5–57.5	30–35	7.5–12.5

Defining roles

There is a need to clearly define the roles of HR/reward and line managers in handling and eventually signing off pay reviews. It is helpful to agree a clear timetable with line managers, including time set aside as necessary for conducting individual reviews, calibration procedures, handling appeals and eventual sign-off.

7 Links with bonuses and wider reward management

The basic salary review process must be considered in the context of the total earnings/total reward picture, particularly the awarding of non-consolidated cash bonus payments and/or the use of market adjustments in the form of separate payments on top of base pay (which can go down as well as up and need to be reviewed regularly).

Bonuses

There has been much public debate recently surrounding the use of bonuses – some more measured than others, as noted in our [factsheet](#) on that topic and in the CIPD report [Managing Reward Risks: An integrated approach](#). There is a view among many in the field that the principle of paying bonuses to encourage high business performance remains sound, but that there is a clear need to ensure that targets set do not reward the wrong behaviours.

Specsavers

At Specsavers, there is a focus on the use of bonuses to achieve rounded performances among individual employees – rather than simplistic targets based on, say, solely numerical targets. Bonus payments are made frequently – taking effect in June each year and quarterly thereafter – enabling clear links with current performance as well as timely rewards for high performance levels.

Many firms look at making bonus award decisions alongside resolutions on base pay to achieve the appropriate total compensation message/outcome desired.

Some employers, for example, recognise contribution partially or wholly via the payment of cash bonuses in place of consolidated salary increases, and it may be that the only way for salaries to increase is if the market rate has increased.

A variation on the theme is to use a mix of consolidated salary rises and cash bonus payments to position pay differently for employees who are deemed to be performing at different levels.

Hence consolidated pay rates for employees ‘meeting expectations’ might be positioned to take their salary to the median level for their occupational group while, for ‘exceptional’ performers, cash bonuses could additionally be paid to take their total annual earnings level up to the upper quartile level.

Sainsbury's

For its administrative and management roles, the principle at Sainsbury's is broadly to align pay bands to the market median for ‘competent’ performers. The main way that additional performance is rewarded is through bonus and incentive plans – virtually all employees are covered by bonus arrangements, with schemes typically paying out a little later than the base pay review rise.

However, in some organisations – particularly in the case of employees in parts of the public and voluntary sector – there is a view that the use of bonus payments could be inappropriate. Many such workers (nurses, for example) may be primarily motivated by a desire to serve the public, so the argument goes – and hence would not respond to or appreciate the use of a bonus or incentive payment.

Citizens' Advice

With the basic salary review process at Citizens' Advice closely tied to civil service pay guidance, there is in theory more flexibility on bonuses because this aspect of remuneration is non-consolidated – but the organisation does not currently choose to use the bonus option because of concerns that it does not fit with the 'organisational culture'.

CIPD members can find more information on the issue of bonuses in our [tool on bonus and incentive payments](#).

Total value and total reward

Throughout the salary review process, there is an enduring need to remain aware of the wider reward picture, including variable pay alongside benefits and total reward. Practitioners need to look at positioning the level of cash (fixed salaries plus variable bonuses) within the context of the wider package – especially against the background where changes to salary levels can have a direct impact on associated costs.

It could in certain circumstances for instance be deemed appropriate to take into account the nature of pension provision (defined-benefit or defined-contribution) in considering the level of salary increases.

Impact on wider reward management

There is a danger that the time-consuming and potentially cumbersome nature of the salary review process can 'crowd out' other reward initiatives. However, this effect can be minimised or avoided by good forward planning and the scheduling of broader reward initiatives outside of busy times for the salary review process.

John Lewis Partnership

While the process at JLP is time-consuming and labour-intensive, the outcomes of the approach in reflecting the market and rewarding individual performance does add value. The high volume of pay review background work, in October and November particularly, does mean other reward initiatives need to be phased outside this period.

Transport for London (TfL)

Due to the complexity of the structure at TfL, the process involves a number of teams and different levels of management. Therefore other reward initiatives are planned to take place outside of the peak periods of pay review activity if at all possible so that employees do not 'lose' the message.

Kent County Council

As pointed out by our respondent from Kent County Council, *'If it is a proper performance-management-related process, it is worth the effort...It happens to a set timetable, so other initiatives can be managed around this.'*

Moreover, some case study employers illustrated that it may be possible to use the salary review process as a vehicle for the achievement of wider reward issues.

FirstGroup

The basic pay review process has been used to help bring about change on wider reward issues at FirstGroup, with the capping of pensionable pay in the UK bus division enabling a larger pay increase – while not adversely impacting the issue of pension affordability.

8 Communicating with employees

Good communications are essential to the salary review process, as employees may be left demoralised or resentful if the process is insufficiently transparent or seems unfair.

The operation of a robust performance appraisal and pay review timetable, clearly communicated and with good project management, is imperative to the process.

It is also necessary to ensure clarity over the details of what is being rewarded, how and why, as well as setting out clear guidelines over what the HR function communicates and what line managers communicate. HR and line managers also need to reach a mutually agreed position on how much information should be disclosed on issues such as budgets and the setting and distribution of increases according to performance rating.

Additionally, consideration should be given to the existence and operation of any appeal process relating to the salary review process, with clear guidelines in place for its operation.

Communication techniques

HR practitioners need to choose an appropriate communication strategy for their own organisation, taking into account factors such as the size and culture of the company.

Smaller employers may be able to announce results face to face, whereas communications may need to be via email in larger or more geographically dispersed firms. Some large employers provide a video for employees to watch, although these need to be well produced to maintain credibility and can therefore be costly to resource.

The role of line managers is often critical in communication strategies, given their increasing influence in determining pay for individual employees.

If the pay review involves a consideration of individual performance, it is likely that an individual conversation would be an essential part of the process to avoid jeopardising the hoped-for outcomes of transparency and fairness.

Whichever combination of methods are used, it should be remembered that, for the employees, this is one of the most important pieces of communication they will receive during the year and, from the organisation's perspective, this is one of the biggest investments in people it will make during the year, hence the aim should be to maximise the impact. Employers should also endeavour to ensure that communicating reward with employees is a two-way process, giving them opportunities for feedback.

Many employers in our study regard the annual pay review process as a good time to communicate the full value of the reward package via such means as the provision of total reward statements.

TUI Travel

TUI Travel uses the pay review process as an opportunity to communicate more broadly around total reward, hence enhancing employee engagement and supporting wider business objectives. Each member of staff receives an individualised total reward statement setting out the full value of working at the company – from bonus payments to travel concessions and from pensions to flexible working options – in addition to the basic pay element.

On a practical level, the HR function may need to arrange the dispatch of letters or other formal communication to individual employees (possibly in conjunction with payroll)

confirming practical details of the pay review outcome, such as the level of the pay rise, the new individual salary (including that for contractual hours worked with part-time employees) and the effective date of the new rate.

Sainsbury's

At Sainsbury's, there is a focus on ensuring that reward communication is a dialogue through means such as its staff survey. A range of communications methods is used once pay is determined, such as stand-up presentations in stores as well as individual letters including details of what the pay rise means based on each employee's contracted hours – an important factor given a high proportion of part-time employees.

Specsavers

A focus on employer branding, in addition to total reward, is an essential part of the communications strategy for the salary review process at Specsavers. The announcement of the annual pay award is used as an opportunity to highlight the company's distinctive qualities as a family-run, entrepreneurial business as well as reinforcing the value of the remuneration package itself – encompassing not only basic salary but also elements such as profit-sharing and performance-related bonuses.

Further information on how pay is communicated and how that communication is received can be found in our recent survey [*Employee Attitudes to Pay 2010*](#).

One senior reward practitioner contacted for this research identified the following key issues when communicating the pay review:

- Providing appropriate messaging before and during a review can help manage expectations.
- Face-to-face communication and explanation of outcomes is invariably preferable to telephone calls or texts.
- Total compensation statements with letters can help employees understand the real value of a package, whereas there is a danger that technical reward leads get lost in this 'black hole' of an issue.

External communications

In addition to internal communications with employees, it is important to take account of the role of external communication of the pay review – and the reward function may need to liaise and work effectively with other departments such as public relations in designing communications. There may be a need to 'sell' the increase to a range of external groups such as the media, politicians, shareholders – or indeed the wider general public.

9 Modelling and supporting the decision-making process

Thanks to increasingly sophisticated management tools and technology, a range of support mechanisms are available to help employers model, plan and undertake the pay review process.

On a technical level, managing the salary review process has traditionally involved the use of spreadsheets – and such arrangements remain in place in many, particularly smaller, organisations. However, some very useful, web-based software may help manage the process.

When new technology is being introduced to support the pay decision-making process, it is possible to either run processes through in-house HR systems or to introduce a bespoke system. The former may work effectively, although if heavy customisation is required this could become expensive – and may be counterproductive if a significant amount of work with spreadsheets is still required. Bespoke systems can be useful to overcome such issues although, once again, these can be costly.

There is also a need to consider links with other systems, for example payroll, and whether integration is viable or desirable.

Problems sometimes arise at the administrative stage of the salary review with various documents or spreadsheets containing sensitive salary and bonus award data drifting across the organisation between HR and line managers. Attempts could be made to reduce such difficulties by emphasising the need for care in management communications and/or enforcing data protection rules. The use of web-based software may also help to avoid a plethora of spreadsheet printouts.

Modelling pay

Specialist modelling tools and technology are available to illustrate the outcomes that would arise from a range of potential decisions on pay structures, rises and distribution strategies. This may be particularly helpful in ensuring that individual salary increases ultimately remain within the overall paybill budget and in checking on equality issues such as race and disability.

It is also worth considering at an early stage what elements of reward are to be reviewed and linked on-costs – for example, most basic pay rises will result in higher employers' National Insurance contributions and will often also incur additional pension costs. This is particularly relevant where union negotiations are involved as it is rare in this scenario to discuss base rates in isolation – usually there would be a whole menu (including items such as overtime, shift rates and benefits), which in turn complicates the cost modelling.

It may be helpful to try to agree the likely level of 'on-costs' with the finance team to enable HR to present proposed cost increases both with and without those 'extras'. It is also useful to identify the costs in the relevant fiscal years if the annual rise spans more than one financial year.

Boehringer Ingelheim

A programme of careful and comprehensive pay modelling is undertaken as part of the salary review process at Boehringer Ingelheim. As its pay structure encompasses some 100 pay points, it is critically important to undertake this work to ensure that the overall cost of the review comes in within budget.

Risk management and regulatory impact

There is also a significant role for specifically risk-modelling the pay review process to support risk management. Risk-modelling of the salary review process may be undertaken formally or informally by practitioners.

Transport for London (TfL)

At Transport for London, risk-modelling is undertaken based on appraisals, salaries and budget available – with a view to seeking the most cost-effective option that will allow sufficient differentiation for high-performers. The modelling process is deemed extremely important to enable costs to be accurately detailed and signed off.

Royal Bank of Scotland

At RBS, the management of risk plays a central role in the salary and bonus review process. When calculating bonus pools, these are adjusted to take account of risk – including measuring employees on their level of risk-taking – and payments are deferred with a facility additionally to claw back payments if a risk is identified after the event.

The recent global financial crisis and subsequent economic shockwaves across all sectors have led to a heightened focus on the management of risk across all employing organisations.

In finance, a raft of measures has been introduced – with more anticipated – in respect of the regulation of remuneration, particularly affecting senior pay. Full details are available from the Financial Services Authority (see *Resources* section). The content of investor guidelines also needs to be considered.

It is, however, also important to keep in mind the many potential risks, other than those under the media spotlight of late (the use of bonus payments being the obvious example) – as highlighted in the recent CIPD publication entitled *Managing Reward Risks: An integrated approach*:

‘Risk management...can often be misunderstood,’ according to this publication, and ‘good risk management is not a barrier to risk-taking activity.’ Rather, it concludes, ‘effective risk management ensures that this risk-taking is carried out as a conscious activity’ with judgements made ‘about the appropriateness of the risk-taking in line with organisational objectives at that time.’

Based on workshops and interviews with a range of employers, the report identified seven reward risk groups (see Figure 3).

Figure 3: Seven reward risk groups



Examples of strategic risks identified include: the risk that reward is structured in such a way that the organisation is unable to attract or retain the talent it needs to be successful and the risk that the reward strategy is not aligned with other HR activities, diminishing the effectiveness of the whole HR strategy.

John Lewis Partnership

At JLP, the organisation assesses risks around its process in terms of ensuring it is able to recruit, retain and motivate high-calibre partners within reward best practice and agreed budgets. A series of reports are run through the system ensuring legal requirements are met, for example National Minimum Wage, and identifying areas where the pay review outcome may be at odds with expectations or the average.

10 Evaluating the pay review process and conclusion

It is important to evaluate the pay review process and identify lessons that can be learned for the next time. However, in the view of one senior reward specialist contacted for this research, such evaluation is *'very rarely done, and where done, done badly'* – despite the fact that *'many lessons can be learnt that can inform policy, process and tool development for subsequent years'*.

Evaluations are also important, as noted by another expert commentator, because *'the salary review process is not invariably a wholly rational or scientific affair'*. HR may for instance have to negotiate with line managers and departmental heads (who may want more cash for their 'stars') over whether this is appropriate and, if so, how this can be achieved. This could involve sensitive discussions, say, over whether any problems in employee turnover are necessarily due to uncompetitive salaries rather than other factors such as line manager behaviours.

The evaluation process should also ensure that the pay budget has not been exceeded (for example, employees receive a 3% rise to salaries, but the paybill actually increases by 3.5% once other costs are considered). There is a particular need to be wary of the scenario where HR holds the line to a strict budget for the purposes of the pay review but then loses control or visibility of awards that may be made through the rest of the year. Hence it is also important to monitor any ad hoc pay awards made outside of a formal process, as these can have the effect of circumventing the formal system and increasing costs beyond the initial budget.

Boehringer Ingelheim

Boehringer Ingelheim undertakes a wide-ranging evaluation of the salary review process each year. This involves obtaining online feedback from each division for discussion in meetings between HR and business partners – enabling procedures to be further streamlined in future reviews.

It is important during the evaluation for practitioners to take a particular focus on whether the review has been effective in the aim of supporting business objectives.

TUI Travel

A clear review of the salary review process takes place at TUI Travel, including the preparation of an evaluation summary paper for distribution at senior levels – illustrating key outcomes such as the main areas of expenditure and distribution of awards. This helps ensure that any appropriate adjustments to procedures can be made in future years to further support HR and business strategy.

Transport for London (TfL)

The evaluation of the salary review process at TfL includes the following key elements:

- 'wash-up' session to discuss improvements required and lessons learned
- examination of cost versus benefit of any improvements required
- development of an action plan including timescales, resource requirements, accountabilities and responsibilities
- undertaking of a cost-benefit analysis.

Equality proofing

From the point of view of both the law and good practice, employers should be confident that the pay review process has not discriminated on the basis of personal characteristics (such as race and gender), which often involves monitoring of pay awards for different groups.

In the post-review process it is recommended that practitioners review the allocation to ensure that there is no discrimination on as many factors as the HR information will allow. This should be fed back to the business managers for information and, if necessary, action.

Some employers may choose specifically to conduct an equal pay audit. This *'involves comparing the pay of protected groups who are doing equal work in your organisation, investigating the causes of any pay gaps by gender, ethnicity, disability or working pattern and planning to close any gaps that cannot be justified on grounds other than one of those characteristics'*, according to the [Equality and Human Rights Commission](#).

Additionally, many employers might wish to audit on other characteristics such as age.

Practical issues

On a practical level, practitioners should ensure that the needs of any employees on long-term leave (such as maternity leave) have been effectively accommodated by the pay review process and that any adjustments or improvements are made in time for the following year's review.

Kent County Council

The outcome is analysed in a way that looks at all the equality and diversity strands, and the council uses this to inform how the process can be better delivered in subsequent years.

Changes to the salary review process

Where major changes are planned to the salary review process, the need for evaluation and review is accentuated – and putting the findings from such exercises into practice is essential in adopting new procedures.

National Bank of Abu Dhabi

With the bank's compensation and benefits policies currently under review, the focus for change is on ensuring the following challenges are met: 'understanding the elements a good pay review process must address, transparency of the process, consultation with the business on strategy to arrive at the correct positioning of each role, ability to cost out the models and "selling" the new process to the bank as a whole'.

For the next round of the salary review process – when the bank intends to introduce the use of external benchmarking data and to combine this with internal positioning strategies – the aim is to obtain feedback from business heads on how the process helps them manage their teams by setting the right pay for each role to ensure the fulfilment of recruitment, retention and reward needs.

Conclusion

While the salary review process is of central importance for every business and its employees, its potential to drive and support business performance can only be maximised if it is treated as one important strand of the employee value proposition – clearly linked with business needs and also aligned with the full range of reward and HR processes, including performance management, culture and communications.

Annex 1: Issues affecting public sector pay reviews

In the public sector, quite distinct arrangements usually exist for the salary review process, with many employees covered by national agreements. As in the private sector, however, the process is often a time-consuming one. An illustration of timetabling is set out below covering the input of the Welsh Assembly Government to the pay-setting process for doctors and dentists.

Welsh Assembly Government

Under normal circumstances, the Pay Review Body (PRB) on Doctors' and Dentists' Remuneration takes evidence from a number of interested parties encompassing employer and union representatives, in addition to the four governments of constituent parts of the UK – including the Welsh Assembly Government. Each pay round typically begins with the issuing of guidance from the PRB in the summer, with evidence submitted during the autumn and hearings taking place during December. In around March each year the PRB submits its recommendations to government, which may accept them partly or in full or reject the recommendations. The usual effective date is April, although sometimes pay implementation dates are staggered to reduce the cost of settlements.

A more localised or delegated approach applies to pay determination in certain parts of the public sector, and hence a wider remit may sometimes be relevant in terms of information-gathering.

Kent County Council

Information sources drawn on by the council include the LGE Statistical Bulletin, data from the Office for National Statistics, Treasury reports and its internal finance function

An overarching pay freeze (as imposed above the £21,000 threshold across the public sector by central government for two years in 2010) obviously inhibits any scope for flexibility in the sector, although it may be difficult to achieve a pay freeze for certain groups in practice because of pay progression arrangements within grades. Under certain pay structures, incremental progression may be contractual.

In normal circumstances (that is, when pay levels are not frozen), there are some quite distinct issues facing reward professionals involved with the salary review process in the public sector and, under that broad umbrella, within differing organisations in the sector.

In the civil service, for example, unions have reportedly raised concerns about the way pay is governed compared with other parts of the public sector, with no separate funding for the cost of progression – meaning that there is less money to fund any basic increase, which often results in staff at the top of their pay band receiving no consolidated increase.

As is the case for their private sector counterparts, data-gathering may be a laborious process for public sector reward professionals – although the end results may mean that the efforts are deemed worthwhile.

Welsh Assembly Government

The heaviest part of the workload in respect of the Welsh Assembly Government's input to the pay-setting process for doctors and dentists is the preparation of evidence for the Pay Review Body – with this process encompassing the collation of both quantitative information and views from colleagues on key issues such as recruitment and retention trends.

The 2010 PRB report also identifies a particular issue in respect of ensuring good attendance levels on some of its local visits at meetings organised to gain input from doctors and dentists in the field. While already taking steps such as endeavouring to arrange meetings during lunch breaks, it hopes to identify ways of further improving attendance in the future.

Although the process of gathering data is a time-consuming exercise, its focus on the collection of evidence from all interested parties gives a perceived independence and fairness to the pay-setting process – perhaps helping to reduce the potential for friction over pay settlements.

In summer 2010, the Government commissioned economist Will Hutton to conduct an independent '[review of fair pay](#)' in the public sector with a brief to produce a final report in spring 2011.

Annex 2: Union-negotiated pay reviews

In organisations where unions are recognised, the pay review process often takes quite a different format from non-unionised environments.

In particular, the pay review budget is more likely to be distributed evenly across the entire pay bargaining group.

FirstGroup

There are multiple pay reviews at FirstGroup, as individual operating companies are responsible for reviews, and there may be different bargaining groups within operating companies. The organisation is heavily unionised and pay rises are generally applied on an across-the-board basis – so with, say, a 2.5% budget pot, that rise would be paid to every employee. Despite any lack of sophistication, the advantage is that the review is a fairly simple process that does not consume excessive time or reward/HR resources.

However, such systems are declining in coverage. Structural changes in the economy and employment have encompassed a decline in traditional union strongholds such as manufacturing as against an increase in higher-level occupations and smaller-scale enterprises, where unions are traditionally weaker.

Almost half of organisations no longer award employees an across-the-board annual pay rise or cost-of-living adjustment, according to our annual *Reward Management* survey.

In unionised organisations nevertheless, it is important for practitioners to be aware of union priorities, bargaining agendas and policies (for example, their preferred measure of inflation). Current issues, for instance, include the Campaign for a Living Wage and the wider fairness agenda together with the issue of whether pay restraint is preferable to redundancies.

Citizens' Advice

The majority of the time that is expended on the salary review process at Citizens' Advice is tied up with the employee relations side. In recent times, there has been a particular focus on the trade-union-supported fairness agenda. So, for example, there has been some pressure to award lump sum payments rather than across-the-board percentage increases – designed to ensure lower-paid staff benefit from proportionately higher pay awards. However, increases at the organisation follow government guidelines closely, with very little scope for flexibility.

Trade unions also tend to have a strong focus on the area of equality of opportunity across the workforce and may often press employers to conduct pay audits on areas such as gender or age.

The impact of internal union consultations and balloting needs to be clearly factored into the pay review process, for example there is a need to ensure sufficient time is scheduled for such processes. Negotiations may be facilitated by offering to cost any suggestions put forward by union negotiators as a way of encouraging dialogue and working in a partnership style.

FirstGroup

The time taken up with union negotiations has tended to increase at FirstGroup as a result of the prevailing climate (until recently) of low inflation levels. In the company's experience, it can be more difficult to reach agreement on a pay deal when inflation is low because of an inclination to focus on the absolute pay rise figure – especially when most employees are hourly paid – when the increase might equate to only a few pence an hour.

Further information on unions' interests and bargaining agendas is available from sources such as the TUC and individual unions' websites, IDS, XpertHR and OME (see *Resources* section for links).

Annex 3: The international pay review process

In light of growing globalisation, pay review procedures for many companies need to encompass employees based outside the home country.

It is important to distinguish between two such groups:

- international, whose terms and conditions are determined in the home country but are undertaking international assignments
- locally hired staff.

Where the salary review process covers employees working overseas, a number of additional challenges are typically thrown up.

One issue concerns the need to take account of international data-gathering variations and differing pay and labour market pressures in various countries, balanced with a desire to maintain consistency of approach.

Reward professionals might look at publications such as Eurostat for data on EU inflation, together with a range of international-level salary surveys that are available from private producers.

Shell

Shell operates a global HR management system to support its salary review procedures, based on the use of a company-wide performance rating methodology. The pay increase budget is distributed via pay models for each country, which are developed each year using a common format of an individual performance rating (the 'x' axis) and position in salary range (the 'y' axis), with a set salary percentage increase applying for each cell.

Shell (continued)

When reviewing pay for its overseas-based employees, Shell inevitably has to balance the need for rational uplifts in relation to base pay in the home country – set against a desire to refrain from generating too wide differentials between different nationalities working at the same job level in the same location.

The management evaluation of the salary review process at Shell is undertaken via PayNet (a global network of central and major country reward managers), while employee input to gauge the effectiveness of the process is obtained through the inclusion of specific reward questions in the company's annual global employee survey.

Following previous evaluations, Shell has reduced the amount of time taken up with the salary review process by standardising its pay tools and architecture globally – so allowing more work to be done centrally and avoiding duplication in each country. As the common architecture has been in place for some years now globally, this has reduced the time needed for communication. Global centres of expertise have been developed to support the global pay delivery processes, for example obtaining and interpreting market data to ensure pay is competitively positioned to attract and retain skillpools where talent is in high global demand.

Reward communications may involve specific issues at the global level – with challenges encountered including the need to reflect any local differences while also co-ordinating central communications.

Royal Bank of Scotland (RBS)

At RBS, the need is identified for particular care in the management of the communications of pay outcomes outside the UK, as colleagues working across differing parts of the business may be located in the same office building in a particular country – therefore it is important, albeit challenging, to ensure where possible that all overseas employees hear of the award at the same time.

Finally, it is interesting to look at an example of practice outside the UK – which reflects many aspects of practice in the salary review process among UK-based employers.

National Bank of Abu Dhabi

The annual salary review process at the National Bank of Abu Dhabi (NBAD) encompasses an annual incremental system linked to individual employee performance together with a bonus scheme, although the reward system at the bank is currently under review. At present, once performance ratings have been decided, the bank pays an increment to basic salary for all those who have performed at least to the expectation of the bank. The level of increment payable is fixed according to performance level and grade, regardless of the current pay level in relation to the market for the role occupied. For example, a grade 9 employee would receive an increase of United Arab Emirates Dirham (AED) 1,000 (worth approximately £167) for performing to the standards expected, AED 1,100 (roughly £183) if he or she has occasionally outperformed the standards expected and AED 1,250 (approximately £208) for consistently outperforming the standards expected by the bank.

In respect of international pay-setting at the NBAD, the focus is on the need to ensure the veracity of local market pay data together with the capacity of local managers to benchmark roles appropriately.

For more examples of the challenges involved in global pay-setting, our case study on engineering firm Moog (see Annex 5) includes a particular focus on these issues.

Annex 4: Executive pay reviews

The review process for executive pay (covering corporate directors and senior executives) usually operates as a distinct process that is separate from review arrangements for the remainder of the workforce, due to the bespoke nature of the arrangements. However, in setting senior executive pay, the approach for other employees should be taken into account.

The subject of executive pay has attracted huge media attention in recent years and many reports and publications are devoted to this topic.

One recent paper, by Jon Dymond and Helen Murlis (2009), stressed the importance of *'reminding ourselves of what executive reward is actually for, what the various elements of executive reward are supposed to do, and ensuring that we do a thorough, rather than a slap-dash, job of establishing the amounts executives deserve to receive'*.

While the issue of executive reward was largely beyond the scope of our current research programme, the CIPD has conducted separate research in this area.

In February and August 2010, the CIPD published [*Executive Pay: The key principles and putting them into practice*](#) as a framework to help HR directors and remuneration committees when developing executive remuneration policies, practices and structures.

Annex 5: Full case studies of the pay review process – Moog and Oxfam

Case study: Moog

Background

Headquartered in the US with its UK base at Tewkesbury, engineering firm Moog operates two main pay structures for UK employees covering, respectively, technicians and engineers/management staff. Pay rises for the former group are based on a ladder of skill acquisition while awards for the latter are linked to market rates. A single pay review process encompasses the needs of both main UK groups, while there is also a separate review for the company's 'globally mobile group' (as an international centre is based in the UK). At worldwide level, national pay negotiations take place in around 25 countries, which are co-ordinated from the UK.

Pay review process

The approach adopted to the salary review process at Moog aims to keep arrangements as clear and straightforward as possible, although the task of managing pay reviews for overseas employees brings a number of distinct challenges.

At Moog, the planned paybill budget is submitted by the reward function in April each year – nine months ahead of the January implementation date – and a pay budget figure is decided at that stage in conjunction with finance.

In setting its budget, the company draws on forecasts of inflation from both official and private consultancy sources on CPI and RPI inflation measures (see body of text for more information on inflation data) in addition to gathering data from a range of salary surveys.

According to Moog's international compensation and benefits manager, Alan Measures, the company aims to adopt 'an uncomplicated approach' to the management of the salary review process with both the technical and communications side kept deliberately low key. The company uses spreadsheets to support the administrative side of the process, while in respect of communications it mails out information to employees in addition to making use of noticeboards and stand-up presentations.

Global challenges

The international aspect of the pay review process at Moog adds a degree of complexity, however. One central issue facing the company in this respect is the need to aggregate the basic currency for each country in which it operates and report all data back in US dollars – a process that is complicated by daily changes in exchange rates. This is resolved by the setting of a specific date for which the prevailing exchange rate is assumed.

(continued)

Case study: Moog (continued)

As part of the pay-setting process for overseas employees, the HR/reward function in each country is asked to make a submission in a standard format – setting out requests for a ‘cost of living’ element together with adjustments to take account of factors such as promotion, merit increases or changing market conditions. However, these requests can become *‘a bit distorted in terms of locally what, say, a merit rise would be – a little bit gets lost in translation’*, explains Alan Measures. Moreover, some countries will tend to make bids on the high side – in the expectation that these will be reduced – while others do not, hence there is a need to make an overall judgement that takes account of these types of factors.

An analysis of salary review figures in terms of purely percentage increases can moreover distort the true picture across different countries – it is also important to consider factors such as cost per head of employment (much higher in, say, Germany as opposed to India).

The influence of local legislative and regulatory frameworks around the world also brings its own challenges. For example, at the time of the 2009 pay review – in common with many employers faced with the global economic crisis then prevailing – the central function in the US identified a need for a pay freeze worldwide. However, it proved impossible to implement that resolution in some countries, where by law a pay rise must be awarded (such as Luxembourg and the Netherlands). As Alan Measures points out, this means that *‘there are occasions when a one-size-fits-all process doesn’t really work at global level.’*

Conclusions

When reviewing the effectiveness of the process, the main issue at central level is control of actual spend – both headline figures and the difference between mandatory and discretionary costs. However, there is also a need to keep a close eye on paybill growth beyond the immediate pay review process. As Measures points out: *‘The irony is that you can “screw down” the annual pay review – but still have problems with the pay budget because of the need to push through all the exceptions and complications caused by joiners and leavers.’*

The process could, it is thought, be enhanced by better access to good data, particularly at international level – as the company currently has to use multiple data sources across different countries since, for example, different pay consultancies have relatively strong or weak coverage in different parts of the world. Overall, however, the salary review process is deemed to work simply, efficiently and effectively at Moog – reflected (along with other factors) in high levels of job satisfaction and generally very low staff turnover rates.

Case study: Oxfam

Background

Oxfam GB, the Oxford-based charity that works and campaigns against poverty globally, is part of Oxfam International. Reward strategy is based on three central factors: recruitment and retention requirements, staff needs in terms of cost-of-living increases and the organisation's ability to pay. A broadbanded pay structure is in place and annual pay increases may vary by grade. This system is underpinned by performance criteria, meaning that any underperforming employees would receive only a minimal or no increase. Market supplements may also be paid where appropriate.

Pay review process

At Oxfam GB, the pay review process takes the form of a clearly timetabled and methodical programme of work that aims to closely align pay with both business needs and organisational values, such as equity and fairness to employees. This means that the exercise is a detailed and time-consuming one: the start of each annual salary review process overlaps the end of the previous round, running for around 13 months from start to finish.

Early and effective liaison between the reward function and the business is central to the effectiveness of the process, explains the organisation's head of reward, Frances Richardson. As part of the process, the reward function must go to the board with a range of pay review options, including the setting out of its favoured option for implementation if deemed affordable. However, the function liaises with Oxfam's finance director well in advance about the financial situation and takes that into account in the range of options that are ultimately put forward.

Each August – as the very first stage of the process and a full year ahead of the implementation date – finance and HR directors agree financial strategic plan assumptions about the following year's pay review.

This is followed by undertaking detailed research into internal and external data, union consultations, modelling, collation of information from performance reviews, communications and balloting union members, culminating in an August implementation and review of the process with final adjustments.

Collating data

To ensure Oxfam's recruitment and retention needs are met, a wide range of internal and external research is undertaken. Internally, the organisation looks at figures on staff turnover and information from across its divisions to assess whether and where any difficulties are being encountered in recruiting and retaining staff.

Meanwhile, external research on pay data includes participation in a voluntary sector and other specialist salary surveys. The organisation's general principle is to pay a little higher than the charity market median while, in respect of less sector-specific functions, the aim is to pay no more than 90% of prevailing commercial rates – and a lower proportion than this for more senior posts.

Oxfam also uses information from sources providing data on external wages levels to help assess the competitiveness of its pay levels. Additionally – as an international NGO (non-governmental organisation) – some jobs involve recruitment from a global labour market, so the organisation draws on an international survey for relevant data.

A certain amount of supplementary bespoke research is conducted, including phoning around major local employers of similar types of administrative staff – or employment agencies for more junior staff – although the organisation tries to minimise this type of undertaking.

(continued)

Case study: Oxfam (continued)

Turning to economic influences, Oxfam's overall aim – if affordable – is to increase pay levels broadly in line with movements in UK average earnings levels. In light of the recent volatility in inflation levels and difficulties in forecasting, it was agreed with OJTUS (the organisation's joint trade union body) that a 'trigger date' would be set several months before pay implementation dates – with the level of inflation prevailing in March each year now taken into account in setting pay levels.

There is also a desire in principle to take account of fairness and equity issues, hence the organisation aims to reflect the values of the Campaign for a Living Wage (see Annex 2) and routinely examines the gender impact of the review process. Spreadsheets are utilised for pay modelling because the organisation finds this technique to be effective in testing different parameters to assess potential overall costs of the pay review process.

Challenges

Employee relations is the most time-consuming aspect of the pay review process, according to Frances Richardson – including time spent looking into issues raised by line management as well as with unions discussing their areas of concern.

The market research, meanwhile, is deemed the most difficult part of the process, partly because of the need to use so many different data sources. In respect of salary surveys – in addition to the time and effort taken pulling out and interpreting data – the inputting of the organisation's own data is also very demanding, while variability from year to year can be a problem.

Overall, the time devoted to the pay review process has tended to increase for Oxfam in recent years because increased professionalism characterising the charity sector has necessitated more detailed market research for specialist groups of staff. Conversely, however, the employee relations/management aspect has become more streamlined through a partnership approach to pay negotiations, with a clearly defined and timetabled salary review process that also ensures issues are raised and discussed with board members and the union informally at an early stage, prior to the presentation of final proposals.

There have moreover been attempts to simplify the data management process, including a move to undertake two-yearly (rather than annual) pay and labour market research exercises – albeit this brings its own difficulties, especially in such economically uncertain circumstances.

In respect of how the process could be improved further, Frances Richardson identifies a need for better market data and in particular enhanced local labour market coverage.

Conclusions

Oxfam's evaluation of its process indicates that it is effective overall – given that a high proportion of union members tend to vote in favour of the deal and in light of positive feedback from the section of the joint Oxfam–union staff survey looking at reward satisfaction levels, together with the findings from staff turnover and recruitment and retention data. Moreover, the process is deemed to add value for the organisation – encompassing a vision that there should be an ideal pay level for every member of staff while Oxfam should be able to recruit and retain the employees it needs as cost-effectively as possible.

Annex 6: Using salary surveys: checklist

Several issues need to be considered when choosing and using salary surveys. The following checklist sets out the sort of questions that employers need to bear in mind:

- **Who are the publishers of the survey? How, when and why do they produce their figures?**

For example, there is a need to consider whether the sample size is large enough to be reliable and whether the participating organisations are stable over time, whether the figures are up to date and whether the analysis is objective.

- **Which employers are your competitors in the labour market? Are they represented in the surveys under consideration? How can you make sure that you are matching like with like in terms of company – for example, should you benchmark solely against your own sector?**

While survey responses are usually anonymised, many include a list of participants. It is also worth noting on this point that there are frequently differences between firms that are competitors for business and those that are competitors for staff.

- **Is the regional, national or occupational labour market most important to the salary-setting process in your organisation?**

For high-level IT staff or accounting staff, for example, the occupational labour market may be more important, whereas for unskilled jobs in cleaning or catering, a very local area survey may be more relevant.

- **Should the job-matching process make use of sampling or rank all jobs in the organisation? How do you ensure that you are comparing like with like in terms of job size?**

The use of sampling may reduce accuracy while the process of all-job ranking inevitably involves a heavier workload. There will moreover be instances of roles that are unique to a particular organisation, rendering them incapable of direct matching. In such cases market pricing would often take place based on the perceived internal worth of the role using the nearest equivalent job that can be surveyed as a reference point.

- **What elements of earnings are covered by the figures?**

Salary surveys may, for example, set out details of basic salary only or encompass other aspects of direct compensation such as regional allowances, cash bonuses and long-term incentive plans – as well as possibly encompassing the wider benefits package. While these types of data may be useful for purposes other than the salary review, it is important to be sure that like is being compared with like.

- **How many surveys are needed?**

It may be that one survey is sufficient to cover the whole organisation or several may be needed for differing occupational groups or for specific analysis of particular aspects of the reward package.

- **What is the cost of the survey(s)?**

Many are expensive, though discounts may be available for participating organisations. Some survey results are available only to participants. The CIPD Library has a range of salary surveys for use by members – see *Resources* section below.

One senior reward practitioner highlighted the following specific points on the use of salary surveys:

- Market pay rates need to look backwards and forwards. Companies may inflate pay rate data to bring it up to date (not good practice, but common practice). It is also helpful to get a view on prospective salary budgets from key comparator groups.
- It can be possible to provide cuts of data from surveys that provide more focused information, provided it retains the anonymity of participants.
- It is very important to check the data definitions in surveys, so that you are comparing 'apples with apples'.
- Salary surveys – generally the more bespoke, the more expensive!

Annex 7: Resources

Publications

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Websites

CIPD reward factsheets at www.cipd.co.uk/factsheets

Information on unions and pay bargaining campaigns can be found on the TUC’s website: www.tuc.org.uk

More information on the Living Wage Campaign: www.citizensuk.org.uk

Pay bargaining and pay trends information: www.incomesdata.co.uk
www.xperthr.co.uk

Details of public sector pay review bodies: www.ome.uk.com

UK Statistics Authority: www.statistics.gov.uk

Information on conducting an equal pay review can be found at: www.equalityhumanrights.com

Annex 8: Handling the pay review process – key personal attributes

Several key characteristics emerged from our interviews in respect of the attributes required to effectively manage the pay review process with regards to knowledge, skills and competences. Level 3 examples of these are highlighted in the table below.

More details on the CIPD HR Profession Map can be found at www.cipd.co.uk/hr-profession-map

Table 2: The salary review process and CIPD HR Profession Map competencies

Factor	Example of criteria at Level 3	Application to management of salary review process
Knowledge: what you need to know	'Understands the financial drivers of the organisation, the balance sheet and the impact of reward costs.'	As the employer's ability to pay is the most important factor influencing the size of the pay review, financial knowledge is imperative to understanding what can be achieved by the annual review process.
Skills: what you need to do	'Uses market knowledge and insights to advise on changes to the remuneration plan to maintain or increase attraction or retention of employees.'	Effective deployment of the data gathered at the pay planning stage can directly assist in ensuring the right employees are in place to meet business needs.
Competence: How you need to do it	'Creates and drives delivery of clear plans for projects which span the organisation, liaising with key stakeholders.'	Senior reward professionals need to be capable project managers in handling the salary review process, including effective liaison with stakeholders across the organisation such as line managers and finance.

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