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• Employee Reward Systems

CHAPTER OBJECTIVES

On completing this chapter the reader will understand:

- the concept of the reward system
- the elements of the reward system: base pay, variable pay, employee benefits and non-financial rewards
- the concepts of reward philosophy, strategy and policy
- the need for integration and to treat employees as stakeholders
- the aims of employee reward from the point of view of the organisation and its employees
- the conventional view of reward management
- what organisations are paying for
- current trends in reward practice.

Employee reward is about how people are rewarded in accordance with their value to an organisation. It is concerned with both financial and non-financial rewards and embraces the philosophies, strategies, policies, plans and processes used by organisations to develop and maintain reward systems.

The term 'compensation' is often used as an alternative to 'pay' or 'remuneration', especially in the USA, although it is becoming more common in the UK. The problem with 'compensation' is that it implies that employee reward is only about making amends for the distasteful fact that people have to work for a living. It is in accordance with Robert Elliott's (1991) proposition that: 'For most people work is, in the main, a source of disutility, and they therefore require payment to compensate them for the time they devote to it.' This may well be true in many cases but it provides an unsatisfactory basis for a pay philosophy which can and should adopt the stance that people ought to be valued according to their contribution and competence – which is what this book is about – not just compensated because they have to come to work.

On the basis of this understanding, the reader will be able to take an overall view of a reward system and provide advice on reward strategies, policies and practices.

The employee reward system

The concept of a reward system

An employee reward system consists of an organisation's integrated policies, processes and practices for rewarding its employees in accordance with their contribution, skill and competence and their market worth. It is developed within the framework of the organisation's reward philosophy, strategies and policies, and contains arrangements in the form of processes, practices, structures and procedures which will provide and maintain appropriate types and levels of pay, benefits and other forms of reward.

The components of a reward system

A reward system consists of financial rewards (fixed and variable pay) and employee benefits, which together comprise total remuneration. The system also incorporates non-financial rewards (recognition, praise, achievement, responsibility and personal growth) and, in many cases, performance management processes. The combination of financial rewards, employee benefits and non-financial compensation comprises the total reward system.

The main components of the system are:

- *processes* for measuring the value of jobs, the contribution of individuals in those jobs, and the range and level of employee benefits to be provided; these processes consist of job evaluation, market rate analyses and performance management
- *practices* for motivating people by the use of financial and non-financial rewards; the financial rewards consist of base and variable pay and employee benefits and allowances, and non-financial rewards are provided generally through effective management and leadership, the work itself, and the opportunities given to employees to develop their skills and careers
- *structures* for relating pay and benefit levels to the value of positions in the organisation and for providing scope for rewarding people according to their performance, competence, skill and/or experience
- *schemes* for providing financial rewards and incentives to people according to individual, group or organisational performance
- *procedures* for maintaining the system and for ensuring that it operates efficiently and flexibly and provides value for money.

Some people object to the use of the term 'reward system' because it seems to refer to a set of mechanisms that can be applied rigidly by employers to guarantee the results they require. Of course this is not the case, and one of the recurring themes of this book is the need for

flexibility and a contingency approach to the management of reward – ie an approach that fits the particular needs of the organisation in relation to its business strategies and internal and external environment. Employee reward is chiefly about process – ways of getting things done – rather than about rigid structures and sets of procedures.

However, a 'system' is defined by the *Oxford English Dictionary* as 'a set or assemblage of things connected, associated or interdependent, so as to form a complex whole'. And that is certainly what reward is about. It deals with a number of associated, interdependent and complex areas which have to be developed and managed as a coherent whole. It can also be said that the way people use the reward system is the system.

The elements of employee reward

Base pay

Base (or basic) pay is the level of pay (the fixed salary or wage) that constitutes the rate for the job. It may provide the platform for determining additional payments related to performance, competence or skill. It may also govern pension entitlement and life insurance. The basic levels of pay for jobs reflect both internal and external relativities. The internal relativities may be measured by some form of job evaluation which places jobs in a hierarchy (although the trend now is to play down the notion of hierarchy in the new process-based organisations). External relativities are assessed by tracking market rates. Alternatively, levels of pay may be agreed through negotiation: by collective bargaining with trade unions or by reaching individual agreements. The base rate for a job is sometimes regarded as the rate for a competent or skilled person in that job. Such a rate may be varied in a skill-based or competence-based system according to the individual's skill or competence.

Levels of pay may be based on long-standing structures the origins of which are shrouded in the mists of time and which have been updated in response to movements in market rates and inflation, and through negotiations. In many organisations pay levels evolve – they are not planned or maintained systematically. Rates are fixed by managerial judgement of what is required to recruit and retain people. They may be adjusted in response to individual or collective pressure for increases or upgradings. This evolutionary and *ad hoc* process can result in a chaotic and illogical pay structure which is inequitable, leads to inconsistent and unfair decisions and is difficult to understand, expensive to maintain and the cause of dissatisfaction and demotivation.

Base pay may be expressed as an annual, weekly or hourly rate. This can be termed a time-rate or time-based payment system. Such systems are simple but they can be made more complex by the addition of various kinds of allowances such as overtime or shift payments. Time rates may

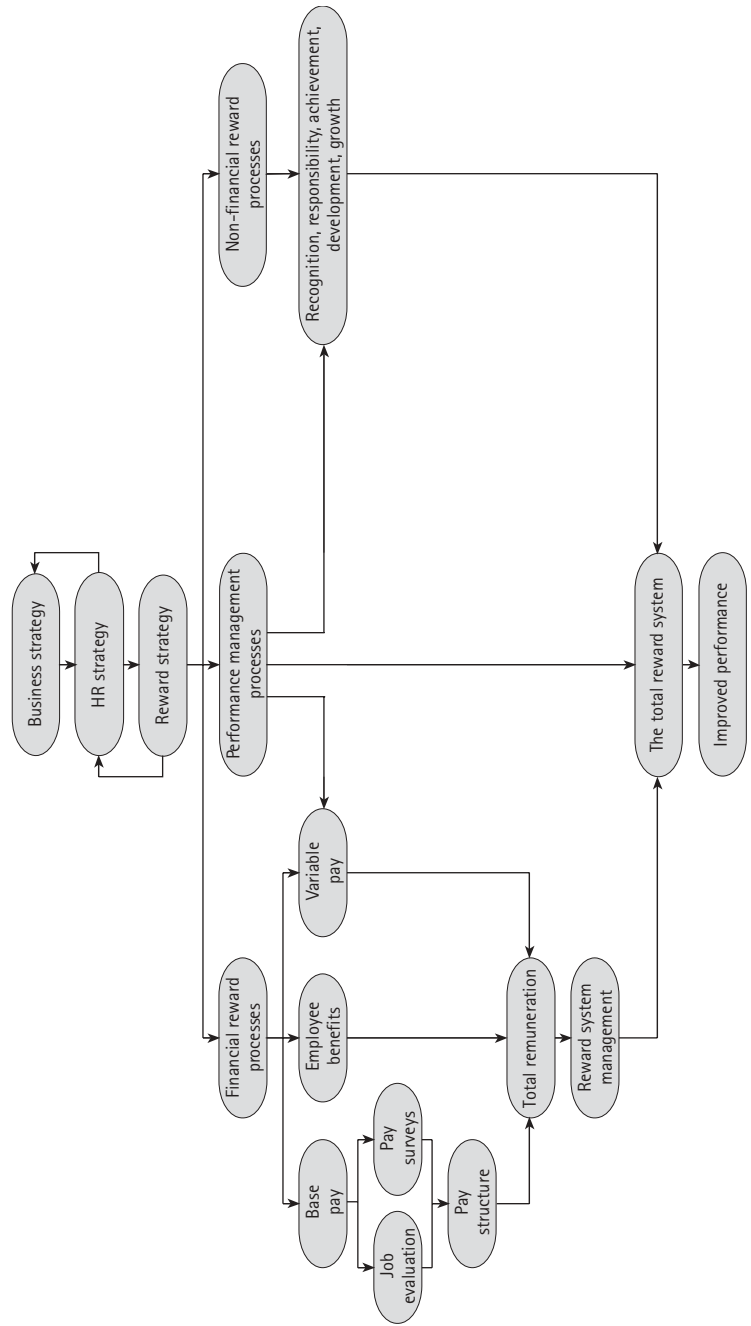
be 'spot rates' – ie comprising one rate for the job – or there may be a range of pay for each job grade in which progression takes place according to time in the job, performance, competence and/or skill. The rate may be adjusted to reflect increases in the cost of living or market rates by the organisation unilaterally or by agreement with a trade union. Service-related, performance, skill-based or competence-related pay increases may be added to, or 'consolidated' into, the basic rate, and these form the basis for pension contributions, sick pay, payment for overtime, and bonuses or profit shares when these are awarded as a percentage of base pay.

Contingent pay

Additional financial rewards may be provided that are related to performance, competence, contribution, skill and/or experience. These are referred to as 'contingent pay'. If such payments are not consolidated into base pay, they can be described as 'variable pay'. Variable pay is sometimes defined as 'pay at risk'. For example, the pay of sales representatives on a 'commission-only' basis is entirely at risk. The main types of contingent pay are:

- individual performance-related pay – in which increases in base pay or cash bonuses are determined by performance assessment and ratings (also known as merit pay)
- bonuses – rewards for successful performance which are paid as cash (lump) sums related to the results obtained by individuals, teams or the organisation
- incentives – payments linked with the achievement of previously-set targets which are designed to motivate people to achieve higher levels of performance; the targets are usually quantified in such terms as output or sales
- commission – a special form of incentive in which sales representatives are paid on the basis of a percentage of the sales value they generate
- service-related pay – which increases by fixed increments on a scale or pay spine depending on service in the job; there may sometimes be scope for varying the rate of progress up the scale according to performance
- competence-related pay – which varies according to the level of competence achieved by the individual
- contribution-related pay – which relates pay to both outputs (performance) and inputs (competence)
- skill-based pay (sometimes called knowledge-based pay) – which varies according to the level of skill the individual achieves
- career development pay – which rewards people for taking on

Figure 1 The reward system



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additional responsibilities as their career develops laterally within a broad grade (a broadbanded pay structure).

Allowances

Allowances are elements of pay in the form of a separate sum of money for such aspects of employment as overtime, shift working, call-outs and living in London or other large cities. London or large-city allowances are sometimes consolidated: organisations which are simplifying their pay structure may 'buy out' the allowance and increase base pay accordingly.

Total earnings

Total earnings are usually calculated as the sum of base pay and any additional payments.

Employee benefits

Employee benefits, also known as indirect pay, include pensions, sick pay, insurance cover and company cars. They comprise elements of remuneration additional to the various forms of cash pay and also include provisions for employees that are not strictly remuneration, such as annual holidays.

Total remuneration

Total remuneration is the value of all cash payments (total earnings) and benefits received by employees.

Non-financial rewards

Non-financial rewards include any rewards which focus on the need people perceive to varying degrees for achievement, recognition, responsibility, influence and personal growth.

The elements of a reward system and their interrelationships are illustrated in Figure 1. But they can be combined in many different ways – there is no ideal pattern for a reward system.

Total rewards

Definition of the concept of total rewards

The concept of total rewards has been defined by WorldatWork (2000) as:



all of the employer's available tools that may be used to attract, retain, motivate and satisfy employees. This encompasses every single investment that an organisation makes in its people, and everything its employees value in the employment relationship.

Vicky Wright, CIPD vice-president, reward, and Ernst & Young partner, speaking at the CIPD National Conference 2001, defined total reward as:

an approach to providing a 'package' of reward to employees in ways that optimise employee satisfaction with reward from their work, and which does this in such a fashion that the employees' contribution to the employer is optimised at an acceptable cost.

Objectives of total rewards programmes

The main objective is to 'drive desired behaviours in your workforce' (WorldatWork, 2000). Total rewards programmes integrate the various ways in which people can be rewarded for their contribution, covering both financial and non-financial rewards. The approach is holistic – reliance is not placed on one or two reward mechanisms operating in isolation. The conceptual basis of total rewards is that of configuration or 'bundling', so that different reward processes are inter-related, complementary and mutually reinforcing. Total reward strategies are vertically integrated with business strategies, but they are also horizontally integrated with other HR strategies to achieve internal consistency.

For Sandra O'Neal (1998), a total reward strategy is critical to addressing the issues created by recruitment and retention:

It can help create a work experience that meets the needs of employees and encourages them to contribute extra effort, by developing a deal that addresses a broad range of issues and by spending reward dollars where they will be most effective in addressing workers' shifting values.

Components of total rewards

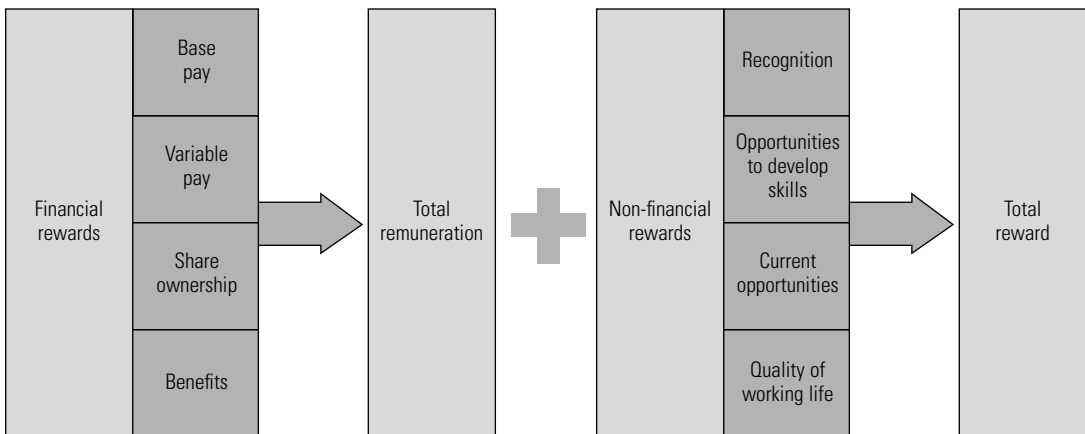
The components of total rewards are illustrated in Figure 2.

A slightly different presentation is offered by WordatWork (2000). They distinguish between:

- *compensation* – the 'foundational' rewards that are primarily financial in nature and satisfy financial needs for income
- *benefits* – which satisfy protection needs and are unlikely to be performance-based
- *the work experience* – which meets the relational needs that bind workers to the organisation more strongly because they satisfy an individual's needs such as personal development and fulfilment.

In each case, the approach to total rewards adopted by organisations is influenced by their internal and external environment.

Figure 2 Components of total rewards



Source: Michael Armstrong and Duncan Brown, *New Dimensions in Pay Management*, CIPD, 2001

As WorldatWork points out, it is the work-related components of total rewards that are the least developed. In most organisations ‘They are often a hodgepodge of programmes cobbled together over time’ (Towers Perrin, 1999).

As set out by WorldatWork (2000), the benefits of a total rewards approach are:

- increased flexibility – rewards can be tailored to particular challenges and circumstances
- recruitment and retention – employees can be presented with the ‘total value’ of the employment package
- reduced costs – many aspects of work experience represent low-cost solutions although cost savings should not be the main aim of total rewards
- heightened visibility in a tight labour market – offering what employees value helps organisations to attract critical talent
- enhanced profitability – direct links can be forged between employee motivation and product/service quality.

Reward philosophy, strategy and policy defined

Reward processes and practices are most effective when they are based on thought-through and appropriate reward philosophies, strategies and policies. These terms are often used imprecisely, even interchangeably. But it is possible, and useful, to distinguish between them:

- *Reward philosophy* represents the broad values and beliefs that an organisation holds about rewards. It specifies the assumptions

which underpin the reward system and determine its form. It shapes the way strategies and policies are developed and implemented in the form of practices and procedures, and may be expressed as a set of 'guiding principles'. Reward philosophy is examined in Chapter 6.

- *Reward strategy* directs pay programmes to what the organisation wants to achieve. It is a declaration of intent as to how the organisation is going to put its reward philosophy into practice. It provides a broad perspective on how critical reward issues will be addressed. Reward strategy is addressed in Chapter 7.
- *Reward policy* indicates how reward processes should be designed and managed within the context of the reward philosophy. It provides guidelines for line managers and personnel or pay specialists on how particular and recurring reward issues should be dealt with. It enables consistent decisions to be made where appropriate while recognising the need for flexibility and the perils of rigidity. Reward policy is discussed in Chapter 8.

The components of the reward system described earlier in this chapter must be considered as a whole – hence the importance of the concept of total reward. This is what employees get, and organisations need to communicate to them the totality of their rewards.

But it is also important to have a coherent philosophy and to achieve the integration of corporate, personnel and reward strategies. This can take the form of vertical integration in which steps are taken to ensure that there is a good fit between business strategy and personnel and reward strategies. The latter flow from the former, but reward strategies can and should support the attainment of organisational and personnel and development strategies.

The integration of reward and other HR and development processes is equally important. This is sometimes called 'bundling' – the processes of bringing all HR policies and processes together so that they form a coherent and mutually reinforcing whole.

Reward can directly affect:

- resourcing through competitive pay
- employee development through competence-related and skill-based pay that encourage the development of competence and skill (enlarging the skill base) and performance management processes that further continuous development through such means as personal development planning
- career development and planning by establishing a framework for lateral career progress in a broadbanded pay structure or mapping out a career ladder in a job family structure

- employee relations by helping to generate a reward culture based on mutual trust, involvement, transparency and fair dealing
- organisational effectiveness by providing the means to motivate superior performance, to align individual and organisational objectives and to gain commitment.

To facilitate integration it is important to treat reward as part of the total approach to managing and developing people. It should not be regarded as a separate entity. Reward management cannot take place in isolation from people development and other business and HR management processes. Frequently, new reward structures and systems are developed to fit or support a new organisational structure or following a business process re-engineering exercise. A business case must be made for changing any part of a reward system.

Employees as stakeholders

Another recurring theme in this book is the need to treat employees as stakeholders – people who have a legitimate claim to share in the prosperity of the organisation and to be involved in decisions affecting their pay and other terms and conditions of service. This implies the generation of a climate of mutual trust.

The (former) Institute of Personnel and Development's (IPD) statement *People Make the Difference* (1994) made the point that much has been done in recent years to introduce a sense of reality into employee relations. But, according to the IPD:



Managers should not kid themselves that acquiescence is the same thing as enthusiastic involvement. The pace of life and changing work patterns in the future will put a strain on the best of relationships between employees and managers.

The IPD suggested that building trust was the only basis on which commitment might be generated and the tensions contained. For these reasons, attaining or sustaining world-class levels of performance will be increasingly unlikely in organisations that do not treat their employees in ways which are consistent with their status as the key business resource. This means that:

- Employees cannot be treated just as a factor of production.
- Organisations must translate their values into specific and practical action. In too many organisations inconsistency between what is said and what is done undermines trust, generates employee cynicism and provides evidence of contradictions in management thinking.

The formulation of reward strategies and policies must take account of

the need for trust and the need for integration. Like the process of developing the reward system, this should take place within the conceptual framework described in this Part.

The aims of employee reward

The organisation's requirements

A reward system expresses what an organisation values and is prepared to pay for. It is governed by the need to reward the right things in order to convey the right message about what is important in terms of expected behaviours and outcomes. The basic philosophy is that people should be rewarded for the value they create.

As O'Neal (1994) points out: 'Pay is a function of the work system it supports . . . Pay systems will need to support the development of intellectual capital, universal use of information technology, strategic alliances, continuous learning, and employee populations that come and go.'

Overall aim

The overall aim of employee reward is to support the attainment of the organisation's strategic and shorter-term objectives by helping to ensure that it has the skilled, competent, committed and well-motivated workforce it needs. This means providing for the continuing improvement of individual, team and therefore organisational performance, and taking steps that contribute to the creation of added value and the achievement of competitive advantage.

As Lawler (1990) has noted:



The challenge is to develop pay programmes that support and reinforce the business objectives of the organisation and the kind of culture, climate and behaviour that are needed for the organisation to be effective.

He also made the important point that 'Pay practices are only as good as the impact they have on organisational effectiveness.'

It has been emphasised by Schuster and Zingheim (1992) that 'People are the principal variable in organisational success.' Pay programmes should aim to accomplish the following organisational objectives:

- to make excellent performance financially worthwhile
- to communicate to satisfactory performers the importance of acceptable and better performance
- to communicate to less-than-satisfactory performers the need to improve.

Management and reward

An organisation's performance depends ultimately on the quality of its management and employees, and the reward system can help to improve that quality. But the improvement of organisational effectiveness cannot be left to the reward system alone: the culture, values and management style of the organisation, together with its performance management and employee development programmes, are equally important. Reward systems, however well conceived and effective, are no substitute for good management.

Reward aims from the organisation's point of view

From the organisation's point of view, the specific aims of employee reward are to:

- help to attract, retain and motivate high-quality people
- play a significant part in the communication of the organisation's values, performance, standards and expectations
- encourage behaviour that will contribute to the achievement of the organisation's objectives and reflect the 'balanced score-card' of the key performance-drivers of customers, finance, processes and people – two of the basic questions to be answered when developing reward systems are 'What sort of behaviour do we want?' and 'How can reward processes promote that behaviour?'
- underpin organisational change programmes concerned with culture, process and structure
- support the realisation of the key values of the organisation in such areas as quality, customer care, teamwork, innovation, flexibility and speed of response
- provide value for money: no reward initiative should be undertaken unless it has been established that it will add value, and no reward practice should be retained if it does not result in added value.

Reward aims from the employees' point of view

From the employees' point of view the reward system should:

- treat them as stakeholders who have the right to be involved in the development of the reward policies that affect them
- meet their expectations that they will be treated equitably, fairly, and consistently
- be transparent – they should know what the reward policies of the organisation are and how they are affected by them.

It is sometimes said that to achieve these aims an organisation's pay practices should be 'internally equitable and externally competitive'. This

is all right as far as it goes, but it is not always easy to attain and it represents a somewhat limited point of view. The first problem is that the goals of internal equity and external competitiveness are often hard to reconcile. The pressure of market forces may overcome internal equity considerations when people with scarce talents have to be recruited. On the other hand, a crude wish to be competitive may be inappropriate. As Schuster and Zingheim (1992) point out: 'The strategic view of competitive practices suggests that achieving competitive pay should be contingent upon providing a level of work quality, productivity, or performance which must justify pay levels that reflect expected reasonable goal performance.' Competitive pay should be linked with competitive performance.

Achieving the aims

The employee reward system will achieve its aims if:

- it adopts a strategic approach that is aligned to the business and HR strategies and is congruent with the culture of the organisation
- reward policies and processes are modified in accordance with the changing needs of the business
- employees are valued according to their contribution, skill and competence
- the reward system is transparent and employees are treated as stakeholders who are entitled to make representations on any area of reward that affects their interests and who will be involved in the development of reward processes
- employee relations strategies are designed to build mutual trust and to develop a partnership approach which provides for increases in prosperity to be shared with all employees (not just the favoured few at the top)
- reward policies emphasise the need for equity, fairness and consistency while recognising that the ideal of internal equity may not be sustainable in full because of market pressures
- maximum freedom is devolved to line managers to manage the reward system within their budgets and in accordance with broad policy guidelines
- there is a constant thrust to maximise the performance leverage of any money spent on pay
- reward initiatives are taken only when a business need has been identified, when their interaction with other business and HR policies has been assessed, and when an integrated approach has been adopted to the development of mutually supportive processes.

List the main factors that are likely to affect employees' satisfaction with the reward system of their organisation and describe what can be done to increase their satisfaction in these areas.

Traditional approaches to managing pay

The traditional approach to managing pay in the 1960s and 1970s embraced all the processes described above concerned with financial rewards. But in line with typical personnel management practices of the time it did not recognise the strategic elements and failed to integrate pay with other personnel processes. It also ignored the total approach to reward management which has emerged in the 1990s and which emphasises the significance of performance management rather than conventional appraisal schemes and the need to pay as much attention to non-financial as to financial rewards.

Salary administration, as it used to be called, placed pay in a subordinate role. Salary administrators, if they existed at all, policed the system, ensuring that everyone adhered to rigidly defined procedures for grading jobs and progressing pay. Line managers did what they were told. As their title indicates, salary administrators were concerned only with white-collar staff. The pay of manual workers was left to industrial relations officers, work study engineers and rate-fixers.

However, as Schuster and Zingheim (1992) remark, 'traditional pay practice was not unplanned or poorly directed'. It emphasised the need to 'attract, motivate and retain' employees but the focus was on 'competitive attributes rather than on the more important strategic or tactical issues'.

Traditional pay practices understandably reflected how organisations were structured and managed. They tended to be bureaucratic and geared to extended hierarchies and vertical communication systems – the organisational 'chimneys' largely separate from other organisational chimneys. Progress up the hierarchy was largely by regrading and, frequently, by means of fixed increments within grades or a pay spine. (These still persist in public or ex-public organisations and in the voluntary sector.)

Job evaluation concentrated on measuring job size, so that jobs could be slotted into an appropriate grade in the hierarchy and job-holders could be upgraded if they were promoted to a job with a higher points rating. Job evaluation schemes were often complex, rigid, administratively cumbersome and paper-intensive. The emphasis was on managing internal relativities and on jobs that were defined by means of elaborate and lengthy job descriptions. The focus was on jobs rather than on

people. The need for pay to be competitive was, of course, recognised, but market-rate pressures were regarded as unwelcome intrusions, and if the organisation had to bow to such pressures, jobs were 'red-circled' to indicate that they were exceptions to the rule.

Employee benefits – 'fringe benefits', as they were known – tended to proliferate, often so as to avoid income tax. Little attempt was made to get value for money, and the system was administered rigidly. Everyone got what management felt they ought to get. There was no choice.

During the 1980s some elements of this traditional approach were changing in many organisations. Incremental pay structures were largely abandoned in the private sector and performance-related pay (PRP) suddenly became popular. The government of the day discovered PRP like religion and sought to impose it on the public sector in the naive belief that it invariably improves performance and transforms everyone into entrepreneurs overnight. The entrepreneurial 1980s were, of course, the decade of greed, when the ultimate answer to motivation, transformation and success was money through PRP, share options, and so on. It was a decade characterised by Gordon Gekko, in the film *Wall Street*, whose creed was that 'greed was good'. It harked back to Jonas Chuzzlewit, whose education, as described by Dickens (1844), 'had been conducted from the cradle on the strictest principles of the main chance. The very first word he learned to spell was "gain" and the second (when he got into two syllables), "money".'

There were also movements towards more flexibility in managing pay and benefits, and some organisations began relating shop-floor pay to skill levels. Traditional job evaluation schemes were attacked by Lawler (1990) and others as unsuited to the new flexible and de-layered organisations and inappropriate for the knowledge workers increasingly employed in high-technology industries.

The advent of reward management

Traditional approaches to pay therefore began to change in the late 1980s, a change that was signalled by the emergence of the term 'reward management'. Armstrong and Murlis (1988) pointed out that:



The essentially static techniques of 'salary administration' have developed into the dynamic approach of 'reward management'. The emphasis is first on performance, recognising that the motivation to improve and the rewards for achievement must extend not only to the high-flyers but to the staff at all levels who help to achieve the success of the organization. Secondly, the emphasis is on flexibility. Reward management processes need no longer be confined to the straitjackets of rigid salary structures and elaborate job evaluation schemes.

The concept of reward management was influenced by writers such as Rosabeth Moss Kanter (1987), who commented:

Status, not contribution, has traditionally been the basis for numbers on employees' pay-checks. Pay has reflected where jobs ranked in the corporate hierarchy – not what comes out of them.

Some commentators have assumed that the reward management concept is solely about performance-related pay. But that is a gross oversimplification. As Armstrong and Murlis (1998) point out, 'Reward management is not just about money. It is also concerned with those non-financial rewards which provide intrinsic or extrinsic motivation.' They concede that 'the impact of PRP as a direct motivator may be arguable' and recognise that:

PRP need not be regarded as the only motivator. Attention should also be given to the non-financial approaches to motivation and recognition. An integrated approach to performance management can motivate all types of employees (not just the high-flyers) by providing the basis for a mix of financial and non-financial rewards.

They emphasise that 'It is neither possible nor desirable to be prescriptive [about reward management] in the sense of providing easy and superficial answers to subtle and far-reaching problems of motivation and reward.'

The reward management movement was the first challenge to the universalist prescriptions of salary administration. In the post-entrepreneurial 1990s there were further developments in the direction of rewarding for skill and competence, de-emphasising the role of money as a motivator, emphasising the significance of continuous development and of the support reward management can give to that process, and recognising the importance of employee involvement, partnership, mutuality, trust and transparency. In the early 1990s many of these beliefs were encapsulated in the concept of the 'new pay' which emerged as a force to be reckoned with.

The new pay

Lawler (1990) originated the phrase 'new pay' to reflect the need for an understanding of the organisation's goals, values and culture, and of the challenges of a more competitive global economy when formulating reward policies. He made a significant initial contribution to the new pay concept, especially through his advocacy of people-based as distinct from job-based pay – paying people according to their value in the market and in relation to their knowledge and skills. Lawler saw new pay as helping to achieve the individual and organisational behaviour that a

company needs if its business goals are to be met. Pay systems must flow from the overall strategy, and they can help to emphasise important objectives such as customer retention, customer satisfaction and product or service quality. Lawler's concept of the new pay was further developed by Schuster and Zingheim (1992). They described the fundamental principles of new pay as that:

- Employees are the primary reason the organisation is able to remain competitive and to compete effectively. New pay is consistent with the organisation's becoming world-class by forming a partnership with its employees.
- Management means leadership rather than hierarchy and bureaucracy.
- Employee communications are crucial to success. Pay is one key element of communication that can be managed so as to convey the right message about the organisation's values, performance expectations and standards.
- Total compensation programmes should be designed to reward results and behaviour consistent with the key goals of the organisation.
- Pay is above all an employee relations issue: 'Employees have the right to determine whether the values, culture and reward systems of the organization match their own.'
- Total compensation should be regarded as an element of the organisation's total management processes. Pay can be a positive force for organisational change.
- Base, variable and indirect pay are elements of a total compensation strategy, not separate and independent.
- New pay starts with the external labour market and does not try to create internal equity across the organisation. Rather, it establishes internal equity within broad job functions and pays the market rate for those functions. (Note, however, that in the USA there is no generally applied 'comparable worth' legislation equivalent to the 'equal pay for work of equal value' requirement in the UK.)
- The major thrust of new pay is in introducing variable pay to employee groups where most organisations pay only base pay. (Variable pay is defined strictly as pay which does not become a permanent part of base pay.)
- The emphasis is on team as well as individual rewards, and on partnership, such that the employee shares financially in the organisation's success.
- The advantages of variable pay are perceived as its ability 'to form

partnerships between employees and the organisation, to vary pay costs with performance, to create the need for high levels of teamwork and collaboration, and to support quality and customer value goals’.

- Organisations should determine the total compensation mix and level of benefit costs they can sustain and then manage benefits so as to free money for spending on direct pay, particularly variable pay, where the return on the organisation’s investment is greater.

An important development in reward management practice which does not feature in the new pay orthodoxy is the devolution of responsibility for pay decisions to line managers working closely with their teams – collectively or with individual members. This changes the role of personnel or reward specialists from that of police force to that of internal consultants and coaches.

The new pay concept should not be regarded simply as a lever for use in transforming organisations, and it does rely heavily on the leverage supposedly provided by variable pay. Its prescriptions are neither universally acceptable nor generally applicable. Furthermore, it should be regarded as a conceptual approach to payment rather than a set of prescriptions. As Lawler (1995) points out:



The new pay is not a set of compensation practices at all, but rather a way of thinking about reward systems in a complex organisation . . . The new pay does not necessarily mean implementing new reward practices or abandoning traditional ones; it means identifying pay practices that enhance the organisation’s strategic effectiveness.

What are we paying for?

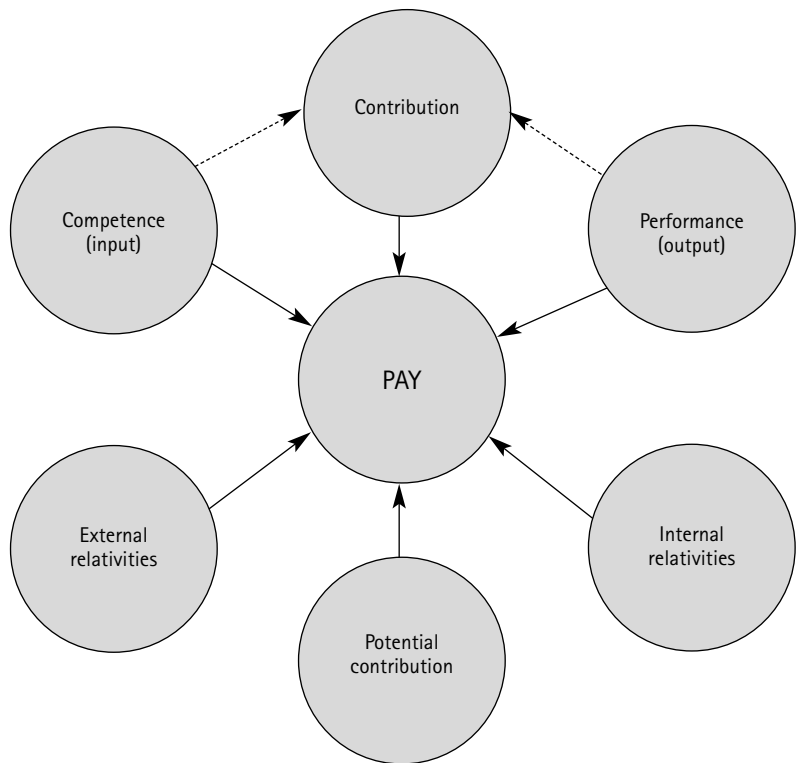
When thinking about reward systems and their design and management it is necessary to start by asking the question: ‘What are we paying for?’ The answer may seem obvious, along the lines of ‘We are paying people what they are worth.’ But this is plainly inadequate. We have to ask two more detailed questions: ‘How do we know what people are worth?’ and ‘What are the factors we need to take into account when deciding how much people should be paid, whether they are individuals in a role or numbers of employees in a similar job?’ A further associated question is ‘Are we paying for the job or the person, or both?’ It is important to be clear about this. The traditional approach to deciding on how much a job is worth is job evaluation, as described in Chapter 9. The mantra used when considering job evaluation is ‘Evaluate the job, not the person.’ This follows the principle that jobs are fixed entities with rigidly-defined duties which are performed in identical ways by job-holders. But in today’s more flexible organisations more and

more people are carrying out flexible roles rather than fixed jobs. The part they play may well vary according to circumstances – and, indeed, may be modified in accordance with the competence or capability of the person in his or her role. There are far more opportunities for people to ‘grow their roles’ as new demands and opportunities occur. In these circumstances, it is illogical to say that it is the job that determines the value of the person. It is, in fact, quite the opposite: it is the person that determines the value of the job. The first person who emphasised this point was Ed Lawler who in 1986 wrote that job evaluation ‘tends to depersonalise people by equating them with a set of duties rather than concentrate on what they are and what they can do’. He advocated a people-based rather than a job-based approach.

As will be discussed in Chapter 3, pay levels are in general influenced by economic factors and in particular by internal and external relativities – that is, internal comparisons between the levels of jobs and external comparisons with the rate at which similar jobs are paid outside the organisation (market rates). But for individuals, the factors to be taken into account in relation to their rate of pay and any increases to their base rate or cash bonuses may be more complex. These factors are modelled in Figure 3 and consist of:

- the *inputs* made by individuals based on the level of skill and/or competence they have attained and can use effectively
- the *outputs* of individuals which comprise the results they have achieved in the form of achieving targets or meeting standards of performance
- the *contribution* of individuals to achieving the purpose of the organisation, their team or their role – this contribution is based on their skill and/or competence and measured by their results
- *internal relativities* – how the individuals’ jobs compare with other people’s jobs within the organisation in terms of such factors as skill, knowledge, responsibility, complexity and impact on end-results
- *market worth* (external relativities) – what individuals are worth in the marketplace because of what they can do and the level of expertise they have attained
- *potential* – the pay of individuals may be affected by judgements about their potential to make a greater contribution in the future, such that their current pay reflects estimates of their future worth and serves to deliver the message that individuals are valued not only for what they do now but also for what they can deliver in the longer term.

Figure 3 What we are paying for



Reward management practices

The IRS Employment Review (2001) survey of reward practices found that of the 190 organisations reviewed, the proportions who had adopted various key reward practices were:

- merit or individual performance pay: 60.5 per cent
- profit-sharing: 24.7 per cent
- broadbanding: 19.4 per cent
- competence-related pay: 12.1 per cent
- flexible benefits: 7.3 per cent
- team pay: 4.7 per cent cent
- gain-sharing: 1.0 per cent

Merit or performance pay is by far the most popular practice, in spite of the doubts expressed on its effectiveness by many commentators. Profit-sharing is quite common, and, as IRS comments, an increasing number of organisations are adopting broad bands (in 2000, only

11.9 per cent had them). Flexible benefits and team pay attract relatively little support, perhaps because although these practices are attractive, flexible benefits are hard to introduce and manage, and team pay is not often appropriate.

The approach to rewarding people

According to Pfeffer (1998), the challenge facing organisations is to consider more than simply managing reward. They should devote time and attention not only to pay but to recognition systems, corporate culture and the quality of working life. He has suggested the following six Golden Rules.

- 1 Include a 'large dose' of collective reward in employees' pay packages.
- 2 Recognise that pay cannot substitute for a working environment 'high on trust, fun and meaningful work'.
- 3 Make pay practices open and transparent, thereby sending a positive message about the equity of the system.
- 4 Use other methods besides pay to signal company values and focus behaviour.

Table 1 Reward trends

| From | To |
|--|---|
| Narrowly-defined jobs and job standards | Broader generic roles – emphasis on competence and continuous development |
| Inflexible job evaluation systems sizing tasks, rewarding non-adaptive behaviour and empire-building, and encouraging point-grabbing | Flexible job evaluation processes assessing the value added by people in their roles, often within job families |
| Hierarchical and rigid pay structures in which the only way to get on is to move up. Focus is on the next promotion | Broadbanded and job family pay structures where the emphasis is on flexibility, career development pay and continuous improvement. Focus is on the next challenge |
| Emphasis on individual PRP | More focus on team performance through team-based pay; contribution-related pay |
| Consolidation of rewards into base pay | More emphasis on 'at risk' pay |

- 5 Realise that pay is 'just one element in a set of management practices which can either build or reduce commitment, teamwork and performance'.
- 6 Ensure that the messages sent by the pay system reflect what the organisation values, and align pay with other management practices.

The future

The main areas in which changes in reward policies and practices are taking place, or are at least being contemplated, are summarised in Table 1.

These movements can be categorised under the headings of contribution-related pay, broadbanding, job family structures and team pay. They are the most forward-looking of current developments in the context of increased devolution of pay decisions to line management and more involvement of employees. All of them are discussed in later chapters of this book.

Identify the main components of a reward system and explain how they should inter-relate.

SUMMARY

- A reward system consists of an organisation's integrated approaches to valuing and rewarding its employees according to their competence and contribution.
- A reward system expresses what an organisation values and is prepared to pay for. It is governed by the need to reward the right things in order to convey the right message about what is important in terms of expected behaviours and outcomes.
- The system consists of processes, practices, structures, schemes and procedures.
- The elements of reward are base pay, contingent pay, allowances, total earnings, employee benefits, total remuneration and, importantly, non-financial rewards and recognition.
- Reward management is concerned with the development, implementation, communication and evolution of processes which deal with the

assessment of relative job values, the design and management of pay structures, performance management, paying for performance, competence, skill or contribution (contingent pay), providing employee benefits and pensions, and managing reward procedures.

- The aims of reward management are to support the achievement of the organisation's goals, encourage appropriate behaviour, support the organisation's core values and help to attract and retain high-quality employees.
- The contributions of the 'gurus' to thinking about reward are summarised in Table 2.

Table 2 The contributions of the gurus

| | | |
|----------------------------------|---|--|
| Rosabeth Moss Kanter | <i>The Attack on Pay</i> , 1987 | <ul style="list-style-type: none"> ● Move towards reducing the fixed portion of pay and increasing the variable portion. ● Think more strategically about reward. ● Use people-based rather than job-based pay. |
| Ed Lawler | <i>Strategic Pay</i> , 1990 | |
| Schuster and Zingheim | <i>The New Pay</i> , 1992 | <ul style="list-style-type: none"> ● Relate pay to results and behaviour consistent with key organisational goals. ● Focus on variable pay. ● Relate rewards to team and organisational performance. |
| Flannery, Hofrichter and Platten | <i>People, Performance and Pay</i> , 1996 | <ul style="list-style-type: none"> ● Align pay with the organisation's culture, values and strategic goals. ● Integrate pay with other people processes. ● Measure results. |
| WorldatWork | <i>Total Rewards</i> , 2000 | <ul style="list-style-type: none"> ● Adopt a 'total rewards' approach which integrates all the available financial and non-financial reward practices. |

Further reading

The basis of reward management is discussed in Armstrong and Murlis (1994: 23–32). M. Beer *et al* provide a thought-provoking view of employee reward in *Managing Human Assets*, New York, Free Press, 1984. Rosabeth Moss Kanter (1987) delivered a number of new pay messages. Lawler (1990) advocates new pay approaches. The definitive exposition of the new pay philosophy is Schuster and Zingheim (1992). Gomez-Mejia and Balkin (1992) discuss the new strategic perspective on pay issues and strategic choices for pay and reward system design issues. Flannery *et al* (1996) provide an insightful and comprehensive review of developments in reward management. The WorldatWork publication *Total Rewards: From strategy to implementation* (2000) provides a comprehensive guide not only to the concept of total reward but also to how they should be introduced.