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Reward: an introduction

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

Introduction

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

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

Explore our stance on [low pay and financial well-being](#) and [excessive executive pay](#) in more detail, along with actions for Government and recommendations for employers.

What is reward?

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

Pay may be divided into two categories:

- **Base (or fixed) pay** is guaranteed cash wage or salary paid to employees for doing their work for a contracted time period, such as a 37-hour week.
- **Total earnings** is base pay plus additional variable earnings such as bonus

payments or overtime earnings.

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

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

Reward in the time of coronavirus

During the COVID-19 pandemic, pay and benefit professionals should consider whether their employers' reward approach is fit for purpose by exploring questions such as:

- Is the organisation paying its essential and key workers enough?
- Should top management receive more paid sick leave than those on the shop floor?
- Are the measures currently used to assess employee performance and bonus, incentives and pay awards still appropriate?
- Is the amount of paid bereavement leave appropriate?
- How can employee performance be improved to reduce the cost base?
- What's happened to employee financial security?
- Does the organisation need to invest in HR technology to ensure that people are being paid fairly?
- What can employers do to protect staff from financial scams, such as around pensions?

The answers to these and other questions will help ensure that the total reward budget is being spent wisely.

In addition, the Coronavirus job retention scheme has had an impact on the pay and benefits of those on furlough.

Listen to our [Reward and benefits during and after COVID-19](#) webinar. There's more on what employers should be doing in our [Responding to the coronavirus hub](#).

Managing reward

The main reason for offering pay and benefits is to influence behaviour so employees want to join and stay with an employer and aspire to do their best. Traditionally, salaries were used to attract people to an organisation, while benefits helped retain them, and bonus and incentive schemes motivated them in their work. However, thinking about which parts of reward are best suited for recruitment, retention and motivation has

changed. Listen to our [podcast on the changing landscape of reward](#).

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

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

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

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

When making decisions about how to reward and recognise people's contribution, it's important to recognise the [people risks](#) involved. Employers operating overseas should also consider whether to set reward centrally or allow each region or subsidiary develop its own approach - see our factsheet on [international and expatriate reward](#).

Organisations should establish a [reward strategy](#) that clearly articulates the aims of the various reward elements and how they are integrated. A reward strategy reflects the organisation's values, so it's important that appropriate communications explain to staff what behaviours and performances the organisation is rewarding, how, why and when. This may include employee education so that staff understand the benefits on offer, especially if the level of coverage varies. Employers also need to have measures in place to assess the impact of their reward strategy on people and performance.

[Determining base pay and total earnings](#)

Pay structures

Pay structures provide a framework for valuing jobs and understanding how they relate to one another within the organisation and to the external labour market.

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

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

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

Pay levels

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

Pay awards

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

- ability to pay
- inflation
- market rate changes.

There are variations by sector. For instance, in the public sector the government's pay policy is key, sometimes together with union pressure, whereas the latter is rarely an issue for many private sector companies. Our report [Megatrends: have we seen the end of pay rise?](#) looked at UK pay and inflation trends, while our quarterly [Labour Market Outlook](#) reports look at pay forecasts for the coming year.

Pay progression

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

[factsheet on pay progression](#).

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

Variable pay: cash bonuses and incentives

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

Among those employers offering a performance-related reward scheme, the most common individual performance-related variable schemes are individual bonuses and sales commission, while profit-sharing and gain-sharing are the most common group performance-related plans. See more in our [factsheet on bonuses and incentives](#).

The advantage of variable pay schemes is that they can link earnings closely to desired performance and, in theory, only pay out when there is reason to do so. Variable elements of pay do not generally feed through into other elements, such as overtime or pension contributions, and so create no additional on-costs.

The UK legal position

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

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

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

The [National Minimum Wage](#) applies to all workers age 16 and over. There are currently four categories covering apprentices, workers aged under 18, those aged 18 to 20, and those aged between 21 and 24. In April 2016, a new rate (the [National Living Wage](#)) was introduced for those aged 25 or over. Our report [Weighing up the wage floor: employer](#)

[responses to the National Living Wage](#) examined the expected responses between small and large employers, and across different sectors of the economy. The Summer 2019 issue of our [Labour Market Outlook](#) found that the main response from employers to the National Living Wage was to absorb the cost.

While not a legal requirement, more than 6,000 organisations employing over 180,000 workers have signed up to the voluntary [Living Wage](#).

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

Executive pay

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

Our most recent report on [Executive pay in the FTSE 100](#) looks at what the UK's largest firms pays their CEOs. It finds that CEO remuneration has fallen marginally over the year, but it would still take a UK worker on median full-time earnings 119 years to earn what the median FTSE 100 CEO gets paid in 12 months. . Listen to our podcast exploring [executive pay and what motivates top earners](#).

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

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

The role of employee benefits

Many employers offer a wide range of benefits from traditional items such as paid leave and occupational pensions to newer elements such as concierge services.

There are various reasons why benefits are offered, including to: match market practice, provide workers with some measure of health or disability security, or retain employees. Some benefits, such as [pensions](#), are offered because it's required by law. Some benefits can be tax-efficient methods via salary sacrifice provisions. Share schemes are one

specific option for attracting, retaining or motivating senior managers as well as employees.

Flexible benefits schemes (also known as 'cafeteria benefits' or 'flex plans') allow employees to vary their benefits package in order to meet their individual needs.

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

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

Non-financial rewards and total reward

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

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

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

Useful contacts and further reading

Contacts

[Acas - Pay and wages](#)

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

Books and reports

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

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

PERKINS, S.J. and WHITE, G. (2020) *Reward management: alternatives, consequences and contexts*. 4th ed. London: Chartered Institute of Personnel and Development and Kogan Page.

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

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

Journal articles

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

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

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

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

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

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This factsheet was last updated by Charles Cotton.