Reward Strategy: Building Block or Mental Block?

By Roger Down

Ways HR Consulting
1 Portland Street
Manchester
M1 3BE
T: 0870 890 9882
F: 0871 431 0655
W: wayshrconsulting.com

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Overview

According to recent surveys published by the CIPD in 2007 and 2008, developing and implementing a reward strategy is high on the agenda of many respondents. But what, if any, real progress has been made?

In the 2007 survey, 35% of organisations claimed to have a reward strategy in place, and a further 40% planned to create one during the year. In the 2008 survey (not a matched sample, true, but targeted on substantially the same respondent base), 33% of organisations claimed to have a reward strategy, and only 23% were planning to introduce one on 2008. (See **Table 1**)

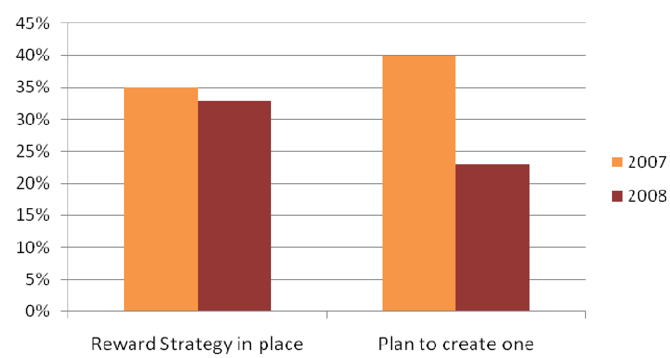

Table 1: % Organisations and Reward Strategies; CIPD survey results 2007, 2008

Why then is there a lack of progress, even before the current woes of credit crunch and economic recession appeared as corporate business variables?

- Part of the answer lies with the sample composition, where public and voluntary sector employers make up about a third of the response. But even these sectors have much more freedom than hitherto, to decide how and at what level they reward their staff, so that is not the total picture.
- We suspect that many employers have been paying more attention to packaging, to make their reward packages more attractive, rather than focusing on content and an offering that truly differentiates.

  Major change requires clear direction and a realisation that it doesn't happen overnight, but needs tenacity and commitment at all management levels.

One thing is clear from the priority list: one employer in three is looking to review or introduce bonus schemes, with almost the same number looking at managing pay progression more effectively.

And since the publication of this year's report, the sharp economic downturn will force employers to look carefully at managing pay and employment costs, to make the most of what will become a scarce resource: cash.

Despite the posturing of the Government about an area it does not understand or operate well as an employer, bonuses will remain an integral and important part of the reward armoury, though perhaps better thought through and targeted.

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Economic recession

The recent collapse of confidence in the economy, both at home and globally, has changed the financial environment in which most employers are now forced to work, with inevitable consequences for cost and employment prospects.

Some sectors, such as the financial institutions, have employment costs that form a major part of their total costs. They will seek to reduce liabilities through cutting jobs and possibly variable pay.

Other sectors may be less able to take cost out of employee numbers without seriously affecting their ability to maintain a service or remain competitive.

For these employers, a long term reward strategy may remain an ideal goal. But today's priorities may well dictate a more pragmatic and basic approach to managing pay in the short term.

What guidelines or practical advice can we offer?

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Employment cost management

Whether your organisation is capital or labour intensive, staff costs are still a significant factor. The first step in managing employee costs is to know exactly what they are, and how they are built up. Not just basic wages or salaries, but the total reward package, including incentive payments and benefit costs.

How do these compare to your industry sector and the local community? Are you being more generous than you need to be? Do you have objective data that lets you know?

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Employee benchmarking

The principle of benchmarking is simple: find out what your competitors are paying. But where should you pay in relation to them: what can you afford to pay and what can you not afford to pay? Employers should be realistic about who they are competing with for labour, and it is likely that it will not be the same organisations for all staff.

Most employers want to pay "around market median" to stay competitive whilst not overpaying. But does this apply only to salaries or should it take account of variable pay and employee benefits like company cars and private health insurance?

What's the market practice in your sector, but more importantly, can you or do you want to compete at the same level?

Who should you pick and at what level should you compete?

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Total reward

To employers the key issue is total employment cost, which includes incentives and benefits. But the "extras" above basic salary need careful consideration.

Leaving aside pensions, which is a complex area with its own set of issues, and which for many public sector employers is non-negotiable anyway, the main on-costs are likely to be in the area of variable pay:

- Incentive or bonus schemes;
- Company or personally leased cars; and
- Private medical insurance.

The market median approach is an easy option and it would be straightforward to take this as a yardstick for each benefit.

However this approach can be inflationary, and produce total reward costs that are approaching market upper quartile, an undesirable consequence except perhaps for the highest performing organisations.

Tables 2 & 3 illustrate the case:

Company	Salary	Bonus	Car	Pension	Other benefits	Total	Rank order
A	£25,000	£6,000	£0	£2,000	£3,500	£36,500	1
B	£28,000	£3,000	£4,000	£2,000	£4,000	£41,000	2
C	£30,000	£10,000	£6,500	£3,000	£3,000	£52,500	4
D	£31,000	£11,000	£7,000	£3,000	£2,500	£54,500	5
E	£36,000	£10,500	£0	£4,000	£1,000	£51,500	3

Table 2: Sample reward data

Company	Salary	Bonus	Car	Pension	Other benefits	Total	Rank order
A	£25,000	£6,000	£0	£2,000	£3,500	£36,500	1
B	£28,000	£3,000	£4,000	£2,000	£4,000	£41,000	2
E	£36,000	£10,500	£0	£4,000	£1,000	£51,500	3
C	£30,000	£10,000	£6,500	£3,000	£3,000	£52,500	4
D	£31,000	£11,000	£7,000	£3,000	£2,500	£54,500	5

Table 3: Sample reward data

In **Table 2**, company C has a median position in the group on each of the major pay components. But when ranked on total reward, in **Table 3**, the position is almost at upper quartile.

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Variable pay

Variable pay has an important role to play when cash is tight. It can ensure that any available cash is applied most effectively in rewarding and retaining those that achieve for the organisation.

It can apply to:

- Consolidated base salary increases;
- One off payments in recognition of personal or company performance; or
- The achievement of key strategic or operational targets.

Unconsolidated salary increases are not a new tactic. But they can be an effective short term solution used with care in the right circumstances.

The use of annual bonuses has been a long time feature of pay in the private sector, especially at the most senior levels. The public sector is moving cautiously towards embracing this reward tool, but there is limited evidence to say that it has been a resounding success.

Designing the right kind of bonus scheme for your organisation's situation is not straightforward, and will be determined to a large degree by company culture.

- If performance management and assessment are an integral part of the organisation's culture, then performance pay has a good chance of working.
- If not, the performance culture needs to be embedded and seen to be effective, before incentive bonuses will become effective.

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What should you do?

Undertaking a reward audit will enable an employer to look carefully at how current costs are built up, and what processes are in place to manage the different components of pay.

Pay and benefit levels should be accurately benchmarked, and realistically assessed against the most appropriate market, and affordability levels. Pay or benefits may need to be frozen where current levels are not justified, and transition arrangements to more practical levels created.

The use of contingent pay, based on appropriate performance measures, should be thoroughly investigated, as a means of replacing fixed or annuitised employment costs, with performance dependent pay.

Ways HR Consulting has extensive experience of analysing all elements of the reward package, and providing effective, creative solutions that match individual employer needs.

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More information

To discuss any of the issues raised in this document in more detail, please contact:

Roger Down,

Director of Reward Services

Ways HR Consulting

1 Portland Street

Manchester

M1 3BE

T: 0870 890 9882

M: 07808176455

E: roger.down@wayshrc.com

W: www.wayshrconsulting.com

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