

Developing a Reward Strategy

Key Facts



Overview

The reward management system needs to support the business strategy. As such there are a number of different approaches, but they all break down into a small number of common overall methods.

One of the key determinants in deciding which approach will work best is the extent to which the business wants integration between its reward system and the other HR systems and policies it utilises. Arguably, the opportunity to leverage real competitive advantage comes from integrating the reward management, performance management, career management and personal development systems into a cohesive whole, rather than seeing each as a separate and disjointed system in isolation.

Developing a reward strategy

The key step in redesigning the reward management system is to determine the reward strategy and the level of integration with other HR systems. This provides an overall framework for the reward system and must be closely linked to the business strategy.

The underlying premise is:

- ◆ In order to meet its strategy, the business must exhibit certain characteristics. It needs to behave in certain ways, for example treating its employees in an open and honest fashion or creating co-operative relationships with its customers and suppliers.
- ◆ Organisations are made up of people, and as such it is how the people behave that will determine how the organisation behaves.
- ◆ The integrated approach to people management starts off with individual behaviour expectations and examines how these will be:
 - ◆ Measured (performance management)
 - ◆ Developed (personal development)
 - ◆ Rewarded (reward and career management)

What is included in a Reward Strategy

The reward strategy will typically describe at a high level the company's policy on:

Component	Need
Underlying structure	Provide a common grade framework that supports a drive for consistency (single, career or job family)
Common threads	Provide a common reward framework to address shared compensation and benefits issues
Base pay structure	Recognise the market value of roles and any role-specific needs
Variable pay	Provide reward that must be re-earned by achieving agreed goals
Recognition	Encourage greater commitment to behaviours that support the business strategy
Non-financial reward	Provide personal development and environmental (hygiene) factors that support the cash and benefit reward programmes
Integration	Provide a consistent and comprehensive approach to managing employees and their performance

1. Underlying structure

There are a number of ways in which a grading structure could be developed according to your business needs.

Single Structure

- ◆ All jobs are covered by a single uniform structure.
- ◆ All jobs of similar value are grouped together.
- ◆ A single salary, or a salary range, is attached to each grade.
- ◆ Variation in pay for individual employees is due to different performance levels or service.
- ◆ There is scope for individuals to progress from one grade to the next, by taking on more demanding jobs.

Career Families

- ◆ A career-graded structure is a single graded structure sliced vertically into 'career families'.
- ◆ A career family contains jobs that have common elements e.g. functions or type of knowledge required.
- ◆ There are defined career paths for progressing to higher levels, into roles requiring related knowledge and skills in other families.
- ◆ Family Levels are defined by reference to key activities and the knowledge and skill requirements.

- ◆ Every family may not appear at every level in the structure.
- ◆ Corresponding levels across career families are determined using a common job evaluation framework.
- ◆ Pay arrangements can be career family specific.
- ◆ Individuals can easily move across career strands as appropriate to gain broader functional experience.

Job Families

- ◆ A number of job families are identified.
- ◆ Families group together jobs in which the type of work and the knowledge and skills required are broadly similar.
- ◆ Separate job family grade structures are developed for each job family, each consisting of a number of levels which can vary between families.
- ◆ The number and width of levels (grades) within a job family can be different to the number and width of levels in other job families.
- ◆ Job evaluation points and pay can vary between levels in different job families.
- ◆ Family Levels are defined by reference key activities and the knowledge and skill requirements.

For further information refer to PAYdata's paper on Job & Career Families available at www.paydata.co.uk.

2. Common threads

Common threads are the policies, systems and procedures that operate across the business. For example:

- ◆ Sick pay rules
- ◆ Benefit allocation rules such as cars, pensions and private medical insurance
- ◆ Procedures such as holiday or absence notification and promotion.

They are there to make everyone's life easier because there are clear rules and everyone sticks to them. Included in this area would normally be decisions about flexible benefit schemes, choice of carriers for insured benefits, and so on.

3. Base pay structure

There are three decisions that need to be made:

- ◆ Market alignment
- ◆ Number and shape of the salary scales
- ◆ Access to and use of market data

3.1 Market Alignment

Choosing the market alignment is a strategic decision because it determines pay at the policy level. Most organisations choose to align themselves somewhere between the median and the upper quartile:

- ◆ The median is the salary level at which 50% of the market pays a lower salary
- ◆ The upper quartile is the level at which 75% of the market pays a lower salary.

There are a number of points to bear in mind:

1. Even at the median, 50% of the market is paying a lower salary. This means that there is plenty of scope to find people even if a lower market alignment position is adopted in policy or practice. However, the lower the market alignment the longer the search time for new employees and the more likely that a different employer will pay a higher salary.
2. Market data benchmarking is not an exact science. There are many stages where mismatching can occur and as a rule of thumb market data is a good indicator within a tolerance limit of 5 – 10%. Putting this into context, the upper quartile salary for a particular role will typically be around 15% higher than the median.
3. Market alignment does not have to be the same for all types of employees or for all levels of employees. It is quite common for organisations to choose a higher market alignment position for more senior employees. It is also quite common for certain professions to be managed differently, for example in engineering-based businesses a higher market alignment position might be chosen for engineering professionals because they represent the core competency of the business.
4. Market alignment might be different for base pay, total pay and benefits. Adopting a median position across all parts of the package will not mean that the organisation is at median overall – in fact the position will most likely be higher than median overall. This is because most organisations will look to trade off one part of the package against another part.

3.2 Number and shape of the salary scales

In some ways base pay structure follows the decision about the shape of the underlying structure. However, even in what is basically a single structure there may be variation, for example different pay scales for a particular profession (e.g. IT), for a different geographical area (e.g. London) or for a particular business sector (e.g. construction).

Within a career family or job family based structure base salary scales might vary between families. Sometimes this can be because of market pay differences and sometimes because of conscious decisions about addressing different salary needs for different groups of employees. For example, the organisation might make a conscious decision to pay high salaries for new graduate engineers on recruitment but to scale back the pay for longer serving engineers in the later stages of their career.

3.3 Access to and use of market data

Whatever approach is adopted, there is a need to determine how market data will be accessed and used. In mature organisations and / or those with low turnover, there may be very little exposure to the market and therefore internal pay relativity becomes more relevant than market relativity. In fast growing organisations that are recruiting new skills, or in those that experience high labour turnover, good quality market pay data is essential in order to ensure that the organisation's pay remains relevant in the recruitment and retention market place.

Pay data is available in three main forms:

- ◆ Data in the public domain such as recruitment agency surveys, government statistics and institute surveys. These are good indicators but should not be relied upon as the primary data source.
- ◆ Surveys published by the salary survey specialist businesses, which may be only available to participants in some cases. These tend to rely on a job matching methodology designed by the survey provider and provide good information for roles that are found across a number of different business types, for example HR roles. They are less useful for roles that are specific to particular industries, or where particular geographical or segmentation data is required.
- ◆ Club surveys are formed from groups of companies in the same industry and/or location and often use a third party to exchange and report salary data provided by members of the Club. Club surveys are excellent for concentrating on industry specialist roles, and for very focussed reporting. Participants usually have a lot of control over the design of the survey. The major disadvantage is that sample sizes are relatively small because they are limited to Club members, and therefore they may be unsuitable for roles recruited across a wide range of industries, for example Finance roles.

In reality most organisations of any size require access to all three types of data.

4. Variable pay

Variable pay takes three main forms:

- ◆ Annual schemes which are normally bonus arrangements where there is some link to underlying business performance
- ◆ Commission type arrangements where the main link is to individual performance e.g. sales schemes
- ◆ Long-term schemes that might be cash or shares based and are typically used for the more senior employees, although all-employee profit related schemes sometimes fall into this category

The key to variable pay is that it is relevant to the role and delivers in proportion to the contribution. As discussed above under Market Alignment, most organisations will look for some form a trade off between base pay and variable pay. For example,

- ◆ Organisations that make no or low variable rewards may pay higher base salaries or compensate elsewhere in the package
- ◆ Organisations that make high variable rewards may pay lower base salaries
- ◆ High variable pay achievement should mean high performance has been delivered. It is much easier to benchmark variable pay than to benchmark what has to be done to achieve it. For this reason it is also common for variable pay schemes to fail to differentiate between the external benchmarking of pay and internal benchmarking of performance.

5. Recognition

Recognition schemes are either non-cash or low-value cash equivalent schemes that recognise behaviour that reinforces the organisation's values. They tend to be "award" based with some form of nomination process, either from other employees or line managers.

Examples include:

- ◆ Voucher based schemes for "going the extra mile"
- ◆ "Goodie cupboard" based employee-nominated schemes used in call centres
- ◆ Annual Award schemes for technical or business excellence
- ◆ Alternatively, the scheme might reward something else that the employer values, such as long service.

These schemes tend to have high visibility and relatively low cost, but are an essential part of the total reward package.

6. Non-financial reward

From an individual's perspective the total reward of working for a particular organisation is made up of four elements:

- ◆ Cash
- ◆ Benefits
- ◆ Personal development and growth
- ◆ Environment (culture and physical working conditions)

This part of the reward strategy is concerned with last two elements. Again, the reason why these are important is because they provide the opportunity for trade-off with the other elements of the package. An organisation with a strong people-based culture and a good track record of providing personal development opportunities will most likely be able to offset this against base pay or some other part of the package.

7. Integration

Integration is about creating a common theme throughout the people management processes. For example, it may be about:

- ◆ Ensuring performance management and performance-pay processes are consistent
- ◆ Using common factors for measuring job size and determining employee development needs
- ◆ Creating a common language which is used consistently throughout all people management processes
- ◆ Developing structures that manage more than one people management process at a time – for example the career families approach discussed above attempts to integrate job grading and career tracks.

Arguably integration is one of the most important decisions because it ensures that everything is consistent and gives the same message (and more importantly that there are no contradictory messages). It is also the area that is most commonly ignored.

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