

STRATEGIC ASPECTS OF PAYMENT



THE OBJECTIVES OF THIS CHAPTER ARE TO:

- 1 ASSESS THE MAJOR OBJECTIVES MANAGERS HAVE WHEN DETERMINING PAY RATES AND SYSTEMS
- 2 CONSIDER THE MAIN EMPLOYEE OBJECTIVES FROM A REWARD PACKAGE
- 3 EVALUATE THE MAJOR ALTERNATIVE METHODS OF SETTING BASE PAY RATES
- 4 INTRODUCE THE DIFFERENT ELEMENTS THAT MAKE UP A PAY PACKAGE
- 5 STATE THE SIGNIFICANCE OF EQUITY IN DESIGNING AND MAINTAINING EFFECTIVE REWARD SYSTEMS
- 6 DEBATE THE EXTENT TO WHICH REWARD MANAGEMENT HAS OR HAS NOT TAKEN ON A 'STRATEGIC' CHARACTER IN RECENT YEARS

Pay is all sorts of different things. It is basically a transaction, as an employer pays £X in exchange for generally specified time, skills, commitment and loyalty. But pay is also a label (the £3,000-a-day libel lawyer), a status symbol (professors are paid more than senior lecturers) and a determinant of standard of living. Pay is also likely to be a discriminator according to gender (average earnings are lower for women than for men) and social class (average earnings are lower for manual workers than for non-manual workers), and is one of the main influences on the degree to which people value their employment. It is not just the amount they are paid, but the nature of the contract. Salaried posts in the main are for what a person *is* as well as for what he or she does. The government minister in charge of the treasury is paid to *be* Chancellor of the Exchequer, not just to prepare and deliver an annual budget.

The reason why pay is a crucial issue for managers is that managers decide what employees should be paid, so they influence all of these factors in the lives of John Brown and Mary Smith. Managers mediate between the customer and the worker as a supplier of goods and services, and we are all highly sensitive to issues such as our social status. This is why trade unions were created and pay review bodies formed. This is why we have laws to control at least some aspects of the pay bargain. If you are an employee at any level someone decides what you are worth, and few things matter more to us than how we are valued.

This type of management mediation between customer and worker applies only to employees; it is different for the self-employed and sole traders. In writing this book we have one thing in common with J.K. Rowling and Delia Smith: we have all recently published books. Every copy of this book that is sold puts a modest amount of money in our pockets, that is predetermined by a royalty agreement. There is no employer intervention to vary the amount. If the publisher sells a huge number, then our royalty payments rise in strict proportion. If they sell few, then our royalty payments are disappointing, but there is no argument about worth or value, because there is no mediation.

In the following chapter we look in detail at the measurement and grading of jobs. In Chapters 28 and 29 the focus is on incentives and employee benefits. Here we introduce some of the fundamental choices that managers have to make in deciding how much and in what form to pay their employees.

TERMINOLOGY

A strange thing about payment is that managers seem to shy away from actually using the word. We hear about ‘compensation’, ‘reward’ or ‘remuneration’, yet the idea of compensation is that it involves making amends for something that has caused loss or injury. Do we want to suggest that work necessarily causes loss or injury? Reward suggests a special payment for a special act. Much current management thinking on pay issues concerns the need to induce more special effort by employees, but the bulk of the pay bargain for an individual is not affected by performance. Remuneration is a more straightforward word which means exactly the same as payment but has five more letters and is misspelled (as renumeration) more often than most words in the human resource manager’s lexicon. We use the general term ‘payment’ as this part of the book includes material about pensions,

sick pay and other benefits, but the current general term is certainly 'reward'. This term is used to identify the system of payment as a central, integrated feature of the approach to HRM. The traditional collective bargain was separated from the management of the people receiving the money: the concept of reward is to have some sort of multiple helix, where motivation, skill, career and performance are all intertwined to produce added value to the individual career and corporate aspects, with the pay reflecting, describing and moving with the other elements continuously. In recent years there has been increased interest in the concept of 'total reward' (see Armstrong and Brown 2001, pp. 3–5) which views pay as just one part of a far bigger package of rewards that employees derive from their work. Seen from this perspective, non-financial rewards such as recognition, career development opportunities and the ability to achieve an acceptable work-life balance play as much of a role as financial rewards in meeting organisational objectives.

ACTIVITY 26.1

How far do you agree with the proposition that managers should think in terms of 'total reward' as a means of recruiting, retaining and motivating their staff? Are praise and career development as important as pay? Would you trade some of your pay for greater recognition and development opportunities?



REWARD STRATEGY

A major current feature of the literature and rhetoric about payment systems has been a concern with defining and refining reward strategies. While different writers have different ideas about what exactly constitutes a strategic approach to the management of pay, most agree that it is primarily about aligning an organisation's payment arrangements with its business objectives. This means developing payment systems which enhance the chances that an organisation's employees will seek actively to contribute to the achievement of its goals. So if improved quality of service is the major business objective, this should be reflected in a payment system which rewards front-line staff who provide the best standards of service to customers. Alternatively, if increased productivity is sought, then a payment system which rewards efficiency would be more appropriate. But choices in this area are not always as straightforward as this because organisations are obliged to compete with one another for good staff as well as for customers. The extent to which organisations can impose payment arrangements which serve their business objectives is thus limited by the equally important need to recruit, retain and motivate staff to carry out the work. So a balance always has to be sought between the objectives of employers and employees when developing payment strategies.

Interestingly, and perhaps surprisingly, it is only in relatively recent years that managers have had the opportunity to think strategically about pay in this way. This

is because until the 1970s (and much later in many industrialised countries) the majority of employees had their payment determined in large part through national or industry-level collective bargaining arrangements. Managers at the local level thus had little freedom of manoeuvre beyond determining who should be employed on which grade and how much overtime was worked. Multi-employer bargaining declined steeply during the 1980s and 1990s, so that by 2000 only 40 per cent of public sector employees and just 4 per cent of those employed in the private sector were covered by such arrangements (Brown *et al.* 2003, p. 202). As a result, unlike other areas of HRM, there have been relatively few years in which new approaches to the management of pay have been tried out, established and subsequently evaluated. To a great degree we are still at the experimentation stage with many newer approaches, and this means that fierce debates rage among commentators about the effectiveness, efficiency and fairness of systems which aim to enhance individual effort, encourage skills acquisition, reward specific employee behaviours and try to establish an identity of interest between employers and their staff.

EMPLOYEE OBJECTIVES FOR THE CONTRACT FOR PAYMENT

Those who are paid and those who administer payment schemes have objectives for the payment contract which differ according to whether one is the recipient or the administrator of the payments. The contract for payment will be satisfactory in so far as it meets the objectives of the parties. Therefore we consider the range of objectives, starting with employees.

First objective: purchasing power

The absolute level of weekly or monthly earnings determines the standard of living of the recipient, and will therefore be the most important consideration for most employees. How much can I buy? Employees are rarely satisfied about their purchasing power, and the annual pay adjustment will do little more than reduce dissatisfaction, even if it exceeds the current level of inflation. Enhanced satisfaction only occurs when a pay rise is given which surpasses expectations.

Second objective: felt to be fair

Elliott Jacques (1962) averred that every employee had a strong feeling about the level of payment that was fair for the job. In most cases this is a rough, personalised evaluation of what is appropriate. The employee who feels underpaid is likely to demonstrate the conventional symptoms of withdrawal from the job: looking for another, carelessness, disgruntlement, lateness, absence and the like. Perhaps the worst manifestation of this is among those who feel the unfairness but who cannot take a clean step of moving elsewhere. They then not only feel dissatisfied with their pay level, but also feel another unfairness too: being trapped in a situation they resent. Those who feel they are overpaid (as some do) may simply feel guilty, or may seek to justify their existence in some way by trying to look busy. That is not necessarily productive.

Third objective: rights

A different aspect of relative income is that concerned with the rights of the employee to a particular share of the company's profits or the nation's wealth. The employee is here thinking about whether the division of earnings is providing fair shares of the Gross National Product. The focus is often on the notion of need – the idea that someone has a right to a greater share because they or their families are suffering unjustly. These are features of many trade union arguments and part of the general preoccupation with the rights of the individual.

Fourth objective: relativities

'How much do I (or we) get relative to . . . group X?' This is a version of the 'felt to be fair' argument. It is not a question of whether the employee believes the remuneration to be reasonable in relation to the job done, but of whether they believe it reasonable in relation to the jobs other people do. There are many potential comparators, and the basis of comparison can alter. We may compare our own pay with that of the person sitting in the next desk, with an opposite number in a competitor company or we may be concerned more generally about comparisons with other professional or occupational groups.

Whichever comparator is chosen, it is often difficult to make a fair comparison. For example, basic pay may be very different from overall earnings, while jobs themselves can share a title or job description in common while carrying rather different levels of real responsibility.

Fifth objective: recognition

Most people have an objective for their payment arrangements, that their personal contribution is recognised. This is partly seeking reassurance, but also a way in which people can mould their behaviour and their career thinking to produce progress and satisfaction. It is doubtful if financial recognition has a significant and sustained impact on performance, but providing a range of other forms of recognition while the pay packet is transmitting a different message is certainly counter-productive.

Sixth objective: composition

How is the pay package made up? The growing complexity and sophistication of payment arrangements raises all sorts of questions about pay composition. Is £400 pay for 60 hours' work better than £280 for 40 hours' work? The arithmetical answer that the rate per hour for the 40-hour arrangement is marginally better than that for 60 hours is only part of the answer. The other aspects will relate to the individuals, their circumstances and the conventions of their working group and reference groups. Another question about composition might be: is £250 per week plus a pension better than £270 per week without? Such questions do not produce universally applicable answers because they can be quantified to such a limited extent, but some kernels of conventional wisdom can be suggested as generalisations:

- 1 Younger employees are more interested in high direct earnings at the expense of indirect benefits, such as pensions, which will be of more interest to older employees.

- 2 Incentive or performance-related payment arrangements are likely to interest employees who either see a reliable prospect of enhancing earnings through the ability to control their own activities, or see the incentive scheme as an opportunity to wrest control of their personal activities (which provide little intrinsic satisfaction) away from management by regulating their earnings.
- 3 Women with children are less interested in payment arrangements that depend on overtime than men often are.
- 4 Overtime is used by many employees to produce an acceptable level of purchasing power particularly among the lower-paid.

ACTIVITY 26.2

Which of the above objectives do you consider to be most important to you? How far do you think priorities in this area change with age?

EMPLOYER OBJECTIVES FOR THE CONTRACT FOR PAYMENT

In looking at the other side of the picture, we consider the range of objectives in the thinking of employers, or those representing an employer interest *vis-à-vis* the employee.

First objective: prestige

There is a comfortable and understandable conviction among managers that it is ‘a good thing’ to be a good payer. This seems partly to be simple pride at doing better than others, but also there is sometimes a feeling that such a policy eliminates a variable from the contractual relationship. In conversation with one of the authors a chief executive expressed it this way:

‘I want to find out the highest rates of pay, job-for-job, within a fifty-mile radius of my office. Then I will make sure that all my people are paid 20 per cent over that. Then I know where I am with them as I have taken money out of the equation. If they want to quit they can’t hide the real reason by saying they’re going elsewhere for more cash: they can’t get it. Furthermore, if I do have to fill a job I know that we won’t lose a good guy because of the money not being right.’

Whether high pay rates succeed in bestowing on an organisation the reputation of being a good employer is difficult to see. What seems much more likely is that the low-paying employer will have the reputation of being a poor employer.

Second objective: competition

More rational is the objective of paying rates that are sufficiently competitive to sustain the employment of the right numbers of appropriately qualified and experienced employees to staff the organisation. A distinction is drawn here between competition thinking and prestige thinking, as the former is designed more to get a good fit on one of the employment contract dimensions than simply to overwhelm it. It permits consideration of questions such as: how selective do we need to be for this range of jobs? and: how can we avoid overpaying people and inhibiting them from moving on? Every employer has this sort of objective, even if only in relation to a few key posts in the organisation.

Third objective: control

There may be ways of organising the pay packet that will facilitate control of operations and potentially save money. The conventional approach to this for many years was the use of piecework or similar incentives, but this became difficult due to the unwillingness of most employees to see their payment fluctuate wildly at the employer's behest. Theoretically, overtime is a method of employer control of output through making available or withholding additional payment prospects. In practice, however, employees use overtime for control more extensively than employers. Other ways in which employers could control their payroll costs have been eliminated or made more difficult by legislation. Redundancy, short-term layoff and unfair dismissal are all now more expensive, and it is unlawful to regard women as a reservoir of inexpensive, temporary labour as once was common.

Fourth objective: motivation and performance

Employers also seek to use the payment contract to motivate employees and thus to improve their work performance. The subject of incentive payment systems is discussed in detail in Chapter 28, but some features of payment and its influence on performance are worth mentioning here.

Until recently incentive payment systems were primarily used as part of the payment package for manual workers and sales staff. The design of such schemes is simple, with a built-in bias towards rewarding the volume of products manufactured or sold. Wherever the quality of output is a matter of significance such approaches are, therefore, inappropriate. Two extreme examples indicate the weakness of this approach. Someone engaged in the manufacture of diamond-tipped drilling bits would serve the employer poorly if payment were linked to output. If it were possible to devise a payment system that contained an incentive element based on high quality of workmanship or on low scrap value that might be more effective. If schoolteachers were paid a 'quantity bonus' it would presumably be based either on the number of children in the class or on some indicator like the number of examination passes. The first would encourage teachers to take classes as large as possible, with probably adverse results in the quality of teaching. The second might increase the proportion of children succeeding in examinations, but would isolate those who could not produce impressive examination performance.

WINDOW ON PRACTICE

The case of the AIDS counsellor

The difficulty of determining a fair and satisfactory rate of pay for particular individuals is illustrated in the following example of a nurse employed by a large NHS hospital as a counsellor for haemophilia patients who have contracted AIDS through blood transfusion.

The nurse concerned was employed on a senior sister's grade but was required to work in the community, undertaking counselling duties with patients and their families. The nature of the job, however, meant that she was required to work very irregular and unpredictable hours and could not delegate duties to anyone else or share the burden of cases with others. She requested a regrading with the full support of her managers who perceived her to be a uniquely good performer. No performance-related scheme had, however, been developed and regrading the nurse was not straightforward. The first stumbling block came when her duties were assessed according to grading criteria negotiated by the relevant NHS Whitley Council. Although several attempts were made to try to make the job fit the criteria for the higher grade, the task proved impossible. Authorising a regrading on these grounds would have set a precedent leading to large numbers of regrading claims.

The next approach taken was to analyse the nurse's job using the hospital's computerised job evaluation system. This route also failed because the results of the analysis suggested that the job was already graded too highly. To regrade in spite of this would render the decision indefensible were an equal value claim to be brought by a male nurse employed at the same grade.

Finally an attempt was made to justify the proposed regrading by discovering at what level other hospitals paid nurses undertaking similar roles. It was found, however, that other AIDS counsellors were paid on the same or lower grades.

It thus proved impossible to pay the nurse concerned a rate which she and her managers regarded as 'fair' because no decision to regrade could be objectively justified.

In recent years a great deal of attention has been paid to the development of incentive payment systems which go beyond rewarding the quantity of output to take account of job performance as a whole. In particular there has been a marked increase in the use of performance-related pay (PRP) for management and professional staff, especially for senior managers; organisations have sought either to re-establish or to introduce for the first time schemes which reinforce the messages required to produce improved performance and increased productivity. Private sector employers in particular now increasingly believe that they are not providing an appropriate or competitive package for their directors and senior executives unless there is some element of risk money to add on to the basic salary and reward the achievement of company growth, profitability and success. At the same time,

companies have been re-examining the use of bonus schemes for more junior employees in order to increase motivation and to reward them for their contribution. The use of PRP is also growing in the public sector following active promotion of its benefits by government ministers.

Fifth objective: cost

Just as employees are interested in purchasing power, the absolute value of their earnings, so employers are interested in the absolute cost of payment, and its bearing on the profitability or cost effectiveness of their organisation. The importance of this varies with the type of organisation and the cost of employees relative to other costs, so that in the refining of petroleum employment costs are modest, in teaching or nursing they are substantial. The employer's interest in this objective is long term as well as short term. Not only do employees expect their incomes to be maintained and to carry on rising, rather than fluctuating with company profitability, but the indirect costs of employing people can also be substantial.

Sixth objective: change management

Pay can be used specifically as one of a range of tools underpinning change-management processes. The approach used is to tie higher base pay, bonuses or promotion to the development of new behaviours, attitudes or skills gained by employees. Pay works far more effectively than simple exhortation because it provides a material incentive to those whose natural inclination is to resist change. It also sends out a powerful message to employees indicating the seriousness of the employer's intentions as regards proposed or ongoing changes.

APPROACHES TO SETTING BASE PAY RATES

One of the most important decisions in the design of payment systems concerns the mechanism or mechanisms that will be used to determine the basic rate of pay for different jobs in the organisation. There are, of course, restrictions on management action in this area provided by the law. Since 1999 the UK has had a National Minimum Wage (£4.50 an hour in 2004) to which workers over the age of 22 are entitled; a lower minimum rate is set for those aged 18–22. Equal pay law is a further way in which the state intervenes, providing a mechanism for employees to complain when they consider their pay to be unjustifiably lower than that paid to a colleague of the opposite sex. Moreover, in many countries incomes policies are operated as tools of inflation control. These restrict the amount of additional pay that people can receive in any one year while remaining in the same job. While formal incomes policies were abandoned in the UK after the 1970s, similar thinking continues to underpin government decision making in the area of public sector pay (Thorpe 2000, pp. 34–5).

A further restriction on management action is the nature of the product markets in which their organisations operate. The extent of this influence varies according to how important labour costs are in deciding product cost, and how important product cost is to the customer. In a labour-intensive and low-technology industry such as catering, there will usually be such pressure on labour costs that the pay

administrator has little freedom to manipulate pay relationships. In an area such as magazine printing, the need of the publisher to get the product out on time is so great that labour costs, however high, may be of relatively little concern. In this situation the pay negotiators have much more freedom of manoeuvre.

It is possible, notwithstanding the above restrictions, to identify four principal mechanisms for the determination of base pay. They are not entirely incompatible, although one tends to be used as the main approach in most organisations.

External market comparisons

In making external market comparisons the focus is on the need to recruit and retain staff, a rate being set which is broadly equivalent to 'the going rate' for the job in question. The focus is thus on **external relativities**. Research suggests that this is always a major contributing factor when organisations set pay rates, but that it increases in significance higher up the income scale. Over 75 per cent of employers look to the external market when determining pay for senior managers, but only 55 per cent say they do so when setting rates for manual staff (CIPD 2004, p. 21). Some employers consciously pay over the market rate in order to secure the services of the most talented employees. Others 'follow the market', by paying below the going rate while using other mechanisms such as flexibility, job security or longer-term incentives to ensure effective recruitment and retention. In either case the decision is based on an assessment of what rate needs to be paid to compete for staff in different types of labour market. Going rates are more significant for some than for others. Accountants and craftworkers, for instance, tend to identify with an external employee grouping. Their assessment of pay levels is thus greatly influenced by the going rate in the trade or the district. A similar situation exists with jobs that are clearly understood and where skills are readily transferable, particularly if the employee is to work with a standard piece of equipment. Driving heavy goods vehicles is an obvious example, as the vehicles are common from one employer to another, the roads are the same, and only the loads vary. Other examples are secretaries, switchboard operators and computer operators. Jobs that are less sensitive to the labour market are those that are organisationally specific, such as most semi-skilled work in manufacturing, general clerical work and nearly all middle-management positions.

There are several possible sources of intelligence about market rates for different job types at any one time. A great deal of information can be found in published journals such as the pay bulletins issued by Incomes Data Services (IDS) and Industrial Relations Services (IRS), focusing on the hard-to-recruit groups such as computer staff. More detailed information can be gained by joining one of the major salary survey projects operated by firms of consultants or by paying for access to their datasets. Information on specific types of job, including international packages for expatriate workers, is collected by specialised consultants and can be obtained on payment of the appropriate fee. White (2000, pp. 44–5) identifies a range of other sources of UK pay data including the Confederation of British Industry's Pay Databank and the Office of Manpower Economics. In addition there are more informal approaches such as looking at pay rates included in recruitment advertisements in papers and at job centres. New staff, notably HR people, often bring with them a knowledge of pay rates for types of job in competitor organisations and can be a useful source of information. Finally, it is possible to join or set up salary clubs.

These consist of groups of employers, often based in the same locality, who agree to share salary information for mutual benefit.

Internal labour market mechanisms

Just as there is a labour market of which the company is a part, so there is a labour market within the organisation which also needs to be managed so as to ensure effective performance. According to Doeringer and Piore (1970) there are two kinds of internal labour market: the enterprise and the craft. The enterprise market is so called because the individual enterprise defines the boundaries of the market itself. Such will be the market encompassing manual workers engaged in production processes, for whom the predominant pattern of employment is one in which jobs are formally or informally ranked, with the jobs accorded the highest pay or prestige usually being filled by promotion from within and those at the bottom of the hierarchy usually being filled only from outside the enterprise. It is, therefore, those at the bottom that are most sensitive to the external labour market. Doeringer and Piore point out that there is a close parallel with managerial jobs, the main ports of entry being from management trainees or supervisors, and the number of appointments from outside gradually reducing as jobs become more senior. This modus operandi is one of the main causes of the problems that redundant executives face.

Recent American research has stressed the importance of this kind of internal labour market in determining pay rates. Here the focus is on **internal differentials** rather than external relativities. An interesting metaphor used is that of the sports tournament in which an organisation's pay structure is likened to the prize distribution in a knock-out competition such as is found, for example, at the Wimbledon Tennis Championships. Here the prize money is highest for the winner, somewhat lower for the runner-up, lower again for the semi-final losers and so on down the rounds. The aim, from the point of view of the tournament organisers, is to attract the best players to compete in the first round, then subsequently to give players in later rounds an incentive to play at their peak. According to Lazear (1995, pp. 26–33), the level of base pay for each level in an organisation's hierarchy should be set according to similar principles. The level of pay for any particular job is thus set at a level which maximises performance lower down the hierarchy among employees competing for promotion. The actual performance of the individual receiving the pay is less important.

The second type of internal labour market identified by Doeringer and Piore is the craft market, where barriers to entry are relatively high – typically involving the attainment of a formal qualification. However, once workers are established in the market, seniority and hierarchy become unimportant as jobs and duties are shared among the individuals concerned. Such arrangements are usually determined by custom and practice, but are difficult to break down because of the vested interests of those who have successfully completed their period of apprenticeship. Certain pay rates are expected by those who have achieved the required qualification and it is accepted by everyone that this is a fair basis for rewarding people.

Job evaluation

We assess job evaluation in some detail in the next chapter. Here it is necessary only to define the term and identify it as one of the four principal mechanisms of pay

determination. Job evaluation involves the establishment of a system which is used to measure the size and significance of all jobs in an organisation. It is defined by Bloom (1998, p. 185) as follows:

Job evaluation is a systematic process designed to aid an establishment in establishing differentials across jobs within a single employer . . . The culmination of this appraisal process is a hierarchy of jobs denoting their relative complexity and value to the organisation.

The focus is thus on the relative worth of jobs within an organisation and on comparisons between these rather than on external relativities and comparisons with rates being paid by other employers. Fairness and objectivity are the core principles, an organisation's wage budget being divided among employees on the basis of an assessment of the nature and size of the job each is employed to carry out. Usage of job evaluation has increased in recent years. It is currently used by just over half UK organisations in some shape or form (CIPD 2004, p. 21).

Collective bargaining

The fourth approach involves determining pay rates through collective negotiations with trade unions or other employee representatives. Thirty years ago this was the dominant method used for determining pay in the UK, negotiations commonly occurring at industry level. The going rates for each job group were thus set nationally and were adhered to by all companies operating in the sector concerned. Recent decades have seen a steady erosion of these arrangements, collective bargaining being decentralised to company or plant level in the manufacturing sector, where it survives at all. Meanwhile the rise of service sector organisations with lower union membership levels has ensured that collective bargaining arrangements now cover only a minority of UK workers. According to Cully *et al.* (1999, pp. 241–2) only 41 per cent now have any of their terms and conditions determined in this way. The experience of many other countries is similar, but there remain regions such as Eastern Europe and Scandinavia where collective bargaining remains the major determinant of pay rates. Where separate clusters of employees within the same organisation are placed in different bargaining groups and represented by different unions, **internal relativities** become an issue for resolution during bargaining.

In carrying out negotiations the staff and management sides make reference to external labour market rates, established internal pay determination mechanisms and the size of jobs. However, a host of other factors come into the equation too as each side deploys its best arguments. Union representatives, for example, make reference to employee need when house prices are rising and affordable accommodation is hard to find. Both sides refer to the balance sheet, employers arguing that profit margins are too tight to afford substantial rises, while union counterparts seek to gain a share of any increased profits for employees. However good the case made, at the end of the day what makes collective bargaining different from the other approaches is the presence of industrial muscle. Strong unions which have the support of the majority of employees, as is the case in many public sector organisations, are able to ensure that their case is heard and taken into account. They can thus 'secure' a better pay deal for their members than market rates would allow.

ACTIVITY 26.3

Which of the four mechanisms outlined above do you think is usually most efficient for setting the following?

- 1 Base pay
- 2 Annual cost of living increases
- 3 Executive remuneration packages
- 4 Bonus schemes

**THE ELEMENTS OF PAYMENT**

Once the mechanisms for determining rates of pay for jobs in an organisation have been settled, the second key strategic decision relates to the make-up of the pay package. Here there is a great deal of potential choice available. What is included and to what extent are matters which should be decided with a view to supporting the organisation's objectives and encouraging the necessary attitudes and actions on the part of employees. The payment of an individual will be made up of one or more elements from those shown in Figure 26.1. Fixed elements are those that make up the

Bonus	Profit allocation		Variable elements ● Irregular ● Variable amount ● Usually discretionary	
	Discretionary sum			
Incentive	Group calculation basis			
	Individual calculation basis			
Overtime payment				
Premia	Occasional			
	Contractual			
Benefits	Fringe benefits			
	Payments in kind			Other
				Accommodation
				Car
	Benefit schemes			Other
				Pension
				Sick pay
Plussage	'Fudge' payments		Fixed elements ● Regular ● Rarely variable ● Usually contractual	
	Special additions			
Basic rate of payment		Basic		

Figure 26.1 The potential elements of payment

regular weekly or monthly payment to the individual, and which do not vary other than in exceptional circumstances. Variable elements can be varied by either the employee or the employer.

Basic rate

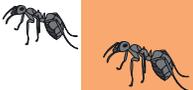
The irreducible minimum rate of pay is the basic. In most cases this is the standard rate also, not having any additions made to it. In other cases it is a basis on which earnings are built by the addition of one or more of the other elements in payment. Some groups of employees, such as operatives in the footwear industry, have little more than half of their earnings in basic, while primary and secondary schoolteachers have virtually all their pay in this form. Indeed, according to the New Earnings Survey as many as 60 per cent of employees receive no additional payments at all beyond their basic pay (Grabham 2003, p. 398).

Plussage

Sometimes the basic has an addition to recognise an aspect of working conditions or employee capability. Payments for educational qualifications and for supervisory responsibilities are quite common. There is also an infinite range of what are sometimes called 'fudge' payments, whereby there is an addition to the basic as a start-up allowance, mask money, dirt money, and so forth.

ACTIVITY 26.4

If your employer offered you a 'remuneration package', which could be made up from any of the items in Figure 26.1 provided that the total cost was no more than £X, what proportion of each item would you choose and why? Does your answer suggest ideas for further development of salary policies?



Benefits

Extras to the working conditions that have a cash value are categorised as benefits and can be of great variety. Some have already been mentioned; others include luncheon vouchers, subsidised meals, discount purchase schemes and the range of welfare provisions such as free chiropody and cheap hairdressing.

Premia

Where employees work at inconvenient times – or on shifts or permanently at night – they receive a premium payment as compensation for the inconvenience. This is for inconvenience rather than additional hours of work. Sometimes this is built into the basic rate or is a regular feature of the contract of employment so that the payment is unvarying. In other situations shift working is occasional and short-lived, making

the premium a variable element of payment. The New Earnings Survey records that shift premia are now received by just 11 per cent of UK workers, but that it accounts on average for as much as 12 per cent of their total pay (Grabham 2003, p. 399).

Overtime

It is customary for employees working more hours than are normal for the working week to be paid for those hours at an enhanced rate, usually between 10 and 50 per cent more than the normal rate according to how many hours are involved. Seldom can this element be regarded as fixed. No matter how regularly overtime is worked, there is always the opportunity for the employer to withhold the provision of overtime or for the employee to decline the extra hours. Overtime is earned by over a quarter of the UK workforce, more than two-thirds of the recipients being men (Grabham 2003, p. 398). It is particularly associated with less well paid manual work. Where overtime is paid it tends to account for a major portion of an individual's gross pay (18.2 per cent on average in 2002).

Incentive

Incentive is here described as an element of payment linked to the working performance of an individual or working group, as a result of prior arrangement. This includes most of the payment-by-results schemes that have been produced by work study, as well as commission payments to salespeople, skills-based pay schemes and performance-related pay schemes based on the achievement of agreed objectives. The distinguishing feature is that the employee knows what has to be done to earn the payment, though he or she may feel very dependent on other people, or on external circumstances, to receive it. One in seven workers receives a portion of their pay via incentives of one kind or another, more men being rewarded in this way than women. On average incentive pay contributes 22 per cent towards their overall salaries (Grabham 2003, p. 398).

Bonus

A different type of variable payment is the gratuitous payment by the employer that is not directly earned by the employee: a bonus. The essential difference between this and an incentive is that the employee has no entitlement to the payment as a result of a contract of employment and cannot be assured of receiving it in return for a specific performance. The most common example of this is the Christmas bonus.

We include profit sharing under this general heading although the ownership of shares confers a clear entitlement. The point is that the level of the benefit cannot be directly linked to the performance of the individual. Rather, it is linked to the performance of the business. In some cases the two may be synonymous, with one dominant individual determining the success of the business, but there are very few instances like this, even in the most feverish imaginings of tycoons. Share ownership or profit sharing on an agreed basis can greatly increase the interest of the employees in how the business is run and can increase their commitment to its success, but the performance of the individual is not directly rewarded in the same way as in incentive schemes.

THE IMPORTANCE OF EQUITY

Whatever methods are used to determine pay levels and to decide what elements make up the individual pay package, employers must ensure that they are perceived by employees to operate equitably. It has long been established that perceived inequity in payment matters can be highly damaging to an organisation. Classic studies undertaken by J.S. Adams (1963) found that a key determinant of satisfaction at work is the extent to which employees judge pay levels and pay increases to be distributed fairly. These led to the development by Adams and others of **equity theory** which holds that we are very concerned that rewards or ‘outputs’ equate to our ‘inputs’ (defined as skill, effort, experience, qualifications, etc.) and that these are fair when compared with the rewards being given to others. Where we believe that we are not being fairly rewarded we show signs of ‘dissonance’ or dissatisfaction which leads to absence, voluntary turnover, on-job shirking and low-trust employee relations. It is therefore important that an employer not only treats employees equitably in payment matters but is *seen* to do so too.

While it is difficult to gain general agreement about who should be paid what level of salary in an organisation, it is possible to employ certain clear principles when making decisions in the pay field. Those that are most important are the following:

- a standard approach for the determination of pay (basic rates and incentives) across the organisation;
- as little subjective or arbitrary decision making as is feasible;
- maximum communication and employee involvement in establishing pay determination mechanisms;
- clarity in pay determination matters so that everyone knows what the rules are and how they will be applied.

These are the foundations of procedural fairness or ‘fair dealing’. In establishing pay rates it is not always possible to distribute rewards fairly to everyone’s satisfaction, but it should always be possible to do so using procedures which operate equitably.

ARE WE BECOMING MORE STRATEGIC?

At the start of this chapter we explained how the decline in collective bargaining as the principal mechanism of pay determination in the UK had provided managers with new opportunities to develop their own pay strategies aimed at underpinning the achievement of organisational objectives. The extent to which such opportunities have in practice been taken up is a hotly debated question. More ‘reward managers’ are nowadays employed in organisations than ‘salary administrators’, but how big a change in practice does the change in job titles actually represent?

Many consultants working in the reward field believe that there has been a major shift in a strategic direction. Armstrong and Murlis (1998, pp. 12–14), for example, go so far as to argue that present-day practice is characterised by an acceptance of a ‘new pay philosophy’ in which decisions about payment levels and packages ‘flow from the overall strategy’ of the organisation. According to their view pay policy now increasingly underpins employer objectives and promotes change by rewarding

'results and behaviour consistent with the key goals of the organisation'. Similar claims are made by specialist managers working in the field of pay. Brown (2001, pp. 2–3), for example, draws on survey evidence from Towers Perrin which reveals that '80 per cent of organisations now have an explicit reward strategy' and that 'these strategic plans have driven the 94 per cent of them who introduced significant reward changes in the past three years'.

Academic researchers have tended to take issue with this assessment, often quite stridently. While they agree that major developments have occurred in pay determination over recent decades, they dispute the claims made about the extent of change and question how far organisations are taking a long-term strategic approach to the management of pay. Smith (1993) and Thompson (1998), in particular, have argued that managers are just as short-termist and reactive when making decisions about pay as they always were. Changes are introduced for damage limitation reasons, to respond to immediate recruitment difficulties or in response to government initiatives rather than as a means of aligning practices with organisational goals.

Kessler (2001) and Poole and Jenkins (1998) also report considerable gaps in many organisations between the rhetoric and reality of strategic activity in pay management. They did, however, also find evidence of the development of genuinely original approaches in some larger private sector organisations. For most, however, the story is one of incremental changes being made in order to improve features of existing systems rather than step-shifts involving the adoption of new strategic approaches (Cox and Purcell 1998; Brown 2001; Thompson and Milsome 2001).

WINDOW ON PRACTICE

Attitudes towards payment arrangements vary radically between different countries. In a survey in Singapore 1,500 respondents were asked to pick three of the following five factors which they believed would have a significant impact on wage determination: wages in the same industry, wages in a different industry, union representation, government influence and productivity. The proportion of respondents identifying the five factors as significant were:

Productivity	33.5%
Government	29.1%
Wages in the same industry	27.1%
Unions	18.3%
Wages in a different industry	14.8%

The same survey demonstrated that the main cause of differences between individual perspectives was the quality and quantity of information that they had received from their employers about their businesses.

Source: D.P. Torrington and Tan Chwee Huat (1994)
Human Resource Management for South East Asia. Singapore: Simon & Schuster.

SUMMARY PROPOSITIONS

- 26.1** In payment matters employees are principally concerned with purchasing power, fairness and recognition of effort and skills. Employers are concerned with recruitment, retention, motivation and minimising the wage budget.
- 26.2** Employers are restricted in pay matters by the law and the realities of their product markets.
- 26.3** There are four main alternative methods of setting base pay rates: external labour market comparisons, internal labour market mechanisms, job evaluation and collective bargaining.
- 26.4** The main elements of payment are basic rate, plussage, benefits, premia, overtime, incentives and bonus.
- 26.5** Procedural equity is essential to the design of successful payment systems.
- 26.6** Analysts disagree about how far UK managers have embraced more strategic approaches to reward management in recent years.

GENERAL DISCUSSION TOPICS

- 1 Can payment ever be truly fair?
- 2 The chapter lists employer and employee objectives in relation to payment. What changes would you make to these lists?
- 3 Do you think it is possible to identify 'best practice' in payment policy? What elements would you consider should make up any such package?

FURTHER READING

Chartered Institute of Personnel and Development

The Chartered Institute of Personnel and Development carries out a big annual survey of reward management policy and practice which is published in February each year. It can be downloaded from the institute's website. They also published two useful broad surveys of the reward field in 2001; a research report entitled 'Reward Determination in the UK' and an executive briefing exploring *The future of reward*.

Kessler, I. (2001) 'Reward System Choices', in J. Storey (ed.) *Human Resource Management: A Critical Text*, 2nd edn. London: Thomson Learning

This excellent chapter assesses different conceptions of reward strategy and reviews the evidence on the extent to which any have been adopted in the UK. The author is particularly good at explaining links between pay policy and the broader debates about HRM strategy we discussed in Chapter 2.

Thorpe, R. and Homan, G. (2000) *Strategic Reward Systems*. London: Financial Times/Prentice Hall

Several of the chapters in this volume take forward the main points made in the present chapter. Many contain case study examples which illustrate the problems organisations face putting pay strategy into action in practice.

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An extensive range of additional materials, including multiple choice questions, answers to questions and links to useful websites can be found on the Human Resource Management Companion Website at www.pearsoned.co.uk/torrington.

