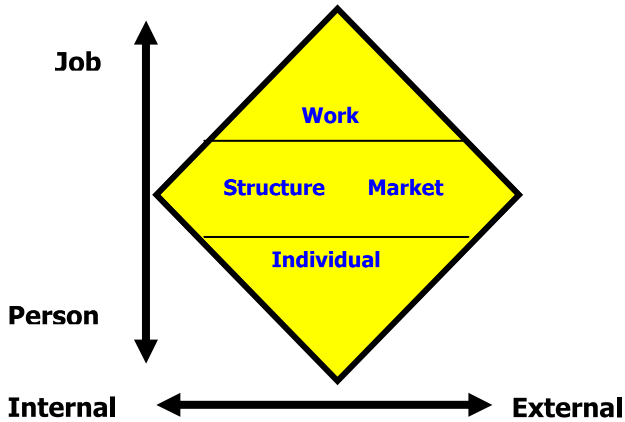
Understanding How Pay Works

How we are rewarded for our contribution is important to us all. We have a need to feel that we are paid fairly both in the amount and in the way it is carried out. Otherwise, this can be frustrating and possibly de-motivating. Pay systems often just evolve over time and as organisations grow more complex the logic of how they work may become confusing. Mostly, they are simply misunderstood.   We are going to try to explain the main aspects of pay systems and how they fit together. The diamond picture below shows the four main aspects that we will discuss. It has four parts: work measurement; pay structure; pay market; individual pay. We will look at each in turn.



Work measurement
The ranking of roles or jobs and /or people is a natural feature of work and forms the foundation for decisions on pay. In the diamond, there is a balance between placing the emphasis on the role itself or on the person.

Work measurement is concerned with valuing the job, independent of the person doing the job, putting all the jobs into a rank order. Not always an easy task. It is frequently done in an ad-hoc way and ends up feeling unfair. Various ways of assessing the relative size of a job have been used from a simple opinion to complex 'job evaluation' systems that put a score on the job. The score is then used as a way of ranking the jobs, sometimes into grades for pay purposes. About half of organisations use some form of job evaluation to help determine pay.

In the UK, the notion of 'Equal Pay' between the genders has been a legal requirement since 1975. Job evaluation plays a key part to determining equal pay and requires the chosen method to be both analytical and free from sex bias.

Pay structure

The pay structure is the way in which the organisation makes decisions about pay. There are many variations, from the distinctly informal and to a highly engineered system. In the diamond, the choice is between managing the internal fairness or adopting a more anarchic process of responding to the apparent external pay markets.

The content of a pay structure considers key areas such as:

- Contractual salary
- Bonus and incentives for performance
- Longer term incentives such as shares in the company
- Benefits, for example pension, cars, insurance, holidays.

Not all organisations choose or are able to use all of these approaches; probably most just use salary and benefits in their structure. Grades are often used to set out a hierarchy of jobs in an organisation and these are usually also used to determine salary and the associated benefits. Sometimes grades are simply arbitrary pay rates but can also be determined from the results of a job evaluation exercise.

A grade may have a single pay rate or it may have a salary range, another pay structure feature. The salary range might be used for a variety of purposes but primarily is there to reward such things as service, experience, capability and performance. In some organisations, an individual will progress automatically through the range each year until the range maximum is reached. However, in modern practice, progression is more discretionary and a decision of line management often using an appraisal system.

Pay Market

All organisations have to pay attention to the prevailing pay market. Usually, but not always, it rises over time. However, it is by no means a scientific or exact process and there is always conflicting information. Statistics show that pay is skewed in its distribution for any given job. The range of pay is quite narrow below the middle and above can be very wide indeed which means the average rate of pay is higher than most people actually receive! Most organisations elect to try to remain somewhere in the middle of the pay market. Naturally, employees may bid for more pay on their own ideas, however many organisations will choose to maintain a degree of internal relativity between staff and resist these requests. There is also an Equal Pay aspect to this constraint.

There are several reasons for variations in pay markets, for example, skill shortages or simple fame. We all know of significant sums paid to a very few entertainers or sports stars. More reasonably, there are variations in pay according to such things as location, type of job and business sector. Some organisations may build such considerations into their pay structure. Of course, what is often over looked is the observation that markets can fall as well as rise.

Individual
Pay has been related to contribution throughout early history. The Romans paid soldiers in salt, hence the phrase 'worth his salt'.

Many people believe that it is right and proper to have a meritocracy and that people should be rewarded differently for their contribution. But, it is not easy to achieve a sense of fairness and objectivity. Organisations often use a formal system of performance management and this may or may not have a clear link to the pay structure. In general, the pay differences actually given are conservative, but some organisations may be quite aggressive in rewarding their best people. Other organisations may be considerably more arbitrary in giving more to some than others and base individual pay decisions on personal feeling. A long way from job evaluation and pay structure.

Whilst the previous three aspects of pay are largely concerned with ideas and management processes, the individual aspect gets personal. Some organisations abdicate this responsibility, letting something else, like time, make the decisions for them.

In conclusion
Peoples pay is remarkably complex and there is no single belief about what is the best way or managing it. Breaking down the complexity using the aspects of the diamond helps everybody understand how pay works.

We believe in a number of principles:

- Equal pay for equal work
- Sensible pay structure appropriate to the business
- Competitive pay against chosen comparators
- Increased reward for higher contribution

We believe reward works!

Reward Works Ltd
+44 (0) 121 684 1306 +44 (0) 777 180 740116
16 Fountain Road, Edgbaston, Birmingham, B17 8NL
s.watson@rewardworks.co.uk
www.RewardWorks.co.uk