INNECTO
REWARD CONSULTING

Pay Trends white paper

Spring 2019

INTRODUCTION

From Innecto CEO Karen Thornley

Thank you for downloading our Pay Trends 2019 report – we hope you find it a useful and enjoyable read.

Feedback from Innecto's client community and audience members at our Pay Trends Roadshows suggests that planning Reward policy in 2019 and beyond is proving exceptionally difficult. On the one hand, the current economic picture is positive - a stable economy, and levels of employment at a record high. On the other hand, uncertainty over Brexit threatens to hold back economic growth as many details of the UK's exit remain undecided.

In this ambiguous climate, it's easy to get stuck in thinking short-term, and simply reacting to events instead of driving your own agenda. We hope that the insights below will help HR leaders to lift their gaze and think strategically about how to support their organisation's performance over the next few years. Making the right investment, at the right time, will help you build a future-proof People strategy and stand out as an employer of choice.

And in other news… Innecto's 2019 got off to a flying start as we announced our acquisition by AIM-listed employee services Personal Group plc. This association offers exciting opportunities for both companies and I look forward to exploring them in my new role as Innecto CEO.

If you'd like to discuss our research in more detail, please email enquiries@innecto.com or call us on 020 3457 0894.

Best wishes, Karen

Biography

Karen brings over 20 years' commercial and strategic experience to her role as Innecto CEO.

Supported by the Senior Leadership and Consultancy teams, Karen plans and executes Innecto's strategic direction and our delivery of long-term business goals. She looks forward to pursuing new opportunities arising from Personal Group's acquisition of Innecto.

Karen's in-depth knowledge of Innecto's operations and services gives her a unique insight into our clients' requirements and how to continually improve our offering. She plans to build on Innecto's impressive track record and is passionate about translating our unique business values across everything we do.

Before joining Innecto Karen worked in senior marketing positions in the leisure, telecoms and not-for-profit sectors, including Zonefit, Excalibur Communications and RAF Charitable Trust Enterprises. She holds a BA (Hons) in Management Studies and Business Administration from Reading University, specialising in Marketing.

1. The Financial Times, 1 January 2019
2. The Financial Times, 8 November 2018
3. BBC News, 19 December 2018

THE BIG PICTURE

We usually set the scene by looking at large-scale political and economic trends, and how they affect the world of HR and Reward. This year one topic takes centre stage: Brexit. Understandably many of our UK-based clients are focused on preparing for Brexit and its immediate aftermath, but whatever the outcome, it's important to stay strategic rather than reactive. We encourage clients to keep sight of their long-term goals, even in an uncertain environment.

Brexit

At present the situation seems deadlocked and options are limited: renegotiate a deal? Reach cross-party compromise? Hold a second referendum? Or leave the EU with no deal?

There is not much time to renegotiate a deal (even if the EU agrees to it) before Brexit day on 29 March. The EU has indicated that it would be open to extending the departure date by three months, but this is still a tight timeline. Parliament is against a no-deal outcome, and if a second referendum is held, there is no guarantee that it would resolve the Brexit question. The cabinet has been stepping up no-deal preparations to ensure that the UK can trade on WTO terms at the end of the first quarter of 2019, but many of the issues remain unresolved.

- **Impact** – Uncertainty is unsettling for both businesses and employees. Whilst contingency planning is underway, many are adopting a 'wait and see' approach. Too narrow a focus on Brexit, however, may risk ignoring the need to get on with business as usual.

Economic forecast

According to 81 leading economists, the UK economy is facing a gloomy future - deal or no deal. Continuing uncertainty will hobble UK business investment and depress consumer spending in 2019, stunting long-term growth even if Britain manages to avoid a disorderly Brexit, according to a Financial Times poll (1). Such predictions may be unfounded, but in the event of long-term uncertainty it's essential that businesses don't just tread water.

- **Impact** - Sluggish economy may mean businesses putting off vital investment.

Migration

We're seeing a skills shortage in several key industries, such as hospitality, IT, and healthcare (2). It remains unclear whether the Government's post-Brexit migration policy will help or hinder this situation.

Current proposals suggest low-skilled workers will be able to work in the UK for up to a year, under a scheme designed to fill vacancies in sectors which are heavily dependent on EU labour and could struggle to adapt when free movement ends (3). The government estimates numbers of such workers will be similar to the UK's current 170,000 migrant workers in low-skill roles – but crucially this total remains uncapped.

Plans are also afoot to scrap the existing cap on the number of skilled workers from the EU and elsewhere, in theory giving the UK access to a wider pool of skilled labour. However, the government are reconsidering a minimum salary requirement of £30,000 for skilled migrants seeking five-year visas. This follows controversy on the policy's initial announcement as starting salaries of key NHS personnel such as nurses, junior doctors, and social care workers fall well under this threshold.

- **Impact** – Still unclear, but changes to availability of migrant labour could affect ability of key industries to recruit the staff they need.

Sources: ONS, OBR, PwC, Organisation for Economic Co-operation and Development

ECONOMY

As usual, we have run through the key economic indicators of GDP, CPI and unemployment that the Office of National Statistics, Office for Budget Responsibility and other reputable forecasters are predicting.

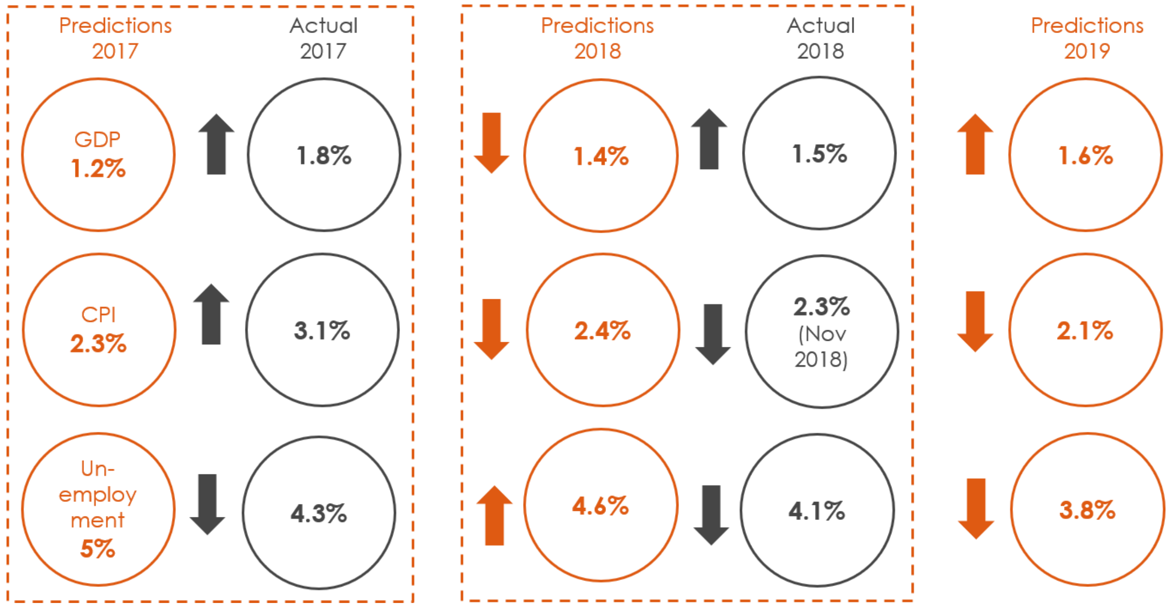
However, forecasting the future is a tricky business, as seen when comparing 2017's predicted vs. actual figures. We'll discuss some key points below but as always, take these predictions with a hefty pinch of salt.

Year on year trends

First, GDP growth has been slightly better than expected, with the UK ending the year on 1.5%. The uplift in the economy has been associated to UK exports which have been boosted by the upturn in global growth over the past two years. The weaker pound, although bad for UK consumers, has been helpful to exporters and inbound tourism.

Second, CPI has remained fairly steady, and a predicted 2019 rate of 2.1% is in line with the Bank of England's inflation target of 2%.

Third, employment levels remain at a historic high; essentially everyone who wants a job can find one. Whilst this is good news, another year of nearly full employment puts pressure on recruitment and many organisations are finding it difficult or expensive to replace key talent in the current climate. We have experience of companies having to offer 10-12% above their outgoing employee's salary when trying to fill a vacancy.



Ongoing impact

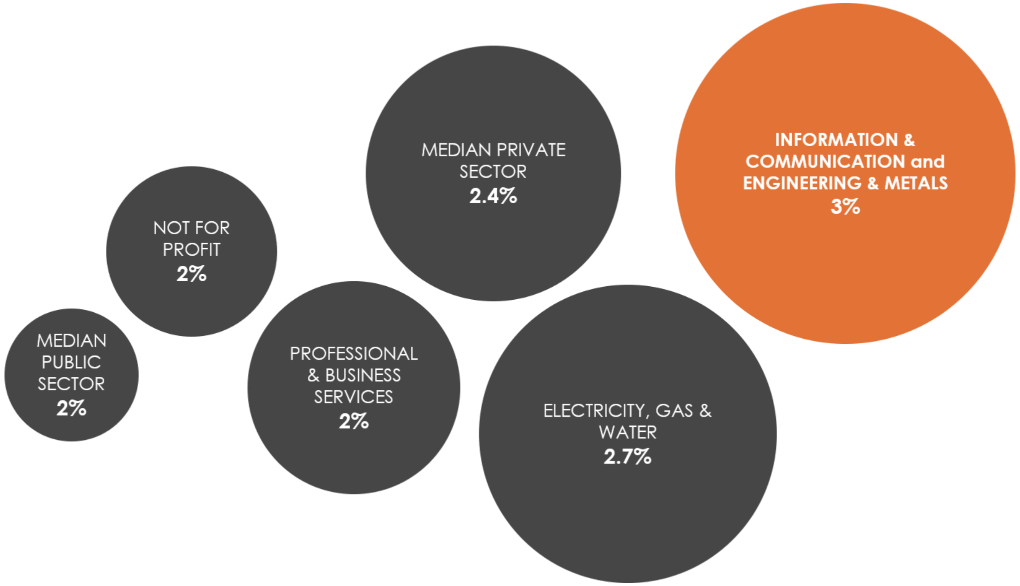
The current economic picture is positive, but future developments will depend heavily on the nature of the UK's exit from the EU. Similarly, changes to migration policy are yet to be finalised but we may see a significant impact on the volume and type of workers entering the UK labour market. Employers will have to be prepared for a knock-on effect to recruitment and retention – and may need to act quickly to secure the right talent.

1. Predicted median pay awards 2019 (Source: XpertHR)
2. BBC news, 24 July 2018
3. Prospect, 27 November 2018
4. IT Pro, 7 January 2019

INDUSTRY EFFECT 2019

The high-level picture of pay settlements by sector in January 2019 suggests that the average pay award is about 2.5% - a familiar picture for the last five years (1).

However, indications from Innecto clients and the wider HR community suggest that this overview masks much larger pay pots in certain sectors. Sustained high levels of employment are forcing employers to keep pay competitive, especially when it comes to retaining key talent.



Pay awards by sector

- **Private sector** – The median pay award is predicted to be 2.4%, a rise on the 2% we've seen for last 7 years. Respondents reported that they expect half of all pay awards to fall between 2% and 3%.

- **Not-for-profit** - Settlements here are expected to be 2% in 2019 which is a 0.5% increase on the 2018 median. This finally brings Not-for-profit more into line with other sectors and is a key indicator of the struggle for talent, even in sectors which have traditionally depended on more intangible retention factors.

- **Public sector** - The 1% cap for public sector workers came off last year, so their median has risen for first time since 2010. Teachers and NHS workers were among the big winners in the public sector this year, receiving pay deals of 3.5% and 3% respectively – but many argue this increase doesn't go far enough to reverse years of pay freeze (2).

- Furthermore, in the Civil Service and arm's-length bodies, Treasury guidance still stipulates a range of 1% to 1.5% rises. Departments wanting to award increases outside this range had to make a special business case to do so but were frequently rejected (3). However, the headline pay increase doesn't tell the whole story. Many public sector roles have incremental pay scales which sit behind the overall pay review – including teachers, nurses, police and some Civil Service roles.

- **Information & Communication** - The IT sector continues to command a high premium. We think a 3% median may not reflect the true value of these skills – for example, job market data from CV-Library found that 2018 pay in fact was up 4.3% in IT (4).

LOW PAY

National Living Wage

The National Living Wage (for employees aged 25 or over) is due to increase from £7.83 to £8.21 an hour in April 2019 – an increase of nearly 5% (1). This jumps to 9.6% next year if the government follows through on its promise to hit £9 an hour by 2020. Either way, it's a significant pot of money to find, and higher salaries at the base of your organisation puts pressure on wage differentials higher up.

Underpayments

HM Revenues and Customs identified a record £15.6 million in National Living/Minimum Wage underpayments last year (2). 240 companies were fined, as well as named and shamed in the media. Common reasons why workers fell beneath the minimum threshold include travel allowances, uniform costs and salary sacrifice schemes.

However, Secretary of State for Business, Energy and Industrial Strategy Greg Clark has stated the government may be considering changes to the law "when evidence shows that rules unnecessarily penalise employers" (3). This follows the case of retailer Iceland facing a possible £21 million fine for letting employees contribute a proportion of their earnings to a voluntary Christmas savings pot – punishing employers for offering such schemes seems counterintuitive at best.

MINIMUM WAGE RATES 2018-19

	Current rate	**Rate April 2019**	**Increase %**
25 years + (National Living Wage)	£7.83	£8.21	4.9%
21-24 years	£7.38	£7.70	4.3%
18-20 years	£5.90	£6.15	4.2%
16-17 years	£4.20	£4.35	3.6%
Apprentice	£3.70	£3.90	5.4%

Upward pressure

We've seen an increase in protests over low pay, particularly in the service sector. For example, in October 2018 staff from McDonalds, Uber Eats, Deliveroo, Wetherspoon's and TGI Fridays coordinated a 'McStrike' to demonstrate the issues of 'poverty pay' and insecure working conditions (4).

The impact of such upward pressure is still unclear. Some companies with a high proportion of lower-paid staff have responded with a blanket pay rise – for example, Amazon UK workers now get at least £9.50 an hour and £10.50 in London – whilst others are prioritizing skills-based pay (5).This is a fast-evolving area and it's possible that the market for low-paid staff will change dramatically depending on migration policy post-Brexit.

1. Minimum wages rates from gov.uk
2. Department for Business, Energy & Industrial Strategy, 22 September 2018
3. People Management, 7 January 2019
4. The Guardian, 20 September 2018
5. The Guardian, 2 October 2018

1. FRC UK Corporate Governance Code, July 2018
2. The Guardian, 1 January 2019
3. Edelman Trust Barometer 2018
4. The Guardian, 19 July 2018
5. The Guardian, 7 December 2019
6. BBC News, 29 August 2019
7. CIPD, 4 January 2019

HIGH PAY

New corporate governance

This year sees a major shake-up in Executive Remuneration as a result of the Financial Reporting Council's new Corporate Governance Code, in effect from 1 January 2019 with initial disclosures in 2020 (1).

The most significant change is that businesses will have to divulge and most importantly justify the difference between executive salaries and average annual pay for employees; AKA CEO pay ratio reporting (2). Organisations must give reasons for why pay policies are appropriate using internal and external measures. They will also need to explain how directors take staff and other stakeholder interests into account when they decide on salaries and bonuses.

Greater disclosure for Executive Pay brings similar challenges to Gender Pay – creating a narrative, contextualising your figures, and communicating your considered pay position to diverse groups of stakeholders. It will be interesting to see the reaction when companies publish their first set of figures early next year, and the degree of employee interest even at those companies which don't have to report.

Increase in shareholder revolts

Public trust in business remains worryingly low, and excessive executive pay is the most commonly cited factor (3). 2018 saw its fair share of controversial pay awards, with packages at Royal Mail, AstraZeneca, and WPP coming in for heavy criticism from both shareholders and the media (4). A particularly striking example was the £1.86 million bonus for Mike Betts, CEO of government-backed charity Motability, in addition to his £1.7 million salary (5).

The Investment Association found that significant shareholder revolts at FTSE firms jumped by 25% in the year to 31 July, with many shareholder groups arguing that high executive pay was not being matched by performance (6). In this charged environment, it's even more important for RemComs to make the right call and crucially, back up their decisions.

Shift towards considering wider context

The new Corporate Governance code encourages a more meaningful approach to Executive Pay, by promoting fairness, rigour, and transparency. In this spirit, the CIPD have called for HR to take a more central role in setting high pay, by providing less focus on external benchmarks and more on people and culture. They argue that involving HR and their direct experience of pay levels across the business, and not just in the Boardroom, will help set pay according to an "internal barometer of fairness" (7).

This seems a sensible suggestion and may help to avoid more glaring examples of poor pay management by rooting RemCom decisions in a wider business context. Our own research shows that the gap between best practice and actual operating procedures remains high, so perhaps education on this front would also be beneficial.

1. Personnel Today, 13 February 2019
2. The Guardian, 1 January 2019
3. Equality and Human Rights Commission, 10 October 2018
4. CBI/Pertemps Employment Trends Survey 2018, 18 December 2018, p.41
5. The Guardian, 8 January 2019
6. The Resolution Foundation, 27 December 2018

GENDER PAY

The long game

With weeks rather than months until the 2019 reporting deadline, just over 1,000 employers have published their data from the 2018 snapshot date (1). Last year saw a rush to publish close to the deadline of 5th April, and we expect this year to be similar. Arguably the legislation has succeeded in its intentions by providing clarity on the extent of the issue, with 2018's figures showing that almost eight out of ten companies and public sector bodies paid men more than women (2).

Enforced reporting has also improved public awareness, as well as much-needed education on the difference between Gender and Equal Pay. Two-thirds of women now take a company's Gender Pay Gap into consideration before applying for a job there, according to research from the Equality and Human Rights Commission (3). Business leaders in particular are taking notice, given their commercial imperative to recruit and retain the best talent regardless of gender. The Confederation of British Industry's (CBI) employment trends survey showed that 93% of businesses are taking action to close the Gender Pay Gap and increase diversity in their workforces, compared with 62% who were asked a similar question in 2017 (4).

Telling your story

In this context, the pressure is on for organisations to show a reduction in their Gender Pay Gap. However, it's likely that actions taken to redress the gap will take 3-5 years to see a real impact, with the result that gaps may stall or even increase in the meantime. For example, HSBC's mean Gender Pay Gap grew to 61% in 2018, compared to 59% a year earlier, and the gap has widened at nearly a third of government departments over the past 12 months (5). Ironically, measures to address Gender Pay Gaps, such as more flexible working and gender diversity in entry level roles, could widen pay gaps before they narrow.

Therefore it's vital for companies to get the full picture out there. Clear and timely communications with tailored messaging are crucial for keeping current and prospective employees onside. However, companies will need to back up their narratives with an evidence-driven action plan; as we enter Years 3 and 4, employees' patience may wear thin with year-on-year significant Gender Pay Gaps that show no sign of narrowing.

Ethnicity Pay

Gender Pay reporting has had an immediate and wide-ranging effect, by shining a light on the problem and putting pressure on firms to address their pay gaps. For many, the logical next step is legislating for mandatory publication of Ethnicity Pay Gaps, with the hope of replicating this success.

Research by the Resolution Foundation found that Black, Asian and ethnic minority (BAME) employees are losing out on £3.2 billion a year in wages compared to white colleagues doing the same work (6). Whilst it's important that the government take action to address these pay penalties, reporting on pay gaps by Ethnicity is likely to be more challenging than Gender Pay since most UK firms do not routinely collect employees' ethnicity data as they do gender. The government's consultation on Ethnicity Pay Reporting closed 11th January 2019, so we expect to see proposals on implementation by late Spring 2019.

FOOTNOTES IN FULL

The big picture

1. 'Brexit 'bad or awful' for UK prospects in 2019, say economists', Delphine Strauss and Gavin Jackson, The Financial Times, 1 January 2019. Accessed at https://www.ft.com/content/5a90765c-0ce6-11e9-acdc-4d9976f1533b
2. 'The five UK sectors grappling with acute labour shortages', Gavin Jackson, The Financial Times, 8 November 2018. Accessed at https://www.ft.com/content/36baacce-ddd0-11e8-9f04-38d397e6661c
3. 'Immigration: White Paper sets out post-Brexit rules for migrants', BBC News, 19 December 2018. Accessed at https://www.bbc.co.uk/news/uk-politics-46613900

Economy

Actuals:

Figures from the Office for National Statistics:
GDP - https://www.ons.gov.uk/economy/grossdomesticproductgdp/bulletins/gdpmonthlyestimateuk/december2018
CPI - https://www.ons.gov.uk/economy/inflationandpriceindices/bulletins/consumerpriceinflation/december2018
Unemployment - https://www.ons.gov.uk/employmentandlabourmarket/peoplenotinwork/unemployment

Predictions:
GDP 2019 - PwC https://www.pwc.co.uk/services/economics-policy/insights/uk-economic-outlook.html
CPI 2019 - Organisation for Economic Co-operation and Development https://data.oecd.org/price/inflation-forecast.htm
Unemployment 2019 - Office for Budget Responsibility https://obr.uk/forecasts-in-depth/the-economy-forecast/inflation/

Industry effect

1. Predicted median pay awards 2019 (Source: XpertHR)
2. 'Public sector workers: Pay rises announced for a million people', 24 July 2018. Accessed at https://www.bbc.co.uk/news/uk-44933009
3. '2% pay rises in public sector are the new norm, says IDR', Prospect, 27 November 2018. Accessed at https://www.prospect.org.uk/news/id/2018/November/27/2-pay-rises-public-sector-are-new-norm-says-IDR
3. 'UK IT sector enjoyed a 4.3% pay rise in 2018', Connor Jones, IT Pro, 7 January 2019. Accessed at https://www.itpro.co.uk/business-strategy/careers-training/32668/uk-it-sector-enjoyed-a-43-pay-rise-in-2018

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1. National Minimum Wage and National Living Wage rates. Accessed at https://www.gov.uk/national-minimum-wage-rates
2. 'Record £15.6 million underpayment identified for workers on the minimum wage', Department for Business, Energy & Industrial Strategy, HM Revenue & Customs, and Kelly Tolhurst MP, 22 September 2018. Accessed at https://www.gov.uk/government/news/record-156-million-underpayment-identified-for-workers-on-the-minimum-wage
3. 'Government reconsidering minimum wage rules as Iceland faces £21m bill', Francis Churchill, People Management, 7 January 2019. Accessed at https://www.peoplemanagement.co.uk/news/articles/government-reconsidering-minimum-wage-rules-iceland-faces-bill

4. ‘Wetherspoon's and McDonald's staff to strike together’, Ben Quinn, The Guardian, 20 September 2018. Accessed at https://www.theguardian.com/business/2018/sep/20/wetherspoons-and-mcdonalds-staff-to-strike-together
5. ‘Amazon raises minimum wage for US and UK employees’, Richard Partington, The Guardian, 2 October 2018. Accessed at https://www.theguardian.com/technology/2018/oct/02/amazon-raises-minimum-wage-us-uk-employees

High pay

1. FRC UK Corporate Governance Code, July 2018. Accessed at https://www.frc.org.uk/directors/corporate-governance-and-stewardship/uk-corporate-governance-code
2. ‘Top UK firms to reveal executive-worker pay gap under new rules’, Kaleenya Makortoff, The Guardian, 1 January 2019. Accessed at https://www.theguardian.com/business/2019/jan/01/uk-biggest-listed-companies-forced-to-reveal-executive-worker-pay-gap-new-rules
3. 2018 Edelman Trust Barometer press release, 22 January 2018. Accessed at https://www.edelman.co.uk/wp-content/uploads/Website-Edelman-Trust-Barometer-Press-Release-2018.pdf
4. ‘Investor revolt over Royal Mail boss's pay deal is biggest for years’, Rob Davies, The Guardian, 19 July 2018. Accessed at https://www.theguardian.com/business/2018/jul/19/majority-of-investors-reject-pay-deal-for-royal-mails-chief-executive
5. ‘Motability firm boss quits after news of £2.2m bonus’, Simon Murphy and Patrick Butler, The Guardian, 7 December 2019. Accessed at https://www.theguardian.com/society/2018/dec/07/motability-firm-boss-to-get-22m-bonus-on-top-of-17m-salary
6. ‘Shareholder revolts ‘up by a quarter’ at FTSE firms’, BBC News, 29 August 2019. Accessed at https://www.bbc.co.uk/news/business-45335841
7. ‘RemCo reform’, CIPD, 4 January 2019. Accessed at https://www.cipd.co.uk/knowledge/strategy/governance/reforming-remuneration-policy#_ga=2.208345495.407155357.1550254075-348039444.1550254075

Gender Pay

1. ‘Gender pay gap 2019: Three in 10 reports have errors’, Ashleigh Webber, Personnel Today, 13 February 2019. Accessed at https://www.personneltoday.com/hr/gender-pay-gap-reporting-2019-errors/
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3. ‘Gender pay gap determines women’s choice of employer’, Equality and Human Rights Commission, 10 October 2018. Accessed at https://www.equalityhumanrights.com/en/our-work/news/gender-pay-gap-determines-women%E2%80%99s-choice-employer
4. CBI/Pertemps Employment Trends Survey 2018, 18 December 2018, p.41. Accessed at http://www.cbi.org.uk/insight-and-analysis/change-and-opportunity/
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