

PAY TRENDS 2016

We get your pay and reward working harder

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ECONOMIC OVERVIEW



Although the UK economy has remained steady, many UK businesses face difficult times this year and with the backdrop of a volatile world economy, 2016 could be a challenging year for organisations. GDP growth in 2015 has slowed against 2014, despite increased consumer spending. However, this follows two years of steady growth, with 10 consecutive quarters of increased GDP (the longest period of growth since 2008). Overall in 2015, GDP grew by 2.4% and is predicted by the Office for Budget Responsibility to grow again this year by 2.4%.

Unemployment continues to reduce with the November 2015 figure at 5.5%, down from 6.2% in November 2014. This downward trend is predicted to continue in 2016, suggesting unemployment at 5.2% despite some high profile, large scale redundancies in the manufacturing sector. This along with tightening of immigration controls, will add fuel to the fire of UK skills shortages.

Headline pay settlement figures are not expected to change from the current 2-2.5% throughout 2016, but low inflation will mean that employees will continue to see a real-terms increase in their pay, with pay awards remaining above the rate of inflation. In fact, almost 70% of full time workers experienced positive real earnings growth in the year to April 2015, close to twice the proportion in 2011. Looking at total cash, average weekly earnings have increased slightly more at 2.4% as more variable pay is earned.

MEASURE	GDP	CPI	AVERAGE WEEKLY EARNINGS	PAY SETTLEMENTS
2015	2.4%	0.1%	2.4%	2.0%
2016 (PROJECTED)	2.4%	1.0%	-	2.0%

Throughout 2015, CPI has been hovering around the zero rate, moving slightly into negative in April and September. This is a reduction from the average rate during 2014 and 2013. Current weakness is driven by falling prices in the cost of goods and oil, and while services inflation has remained steadier at around 2.5% during 2015, this too has fallen from rates in previous years. This is supporting the rise in consumer confidence and spending. There is speculation that inflation will rise in the second half of the year to an estimated 1%, but with the continued decline of oil prices, many commentators predict another year of zero growth.

The wider context is a global economy that is looking unsettled, with the big story being China's volatile economy with growth predictions the lowest in 25 years. With the UK's vote on EU membership, due later this year, businesses remain cautious with their plans.

WHAT THIS MEANS FOR HR:

1. Skills shortages and low headline pay settlements will mean you need to work harder to engage and retain talented employees.
2. Articulating and differentiating your employee deal will become increasingly important in talent acquisition.
3. Self-funding variable pay will become a greater focus for organisations that want to reward those that perform.

“4.3% ...THE REAL FIGURE BEHIND THE HEADLINE”

BASE PAY EXPECTATIONS



The story on base pay isn't particularly exciting. Headline numbers in the private sector will remain at the 2-2.5% figure they have been since 2009. Although organisations will continue to be cautious, the number of pay settlements resulting in a pay freeze has been very low, and this is likely to be the same in 2016.

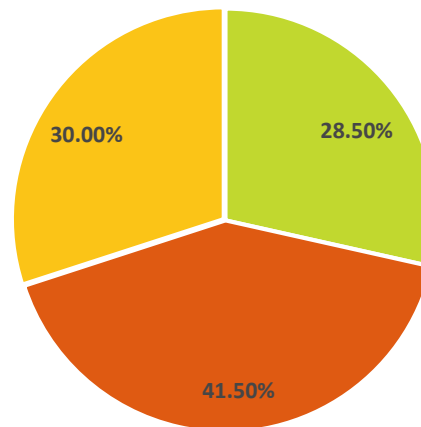
Public sector pay settlements will remain capped at 1%, although when pay increments are added, the median pay increase for the public sector is 1.5%.

Looking ahead to the 2016/17 pay review, according to XpertHR's survey of 'pay award forecasts', 19.8% of companies expect to see a lower increase than in the 2015/16, and 24.6% are predicted to receive a higher award. The majority of 55.6% are predicting to receive the same increase as last year.

Behind the headline figure, the Office for National Statistics (ONS) reports 4.3% pay increases for employees sticking with a role for more than 12 months. That means strategic, merit based increases are being awarded to key people, not always out of the allocated pay budget. The question is whether that money is being spent in the best way and on the right people. A key action for HR is to know where the real talent is in their organisation and where their pay sits against the market.

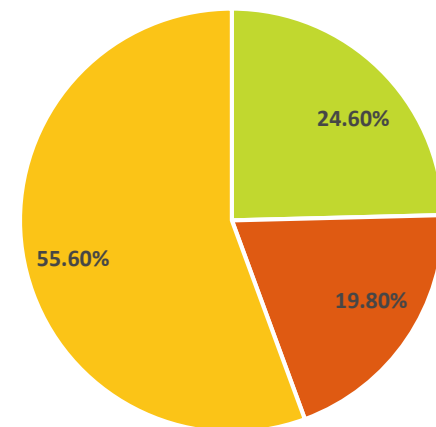
Introduction of the national living wage this April, will mean a 7.5% pay increase for those employees currently on the National Minimum Wage and aged over 25 years old. For organisations with a large cohort of these employees, this will have a major influence on the size of pay review budgets and they will therefore need to think about how to fund the increase.

ACTUAL PAY AWARDS 2015/16



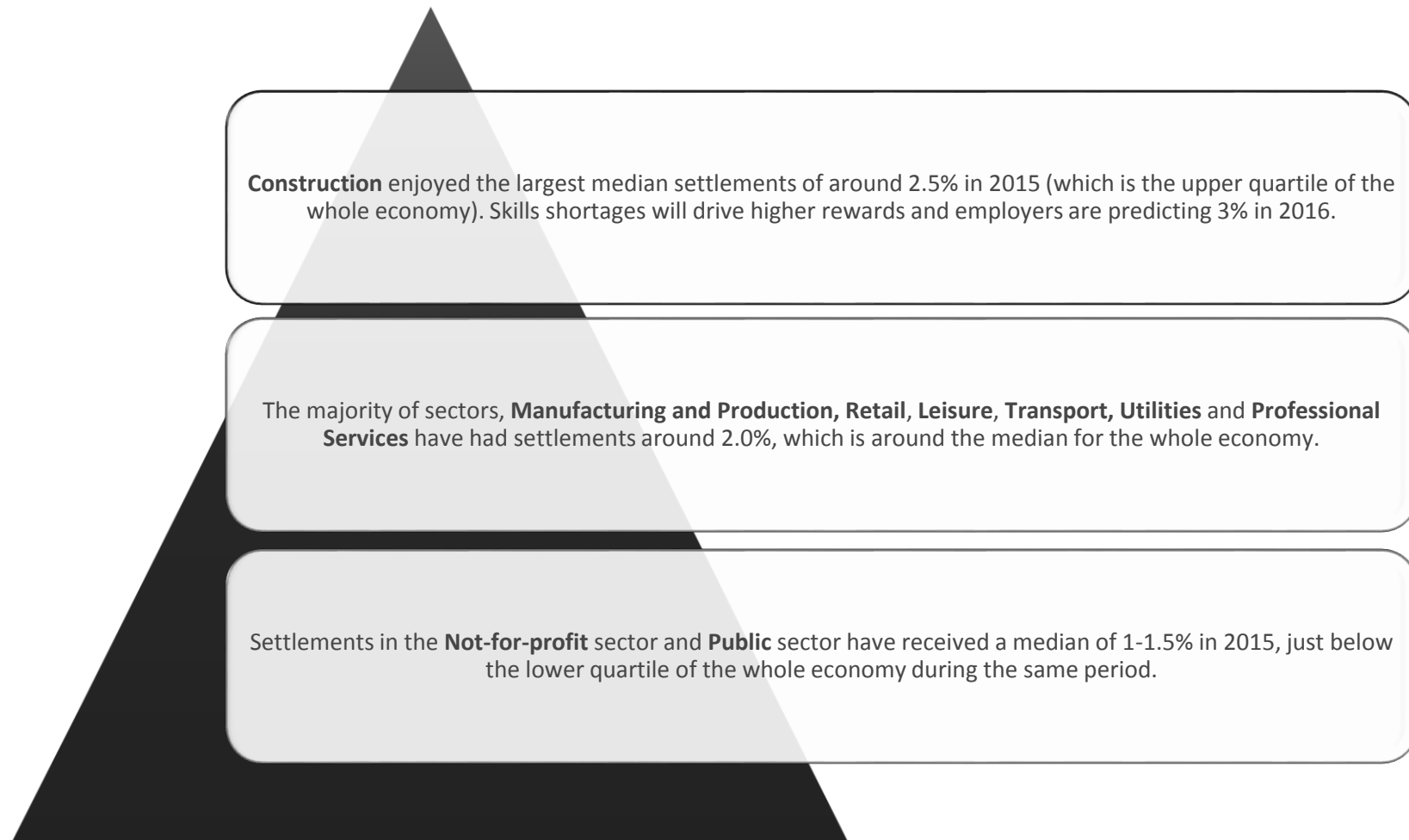
■ Higher ■ Lower ■ Same

EXPECTED PAY AWARDS 2016/17



■ Higher ■ Lower ■ Same

PAY LEVELS BY SECTOR



BROADER REWARD

EXECUTIVE PAY

Over 60% of chief executives, from Europe's top 100 businesses, received no base pay increase in 2015, up from 40% experiencing a 'pay freeze' in the previous year. The research by Towers Watson also shows that the median actual bonus for top CEOs in the last financial year was 100% of base pay, down from 115% in the previous year. The expected value of long-term incentive plans also dropped from 135% of base pay to 119%. Total pay for CEOs remained constant in 2015, with a median total direct compensation figure of €5.4 million for top bosses.*



An analysis of the regulatory scene surrounding top pay in Europe points to a certain degree of convergence, with pay caps and greater pay disclosure being introduced in a number of countries. 'Corporate governance frameworks across Europe are becoming more similar, with the result that executive compensation is increasingly a function of the size and sector of a company and less influenced by its geographic origin.' Richard Belfield, executive compensation team lead at Towers Watson.

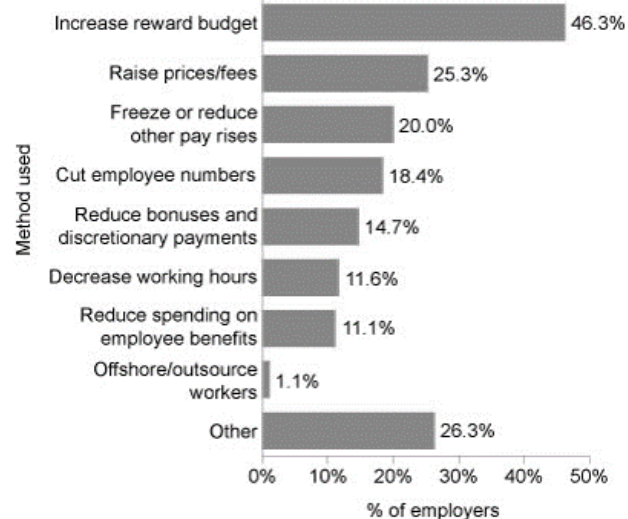
EXECUTIVE PAY CHALLENGES FOR 2016 WILL BE:

1. Continuing pressure on High Pay and employee:CEO differentials: realistically this affects a relatively small proportion of organisations, but it may spark questions in all companies.
2. Regulation around Banking and Financial sectors which affect base pay and bonus levels as well as bonus claw-back clauses. Increasing complexity means increased use of expert advisers.
3. High and rising levels of M&A activity means that executive pay levels may require review and further long-term planning – linked to a range of metrics measuring success. With the majority of M&As resulting in value destruction rather than creation, it's imperative Remuneration Committees are robust in their assessment and targeting in paying for success and no reward for failure.

* Towers Watson October 2015 'CEO pay in the Euro Top 100'

NATIONAL LIVING WAGE

According to a recent survey by XpertHR just under half (48.5%) of survey respondents employ at least some staff aged 25 or over who are paid less than £7.20 an hour. Among these employers, a median 11.8% of the workforce fall into this category and stand to benefit from the introduction of the national living wage. Calculations, based on the total cost of implementing the national living wage for this group of employees, divided by the number of employees



affected, puts the median cost of the new statutory minimum rate at £592.89 per affected employee in its first year of operation. The impact will not be the same on all employers with the analysis showing the cost will be substantially smaller per employee for public-sector employers, at just £161.90. The graph to the left shows how employers will fund NLW increases.



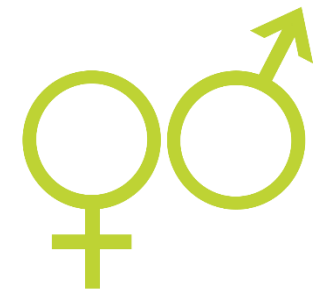
WHAT THIS MEANS FOR HR:

1. This could lead to a significant rise in payroll costs and employers need to consider where this money will come from. If you use your pay review pot to address this issue, what will be the impact on other employees performing well?
2. A requirement to look at the design of variable pay schemes.
3. What does this mean for other employees in your organisation? You need to consider how you keep and fund the differentials between employee levels.

GENDER PAY REPORTING

We all await the results of the Government's consultation on gender pay reporting, due out in the spring. What we expect is:

- Organisations will need to report on the pay gap between men and women's average pay in the organisation.
- This will probably be full-time, part-time and on base pay and bonus payments.
- Headline data of average (mean or median) men full-time vs. women full time is likely to be required to be published on your website.
- Forward thinking organisations are already understanding their own pay gap, producing an action plan to address any issues and creating their narrative for employees.



KEY REWARD TRENDS FOR 2016



The world has changed. Social engineering by Government is driving change in HR with the national living wage and gender pay reporting recent examples. Up to four generations in the workplace with different motivations and priorities increases the need for individualisation. World megatrends of globalisation and the 'gig' economy are driving a different relationship between employer and employee. The talent pool is global, and so is the competition for it. In a changed world, HR needs to change its approach. Engaging people and differentiating the employee deal are the big challenges to meet in 2016.

FAIRNESS & RESPECT

With the impending enforcement of the national living wage (NLW), gender pay gap reporting requirements and a real push on to publish pay ratios, 2016 will be a year for real action in the quest for fair and equal pay. The Government has stated firmly its view that employers have a responsibility to pay fairly with its introduction of the NLW and changes to tax credits, putting the onus on the employer to pay employees enough to live on. The latest wave of open publishing of personal salaries is further driving the desire for more transparency and fairness. Organisations with a clear and fair pay framework and policies, communicated openly will become more attractive to employees.

INDIVIDUALISATION

We now have four generations in the workforce, at different life stages and with different priorities. To motivate and create a strong sense of purpose you need to personalise the employee deal. Benefits, working environment and recognition are increasingly being used as the vehicles to do this. Initiatives such as unlimited holidays, a benefits market place, lunchtime choirs, board games, and quiz nights help to differentiate your organisation and develop an internal identity and culture. HR need to look at the demographics in their organisation and develop options to suit each generation or life stage.

ENGAGEMENT

After legislation changes, engagement is the biggest issue for HR in 2016. Millennials are now the majority in the workplace (just) and bring with them an independent spirit and lack of long-term loyalty to employers. This along with a growing freelance or 'gig' economy means that HR need to work harder to strengthen the bonds and sense of purpose between employee and employer. Not only will that lead to greater employee retention, it will increase the level of productivity in the business.

There is much discussion around what creates employee engagement. Buckingham & Coffman's book, *"First, break the rules,"* cites twelve key factors to engaged employees; from having a best friend at work to the company's mission or purpose making a job feel important. Deloitte's paper, *"Being Irresistible,"* stated five elements and 20 underlying activities. What is common across the board is the need to:

- **Take pay off the table:** employees need to see pay as fair and equitable before any other engagement strategies can hope to start working.
- **Create a strong sense of purpose:** employees need to understand 'Why' is the business operating and 'Why' am I doing what I do?
- **Success needs to be more than financial:** once you understand the real purpose of the business you can look at other success measures. Metrics for reward, in the majority of cases, remain financial e.g. TSR, EBITDA.
- **Employee feedback should be 'real time':** being able to input and provide feedback on pay and reward initiatives but also wider business activities.

Sources:

- <http://www.xperthr.co.uk/survey-analysis/pay-trends-december-2015-subdued-pay-awards-at-year-end/156338/#table-one>
- <http://www.ons.gov.uk/ons/rel/elmr/economic-review/december-2015/art---economic-review-dec-2015.html#tab-Main-points>
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