

# Labour Market Pay:

## Good practice guide



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## INTRODUCTION

This good practice guide examines the practical considerations that need to be explored before decisions are made about whether and when to use labour market supplements.

There is considerable and increasing pressure on employers to pay the “market rate”. Skill shortages and recruitment and retention factors contribute as does employers’ desire to position themselves well in market. Paying the going rate is a perfectly acceptable response where market pressures to do so can be objectively justified. It is common practice now to do so by attaching a supplement to the internal rate for the job. This should have been set through an analytical process, such as that provided by the use of HERA, to ensure internal comparisons satisfy the equal pay for work of equal value requirements.

This guide will discuss the reasons for making additional payments. The legality of so doing will be examined in the context of how such payments can be used to influence turnover and the attraction of candidates of the calibre required. The limitations and their benefits will also be outlined.

If market supplements are used at all, they need to be based on genuine material factors that can be objectively justified. The latter consideration makes valid and up to date sources of labour market data essential. In the past, too many payments have been made in response to pressure and arguments based on flimsy evidence.

The use of market supplements or making changes to base rates in an ad hoc fashion could be disguising the fact that the organisation’s overall level of pay is set too low. If the employer is finding difficulty in recruiting generally or to a range of jobs, using supplements may not be the answer. In such a situation, the employer might be advised to carry out a benchmarking study, using appropriate comparative data.

Once the decision to make an additional payment has been made, its continued use needs to be justified. This requires the maintenance of records and administration of a process to ensure payments are monitored, reviewed and adjusted, if the evidence supports their change. The key aspect of this administration concludes the guide.

We and Capita Health Service Partners will be happy to provide further advice.

## WHY USE LABOUR MARKET PAY

Organisations have always responded to the labour market pressures by paying higher salaries where recruitment and retention difficulties have been found in particular occupational groups, nationally or geographically. Historically, organisations often accommodated these pressures by putting the relevant roles into a higher grade or pay range than would otherwise have been the case. Often decisions have been made without the organization stopping to find out whether low pay was the cause of the recruitment or retention problem.

Most universities and colleges fall into the definition of large employers and are certainly complex organisations, facing considerable turbulence and pressure. Thus they find themselves in the same position as all other large organisations operating in a rapidly challenging world – they must compete locally, regionally and global for the skills required to operate effectively and find appropriate ways of rewarding those individuals in ways that are acceptable, affordable and transparently fair.

The National Framework Agreement, for the first time, recognised formally the need to separate recruitment and retention payments from base pay. If higher education employers are to make full use of this provision, whilst continuing to ensure equity and value for money, access to accurate and reliable pay and labour market information to ensure that payments are justified is essential.

Perhaps a more important imperative is compliance with Equal Pay legislation. There is a growing awareness of the gap between the pay received by men and women and the activities of some of the “No Win No Fee” lawyers are drawing employees’ attention to the possible success of litigation. This level of activity is also drawing employers’ attention to the risks. Moreover, the Gender Equality Duty requires employers in the public sector and those providing services to them to take action to address inequalities in pay, within their organization and generally.

If an organisation cannot show that additional payments are made to take account of “genuine material factors” in the labour market, which can be “objectively justifiable”, it leaves itself vulnerable to claims of unfair discrimination. The risk of litigation increases once the higher salaries have fulfilled their function of attracting more workers into that particular sector of the labour market. Thus, the need for any additional payment in order to recruit and retain staff will have gone away and so will the defence.

## Legal context

The key case is *Enderby v Frenchay Health Authority and the Secretary of State for Health* [IRLR] commonly known as the Speech and Language Therapists claim. At an early stage in the legal process it was found that some part, estimated at 10% of the difference in pay between the claimants and their hospital pharmacist comparators, was attributable to pressures from higher salaries paid in the private sector to the employees of pharmaceutical companies and in retail pharmacy.

The European Court of Justice (ECJ) said that market forces could provide objective justification for all or part of differences in pay between predominantly male and female groups:

“The state of the employment market, which may lead an employer to increase the pay of a particular job in order to attract candidates, may constitute an objectively justified economic ground for a difference in pay.” [1993 IRLR 591 ECJ]

The general qualification is that market related payments meet the general criteria for objective justification, if:

1. They genuinely were the reason for the difference in pay at the time the payments were introduced and have not simply been put forward as a post hoc justification for the difference in pay;
2. The reason for making the payments remains valid;
3. They reflect an economic business need;
4. Neither the payments nor the reasons for them are tainted by gender.

Market forces must account for the whole of the difference in pay attributed to them. Thus, although the ECJ did not say that additional payments in response to market pressures should be paid as a separate supplement and this was not the case in relation to hospital pharmacists, it is probably easier for organisations to justify and monitor market supplements, where they can be separately identified. Failing to do this could mean that the payments are seen as part of the individual's salary, making it nearly impossible to reduce or withdraw the payment when it can no longer be justified.

## Situations where the use of labour market pay is valid

The following are the most likely situations where the possibility of using market supplements may arise:

- 1 During pay negotiations when trade union representatives put forward comparative data to justify their negotiating position. This may include the suggestion there are potential recruitment and retention problems in relation to certain roles;
- 2 When there are recruitment and retention problems in relation to certain roles. Usually this happens when a manager has difficulty in recruiting and attributes the cause to the level of pay on offer;
- 3 When the preferred candidate for a post has a higher salary in their current role than the one being offered.

The most obvious and best evidence for justifying the payment of a market supplement is the failure to attract candidates of sufficient calibre to a post advertised at the appropriate grade rate for the type of work. However, going through one or more failed recruitment processes takes time and resource, and it does not always reveal the true cause of the problem.

## Labour Market Pay Policy

The first practical problem facing organisations wishing to respond to market pressures is to draw up a suitable policy to ensure that any additional payments are justified and can be defended in case of internal or external challenge. In order to ensure that market supplements are transparent, fair and non-discriminatory in impact, such a policy should:

- 1 Identify the evidence required to justify payment of market supplements. This should include evidence to show that pay is the cause of any recruitment or retention problem. If this is not done, it is likely the outcomes will include unnecessary increases to the pay bill and the creation of more problems;
- 2 Outline the coverage of supplements. This is essential to ensure that payments are made to those occupying the role or roles in question and are not being made to the “favoured few”.
- 3 Indicate how the supplements will be monitored and reviewed. These should be carried out at regular intervals to ensure the payments can still be justified on the grounds of justifiable, material factors.

Once a policy has been drawn up, it should be applied in all cases where the question of market supplements arises. This requires some form of central control, particularly in large organisations and those where managers have discretion to negotiate starting pay and other benefits.

## Limitations of labour market pay

Market supplements, in themselves, may not address the real causes of recruitment and retention problems. Their use, therefore, is only likely to be effective if:

- o these problems are related to pay;
- o an increase in pay is likely to resolve the problem by increasing the supply of the staff concerned or preventing them from leaving;
- o pay is the true reward being sought by the individuals or group of individuals concerned;
- o their use does not cause problems amongst other staff.

They will not overcome recruitment problems where the real causes of the problem are:

- o Poor advertising, for example:
  - Posts being advertised in the wrong place so they are not seen by potential recruits;
  - The adverts do not make posts or organisation appealing;
  - The post’s specification contains a mix of skills, qualifications and experience that are very rare.

- Poor recruitment practices which put people off applying or continuing with their application;
- Where there are poor transport links so the organisation is hard to get to;
- The organisation being located in an unattractive part of the country, for example where housing costs are more than average or where crime levels are reported to be high;
- The nature of the post being advertised is unattractive, for example being a fixed term appointment;
- When the cause of resignation is not related to pay but for other reasons such as the lack of career opportunities, poor working conditions or bad management;
- The non-pay benefits do not match what people are seeking for example childcare or flexible working.

Sources of information such as staff surveys, and joiners and leavers surveys will provide information that will help the importance of pay to be considered alongside the other factors that influence the organisation's ability to recruit and retain staff, particularly in critical areas or where the skills required are in short supply.

## **Dangers of using labour market pay**

As noted above, labour market supplements may not resolve the real problems underlying recruitment and retention difficulties. Unfortunately, external factors, such as the use of Golden Hellos and the inclusion of recruitment and retention payments in the National Framework Agreement have drawn attention to their use. Therefore, there is a growing feeling that these are a readily available and appropriate solution. More importantly, there is a strongly held belief that money and pay-related benefits are the most important, if not the only, aspect of the reward package sought by employees. Whilst pay is important, other factors can influence job seekers decisions.

The use of labour market supplements, without consideration of these other factors, contains a number of pitfalls. This is not to say that additional payments do not have a place, but employers are advised to consider all the factors before making decisions to pay supplements. The major pitfalls include:

- The immediate and possible long term costs of using labour market supplements, especially as there are no guarantees they will resolve the problem;
- Introducing labour market supplements can just move problems to neighbouring employers and can cause a pay spiral if other employers respond by also increasing pay. For example, the Metropolitan Police overcame its recruitment problems by paying a £6,000 premium, but this merely transferred problems to other forces in the South East who then had to introduce premiums.
- It can be hard to control the payment of supplements. Data may suggest that payments should only be made to individuals or small groups of staff but other staff are likely to resent this and this can lead to equal value claims or other expressions of dissatisfaction.

- The payments are not paid to individuals but for roles where recruitment and retention difficulties can be demonstrated. This means that the supplements should be paid to all occupants of the role. Where generic role definitions are used, it can be hard avoiding giving the supplements to all staff assigned to these roles thus the object justification of the payment can be eroded. Therefore, the role definition requires great care to allow appropriate groups of staff to be identified in ways that can be related to the labour market.
- Labour market supplements are very difficult to remove, or reduce, once they have been paid, even if there is evidence to indicate they are no longer required.

An article in IDS Executive Compensation Review (Review 310, December 2006) highlights some of the dilemmas facing those making decisions on pay. The following is a summary of one of its key points:

*Why do top rank footballers earn more in a week than the majority earn in a year? A manager may reason "If I pay well above the odds then my team would recruit the best players, win lots of trophies, attract large crowds and secure the best sponsorship deals. The trouble is that other coaches will reason in the same way, so that paying high wages becomes the dominant strategy." Universities face a similar dilemma.*

*To demonstrate it, let us assume that all Professors are paid broadly equal amounts. Assume also that in the available population, 20% are superior to the others and would, if they worked for your organisation they would increase research income by more than the average. Conversely, 10% are inferior to the others and, if you employed them, they would be a cost rather than a source of income.*

*If all universities offered modest remuneration, then it would be in the interests of one to defect and pay over the odds. By doing so they might attract top talent and (potentially) be more successful than their competitors. Conversely, a university would not want to find itself paying significantly below average. To do so might mean it would only attract inferior staff.*

*No one will congratulate the HR department for its financial prudence if the result is a second rate university. Thus offering higher salaries is the dominant strategy, even though by doing so universities will generally be no better off than if they all paid modest salaries. However, some would argue this is better than risking being in the bottom 10%.*

The dilemma for those advising senior managers is how to balance all the risks. Having good quality information about market conditions will go a long way towards ensuring realistic decisions are made.

## LABOUR MARKET PAY DATA

### Sources

The Annual Survey of Hours and Earnings (ASHE), produced by the Office for National Statistics, is a useful general source of information as it draws from a large sample of salary data, which employers are legally required to submit. It contains information on the levels, distribution and make up of earnings and hours. However, it is not suitable for all occupations, for example those with a number of levels of seniority, because it aggregates salaries for a number of levels which make the resultant salary figures less useful.

Data is published at national and regional level (Scotland and Wales are treated as regions) for occupations. ONS will carry out further analysis at a price.

Additional or alternative evidence justifying payment of a market supplement could come from any or all of the following, depending on the role(s) in question:

1. Salary surveys carried out by management or by specialist pay consultancies. These can generally be used to obtain information for particular occupational groups. Incomes Data Services (IDS) publishes a Directory of Salary Surveys to help to identify appropriate data sources.
2. Regional salary surveys often make use of data drawn from the same sources as the national data. Examples include Croner Reward Regional Surveys.
3. Salary data compiled by some professional and similar organisations (for example, the Law Society, the Institution of Civil Engineers, Engineering Employers' Federation) about the jobs occupied by their members.
4. Local labour market data gathered from, for example, Job Centres, local press or recruitment agencies.

All of the above must be treated with caution, as the quality of the information depends entirely on the sample size and the ways in which the source data is collected and collated. This is particularly true of some web site surveys giving comparative salary data. Checks should be carried out to find out if the sources are valid and substantial enough to allow comparisons to be made.

It is very easy for someone without the full understanding of the issues regarding validity and relevance to take a superficial look at such sources and form false conclusions. Likewise, information drawn from a small number of recruitment advertisements is unlikely on its own to be sufficiently robust to justify a market supplement, as it will be limited and partial.

One of the shortcomings of trying to compare internal jobs with those found in external sources is the difficulty of matching the jobs accurately for 'size'. It is important that comparisons are made on a like for like basis, using more than job titles to do so. Information about job content,

level of demand and context are all relevant factors that should be taken into account when drawing conclusions about appropriate pay rates.

Capita Health Services Partners has developed a checklist to help assess the validity of pay data and the comparison of different sources. Key areas include the following:

## **DEFINITIONS**

- Who is doing the survey
- What is it for
- Who completes it
- What is being collected and collated e.g.
  - Basic salaries/base pay
  - Total cash/pay/earnings/remuneration
  - Benefits

## **SAMPLE SIZE**

- What is the sample size, is it reliable (beware anything less than 10)
- Is this provided for each role
- Is it robust and consistent with the level of analysis

## **COMPOSITION OF THE SAMPLE**

- How was the sample selected
- Roles and jobs
  - How were the roles defined e.g. role descriptions or profiles
  - How complete is the description
  - What checking or validation of the data was carried out

## **ORGANISATIONS**

- What size of organisations took part
- Is there an analysis of data by organisation size
- What sectors or industries are represented, are they relevant and comparable
- Is there an analysis of data by sector or industry
- What geographical areas are covered

Using market data alone, even from more than one of the above sources, as a justification for the payment of market supplements, begs the question of whether an employer can realistically anticipate a market forces problem and adjust the pay rate accordingly before an attraction and retention problem arises. Although this is common practice, it represents a fine line to tread, because the anticipated problem may not actually occur.

It then becomes very difficult to justify the payment on grounds of labour market pressures, as the behaviour of job seekers is very difficult to predict. Pay is not the only factor that influences

their decisions and makes one job more attractive than another. Research shows that other diverse determinants, including employer's reputation, access to career development opportunities and knowledge of other employees. Similarly, the reasons why employees leave often relate to the quality of their working relationships with colleagues and managers and their longer term career opportunities just as much to their remuneration package or tempting offers from other employers.

There is a tradition in higher and further education of paying a little more than an applicant's current salary, as it is generally believed this is necessary to secure the deal. However, the fact that the preferred candidate has a higher current salary than the one advertised is insufficient on its own to justify a market supplement. One individual cannot constitute a labour market, which by definition requires numbers of buyers and/or sellers (of labour), unless, in very exceptional circumstances, they have attributes making them uniquely suitable for the post (research scientists in a new field might be seen in this light).

Moreover, it has been shown that around 25% of applicants falsify information including the exact amount they are currently being paid. How many employers check this information before making an offer of employment?

## Assessing the quality of labour market pay data

- Legitimacy
  - Does the information obtained relate to the same roles
  - Has the data been supplied by people authorised and knowledgeable enough to do so. (Some surveys are completed by employees who may under or over report their pay levels.)
  - Are comparisons made on a like-for-like basis.
- Validity
  - Is the sample size sufficiently large to enable conclusions to be formed
  - Are the organisations included relevant
- Reliability
  - Would the same results be achieved if the survey was repeated
  - Would similar results be obtained from other surveys
  - Is there a consistent series of data available for use in any review

## Other sorts of information about the labour market

As already noted, a number of factors influence job seekers' and job leavers' behaviour as well as pay. There are also other factors at play in the labour market which need to be taken into account when deciding when and how to use market supplements. These include:

- Supply and demand. This is particularly evident in IT and Computing staff. This group has seen large fluctuations in levels of demand in recent years. The effects of the skill shortage, needed to deal with the Millennium Bug are perhaps the best-

known example. Sometimes, the labour market can react quickly but in some cases, particularly those involving occupations with lengthy training periods, movement can be quite slow.

- The definition of the market. It is important to draw data from an appropriate and realistically defined market. Some occupations are clearly local while some function in a national or even international market place but checks should be carried out before making assumptions. These can include checking the previous locations of staff recently appointed to similar positions and the destination of leavers.
- Local economic drivers affect the supply and demand and competition. Traditionally, there was a clear divide between public and private sectors locally, with staff rarely moving across the two. However, changes to the nature of the public sector could mean this assumption is no longer true.

Most attention is given to the recruitment side of the equation. However, before market supplements are considered, insight is required into the other side – why has the vacancy occurred?

Many organisations claim to carry out exit surveys. But how seriously are these viewed? Some degree of independence and confidentiality is needed if the leavers' survey is going to reveal anything more superficial than "The pay is better elsewhere". This is a very acceptable reason and provides the smoke screen if there is a need to disclose the real reason for leaving and to prevent the full exploration of what might be sensitive issues. A manager asking leavers on their last day is hardly going to find out whether they are leaving because of the quality of their supervision and their manager's level of interest in their career development.

Understanding of labour market dynamics, knowing the extent to which people move between sectors or employers and what influences them to move are crucial for the legal and effective use of market supplements.

## ADMINISTRATION

### Who receives Market Supplements

Once it is agreed that a market supplement is justified by the evidence, then it should be paid to all those in the same group, even if they were not threatening to go elsewhere for a higher salary. Non-payment to others in the group (that is, those doing the same role or one that can be directly related in labour market terms) could lead to equal pay claims. This is because the role holders are part of the same labour market as the new recruit for whom an additional payment has been shown to be justified. Therefore, accurate and precise definition of the group is essential to prevent the payment being made to individuals.

### Advertisements

Roles with market supplements attached to their base salary could be advertised showing the base salary including market supplement as the 'headline' figure, with breakdown into basic pay and supplement in brackets, in the same manner as is often the case for London allowances, which are after all regional market supplements. In either case, it is important that all applicants and employees concerned understand that the payment is a supplement and will be subject to periodic review.

### Renewal or withdrawal?

The overall trend is not yet clear, perhaps because the use of market supplements is a relatively new feature of reward packages. However, many employees prefer to receive consolidated salaries and do not like the idea of their market supplements being reviewed, as the obvious implication is that they may be withdrawn.

From the employees' perspective, there is no reason why the salary should not be regarded as the whole salary, including the market supplement. Even when the employees have been told the supplement may be reviewed and removed, in practice, they tend to regard their take home pay as their whole entitlement and any movement occurs only in an upwards direction.

Managing the removal of supplements, at best, is tricky. Moreover, there is considerable doubt over whether they can be withdrawn by means other than through some form of protection. This makes administration complex and leaves the employer open to claims of unfair treatment by one group or another.

### Records

Employee files should contain a record of any market supplements paid. This may be needed in case there is a subsequent query or challenge, and to enable reviews to be carried out.

It is apparent from the above that the administration of market supplements can be complex. The situation will be most straightforward if market supplements are regarded as the exception

rather than the rule. Proliferation of such payments risks anomalies and grievances, from those who receive them as well as from those who do not. If there is pressure and evidence to introduce supplements for a range of roles, this may indicate that the overall organisational pay line is low relative to other organisations and may require review.

## Monitoring and Review

There may also be the need to exercise tighter control over salaries paid on appointment. Thus, it may be necessary to revise recruitment policies and practices, particularly where recruitment has been delegated to line managers.

To ensure that market supplements are, at their outset and continue to be justified, there should be central monitoring and regular review to ensure that they continue to be justified.

Key points to be contained in the market supplement policy should include:

- Timescales: the review should be carried out annually; or every two years as labour markets do not usually change dramatically.
- Responsibilities: the policy should state who is responsible for instigating the review and who will be involved in the process. Payments could be viewed as part of a regular equal pay review or alternatively as an adjunct to annual pay negotiations. In the latter case, the market supplement review is likely to be carried out by the participants in the negotiation. If it is a stand-alone process, then allocation of responsibilities will need to be agreed with the trade unions concerned.
- Evidence: the review process requires the same evidence as that used to support the introduction of the market supplement. Someone will need to collate this in advance of the review.
- Outcome: the outcome of the review could be an increase or decrease in the market supplement or no change. This will need managing and an appropriate communication plan developed to head off rumours and speculation.
- Withdrawal: where market supplements cannot be justified, or the evidence indicates that they should be reduced, the payments can be protected to those in receipt of them in accordance with the pay protection policy.
- Long term or short term: in theory, all market supplements should be regarded as short term, as they are predicated on the belief that the labour market will respond relatively quickly to the higher inducements, with higher rewards attracting more individuals into relevant occupations. In practice, this is not always the case, especially where there are time lags for training, those moving into a particular occupational group, or where demand for the roles in question are expected to continue to grow. In such cases, supplements, although regularly reviewed, may be regarded as long rather than short term. This decision is relevant when deciding whether the market supplement should be pensionable.

## FURTHER INFORMATION

ECC, in conjunction with Capita Health Service Partners, runs training in the use of labour market data. Details can be found on ECC's web site – [www.ecc.ac.uk](http://www.ecc.ac.uk).

As part of the service provided to ECC's members, Capita Health Services Partners provides a help desk. This can be accessed through:

ECC's web site – [www.ecc.ac.uk](http://www.ecc.ac.uk)

Capita Health Services Partners web site – [www.capitahsp.co.uk](http://www.capitahsp.co.uk)

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