Cost of living crisis – pay interventions

Introduction

Consumer Price Inflation (CPI) reached a 40-year high of 10.1% in July 2022 and the outlook for the next 12 months remains highly uncertain with a wide spectrum of predictions from the usual commentators. Much of this attributable to rising and volatile energy costs (see Figure 1 below) but other costs are rising too. With a new prime minister and cabinet this week some increase in certainty with regards to energy prices may come in the UK but significant uncertainty on broader economics factors remains.

With job vacancies remaining at record levels, UK businesses continue to operate in a tight labour market characterised by skills shortages in particular areas. However, with GDP growth slowing, warning signs of a recession and wage growth being outpaced by inflation, the labour market could reach its peak later this year.

These three dimensions – cost of living, talent scarcity and economic uncertainty present a number of challenges for organisations trying to balance costs, stem attrition and take care of their people.

Currently, it is the rising cost of living that is drawing the most focus. Data from the ONS states that 1 in 20 large organisations have put in place some kind of bonus. Indeed, from disclosures during July and August of 2022, we found that a variety of interventions have already been made (see Figure 2 below).

Our own research, drawn largely from surveying FTSE 350 companies, suggests that 83% of companies have made or are likely to make an intervention and some of these interventions are also aimed at addressing wider talent attrition issues (see Figure 3 overleaf).*

The focus has been on one off payments, but as the data shows, wider reward programmes are being considered – from enhanced equity to store discounts. Some of the recent interventions have drawn headlines and had an initial positive impact. However, some have faced unintended consequences, and as things get tougher, more may be required.

In this report we look at the considerations for organisations grappling with the impact of these changes for their workforce. This is more than an HR issue, it's a business decision for organisations and the complexity of implementation is including HR, tax, finance and others.

Figure 1: CPI inflation, by component, monthly, year-on-year

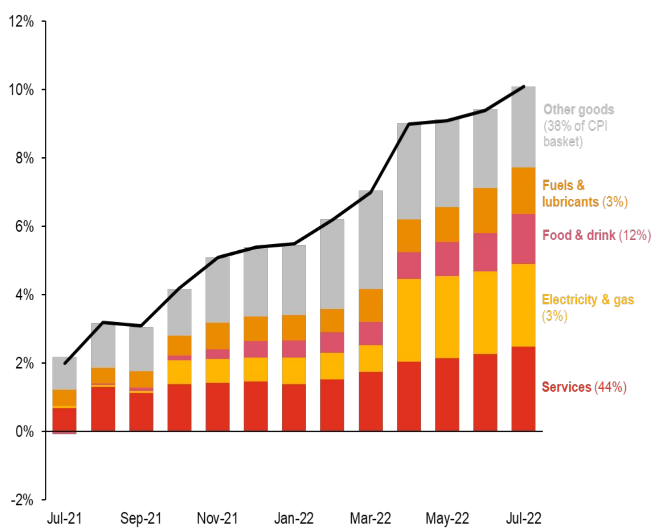
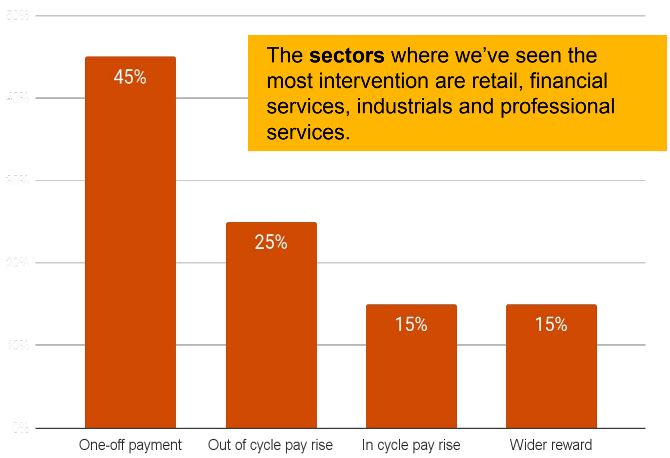
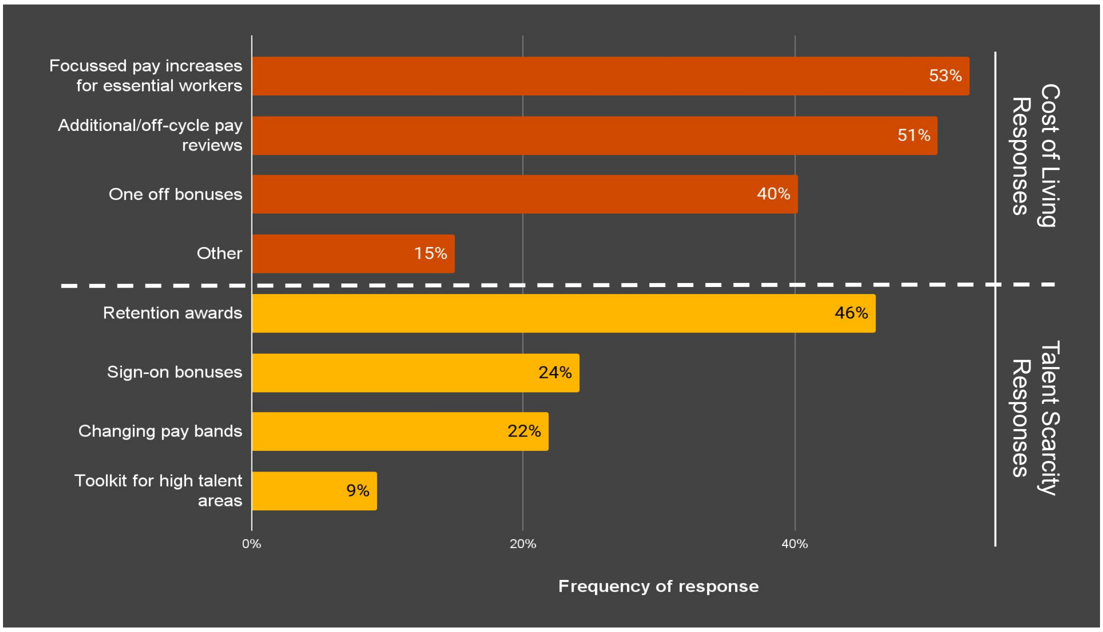


Figure 2: Responses so far (based on public disclosures)**



*Source: PwC – The great rethink survey
**Based on public reporting of employer responses to cost of living from a sample of 53 companies (as at 6 September 2022)

Figure 3: PwC research from The Great Rethink Survey



The big questions organisations need to work through.

To intervene or not to intervene

The first question is whether any kind of intervention is warranted. This is a discussion we are increasingly seeing being part of the agenda for Remuneration Committees and not only management teams, as Committees consider their responsibilities overseeing workforce policies and practices in this context.

Historically, annual pay reviews would try to address inflationary pressures. However, the timing of this sharp rise in inflation (immediately post 2022 pay increases), the disproportionate effect on the lower paid, and the overarching backdrop of skills shortages puts the onus on organisations to consider whether to intervene this Autumn. While we wait for government support around energy prices, many organisations have landed on the side of action of some kind. This may apply increasing reputational pressure as employers and unions will look for action in line with peers. However, the reality remains that there will be significant pressure on pay budgets for 2023 irrespective of any moves this Autumn.

Should intervention be targeted at the lower paid

The effects of inflation will be felt most by the least well-off. Therefore, unsurprisingly, this has been the focus of many organisations. The challenge is in deciding where to draw the line. A starting point has been salaries below £30,000, close to the national average. But in fact, data suggests that households with incomes of up to £70,000 will be significantly impacted.

Some have considered pay adjustments in tiers but this opens up questions of fairness (e.g., family size, other special circumstances etc). One way around this is to pay a cash sum (rather than a percentage) to all (or at least the majority) and that way the largest proportion reaches the lowest paid.

Is it one – off or linked to the pay review, or both

One off awards have been deployed for some as an alternative to an increased monthly pay packet. Practice is mixed here – from accelerated interventions and underpins to pay awards for the lowest paid. One of the issues with one-off payments can be the knock on impact on other areas, such as allowances or state benefits like universal credit and child benefit support. Eligibility, and / or the amount received is dictated by levels of earnings and therefore spikes in earnings can reduce the level of benefits received.

Also linked to the pay review, we are seeing organisations consider their wider benefits offering to ensure that pay is delivered in the most efficient way and maximise the use of cash.

For many this may be considering arrangements such as salary sacrifice which can deliver tax and / or NIC savings to their employees, as well as a saving for the organisation to help manage overall pay costs. This could relate to pension contributions or ultra low emission vehicles – things which many employees may be currently funding from their net pay.

If an employer chooses to consider these types of arrangements, it should be ensured that appropriate safeguards are applied to prevent accidental breaches of regulatory requirements such as national minimum wage.

Wider considerations

Non-financial alternatives

Some organisations are considering non-cash related support in the form of staff discounts (or vouchers). We have seen this at some essential retailers who have increased store discounts for staff and families, and in other organisations who are helping with home insulation and travel costs. Some companies are introducing hardship programmes, whilst others are looking at how they can better optimise existing reward packages – for example, through salary sacrifice schemes (as mentioned above) or enhanced benefits. Finally, either alongside some of these alternatives, some organisations are focussing on ensuring access to and engagement with tools around financial wellbeing.

Use of equity awards

Companies are also considering using employee share plans to provide additional focussed support without reliance on company cash flow. We know that some organisations are using equity to award enhanced or one-off share awards - a different form of wealth creation which can be attractive for certain employee groups. Other companies are seeing existing employee participation in tax advantaged share plans reduce as employees look to release savings to fund an expenditure shortfall. In this situation, companies may wish to add flexibility and enhance communications around existing arrangements to help employees stay invested for the longer term and therefore benefit from the tax savings originally anticipated.

Pay fairness implications

The knock on implications of any action (or inaction) needs to be considered. This includes understanding potential impacts on gender and ethnicity pay gaps (e.g., if an organisation takes a tiered approach to how they intervene, does this have intended consequences for pay gaps). Wider pay governance also needs to be considered (e.g., if an organisation is applying out of cycle increases, what does this mean for pay progression within bands).

Stakeholder management

It is also important to recognise external stakeholders and the extent of their influence. In particular, there are sectors where there is increased union presence or pressure from activists and charities, who will be very focused on how lower income earners within organisations are being impacted. For senior stakeholders (Board level executives and non-executives), having a deeper understanding of pay governance issues during this time and in particular, an awareness of the short and long-term risks, will be critical.

The reward to-do list

Pay budgets are likely to be high into 2023 but it is unlikely any organisation will provide increases in line with inflation given the economic outlook remains so uncertain. These are unchartered waters for many and present a complex set of circumstances about supporting the least well-off workers whilst also taking a position that seeks to address attrition in a tight market. **We believe organisations need to consider the following steps:**

Assess impact and agree objectives – understand your employee base and impact on different groups of employees (regional, global, UK etc) to consider how you want to approach the situation (i.e. whether to intervene or not)

Identify the key internal stakeholders who need to be involved in decision making – the Board and Remuneration Committee, HR, Tax, Finance and Communications

Identify, model and cost – understand which employees will be most impacted by inflation using workforce analytics to model the impact of interventions against the trade-offs

Technical review – work through the tax technical risks and unintended consequences for your employees of any proposed intervention

Wider interventions – consider the alternatives of non-financial interventions and long-term plans into 2023 and beyond

Pay fairness implications – consider how any potential interventions (or not) will impact different groups and wider pay governance (e.g., pay gaps, pay progression etc.)

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For further information, help or support

Alastair Woods
T: +44 (0) 7834 250359
E: alastair.woods@pwc.com
LinkedIn

Andrew Page
T: +44 (0) 7841 954130
E: andrew.x.page@pwc.com
LinkedIn

Anna Vishnyakov
T: +44 (0) 7896 850655
E: anna.vishnyakov@pwc.com
LinkedIn

Daniel Harris
T: +44 (0) 7771 974777
E: daniel.x.harris@pwc.com
LinkedIn

Dean Farthing
T: +44 (0) 7739 873164
E: dean.farthing@pwc.com
LinkedIn

Duncan Nicholls
T: +44 (0) 771 8865201
E: duncan.e.nicholls@pwc.com
LinkedIn

Fiona Camenzuli
T: +44 (0) 7739 876723
E: fiona.camenzuli@pwc.com
LinkedIn

John Harding
T: +44 (0) 7801 042607
E: john.l.harding@pwc.com
LinkedIn

Julian Sansum
T: +44 (0) 7919 057454
E: julian.a.sansum@pwc.com
LinkedIn

Kate Harris
T: +44 (0) 7718 968937
E: kate.harris@pwc.com
LinkedIn

Paul Wolstenholme
T: +44 (0) 7595 850031
E: paul.wolstenholme@pwc.com
LinkedIn

Paula Letorey
T: +44 (0) 7939 063484
E: paula.z.letorey@pwc.com
LinkedIn

Phillippa O'Connor
T: +44 (0) 7740 968597
E: phillippa.o.connor@pwc.com
LinkedIn