



Innecto Insights

Autumn 2026 Edition



WHY PAY COMPRESSION IS BECOMING A STRATEGIC REWARD CHALLENGE

Pay compression is becoming an increasingly common challenge for employers. As statutory wage rates rise and salary budgets remain constrained, organisations must balance legal compliance with the need to maintain meaningful pay progression and internal pay equity.

Over the past few years, the economic climate, characterised by persistent cost-of-living pressures and sharp statutory minimum wage jumps, has created a complex reward environment. Increases to the wage floor are essential to support lower-paid workers, but when baseline costs rise alongside tightly constrained pay budgets, maintaining meaningful pay gaps across job levels becomes a major hurdle. While leaders recognise the importance of internal pay equity, many still rely on rigid pay structures and outdated salary bands that fail to adapt as baseline wages move. In some sectors, pay compression can also emerge where different employee groups operate under separate pay frameworks. This is particularly evident in environments such as the legal sector and parts of the Civil Service, where professional, specialist, managerial and support populations may sit within different grading or reward structures. As those structures evolve independently, pay differentials can narrow unintentionally at the points where they intersect, creating compression between roles with different levels of responsibility or expertise. The

consequences are increasingly familiar to employers: mid-level employees struggle to see the financial value of career progression, pay differentials collapse, and internal pay equity can become harder to maintain.

Pay compression creates an escalating structural risk

In the UK, successive increases to the National Living Wage (NLW) have compressed pay structures across sectors, particularly within organisations employing large lower-paid workforces. Recent data shows that statutory pay floors have consistently outpaced median merit budgets, driving a heavy clustering of roles just above the legal minimum. Recent reward surveys suggest that more than half of UK organisations are experiencing some degree of pay compression, signalling a widespread challenge that impacts every level of the workforce.

Unaddressed pay inequity creates friction that ripples across an entire business, made more visible with an evolving approach to pay transparency. Pay frameworks must clearly differentiate between baseline roles and positions of greater skill or responsibility if they are to remain defensible and fair. Forward thinking organisations are responding by redesigning their annual salary review processes around structural fairness, job value, and sustainable reward principles.

Why pay compression still feels difficult

Addressing pay compression is often treated as an operational payroll issue, but that is where the difficult conversations and questions usually start:

- How do we fund statutory wage increases without sacrificing progression for skilled staff?
- Why should a first-line manager take on extra stress when direct reports earn nearly the same?
- How can we stop new recruits from earning more than experienced internal peers?
- Why take on additional responsibility if the financial return is negligible?

Many organisations find these questions difficult because traditional pay review processes were not always designed to address this level of wage pressure.

Broad salary structures common across many sectors provide flexibility and allow organisations to respond to market hiring pressures, but they make it difficult to prevent pay inversion when external hiring rates outpace internal pay growth.

By contrast, rigid pay frameworks with flat percentage increases across all bands are easy to administer, but they worsen compression over time because baseline increases continually eat into the differentials above them. Neither approach is likely to be sufficient on its own.

The widespread impact of compressed differentials

While pay compression is often associated with lower paid roles, its effects can extend throughout the organisation, quietly eroding motivation, career progression, and operational capability.

At the bottom of the organisation, rapid statutory floor jumps catch up to roles requiring specialised skills or extra tenure. Entry-level staff earn virtually the same as peers with years of technical experience, creating a “treadmill” effect where learning new skills or taking on higher workloads yields no real financial return.

Further up the structure, supervisory gaps collapse to near zero. First-line managers frequently see direct reports catch up to their pay level, removing the financial incentive for step-up progression and causing internal talent pipelines to stall.

At the leadership level, HR teams can find themselves responding reactively to retention pressures, relying on emergency counter offers to retain critical staff, which inadvertently causes market pay inversion where new hires earn more than established internal peers.

Identifying pay compression with a diagnostic approach

To address compression effectively, HR and reward leaders must first know how to spot it before it undermines their reward strategy. Key diagnostic indicators include:

- Checking whether the pay differential between first-line managers and their highest-paid direct report has shrunk, thresholds such as below 10 to 15%
- Tracking whether the percentage of the workforce earning within 5% of the statutory minimum has increased over recent review cycles
- Auditing whether newly onboarded staff are earning within defined thresholds, such as 3 to 5%, of peers with three or more years of tenure in identical job families
- Identifying if internal candidates are actively turning down step-up opportunities due to inadequate pay progression
- Reviewing whether external recruits are consistently joining on higher base salaries than higher-performing internal staff in equivalent roles

Multiple approaches can help address pay compression

There is no single solution to pay compression, and the most appropriate response will depend on the underlying cause. Organisations often need a combination of structural, market and reward interventions.

Common approaches include:

- Redesigning grading and pay structures to restore meaningful differentiation between levels of responsibility
- Introducing targeted market adjustments for critical or highly compressed roles
- Reviewing recruitment pay practices to reduce the risk of market pay inversion
- Strengthening job evaluation methodologies to ensure pay reflects role value consistently
- Using promotion frameworks and career pathways to reinforce progression opportunities
- Applying targeted retention or skills-based premiums where particular capabilities are in short supply
- Adjusting annual pay review processes to identify and address compression proactively

The effectiveness of each approach depends on organisational context, workforce demographics, affordability and the nature of the compression being experienced. In practice, many organisations combine several of these interventions rather than relying on a single mechanism.

One solution: using a principle led salary review process

While organisations can address pay compression through a variety of structural and reward interventions, the annual salary review remains one of the most effective opportunities to identify and correct emerging issues. Rather than applying flat percentage increases across the board, many organisations are transitioning to principle led salary review processes that explicitly identify, isolate and address compressed pay differentials before they become embedded.

Some key considerations when designing a principle led salary review include:

- Splitting the annual salary review budget into two distinct pools, one allocated strictly for statutory compliance (meeting wage floors) and a separate, ring-fenced fund targeted specifically at restoring squeezed differentials
- Defining clear, structural minimum percentage gaps between baseline roles, skilled peers, and line managers so that floor rises automatically trigger targeted adjustments higher up
- Using robust job evaluation frameworks to weight roles objectively based on responsibility and technical skill, giving managers a clear, defensible basis for salary decisions
- Equipping line managers with explicit guidelines and decision matrices so discretionary funds go toward resolving structural compression rather than being spread thin across the board
- Consider more dynamic pay structures that are reviewed whenever significant statutory wage changes occur

Summary

Managing pay compression is no longer simply an operational pay challenge. It is a strategic reward issue that affects progression, retention, employee engagement and perceptions of fairness. Organisations that design salary review processes around clear principles, targeted investment and robust pay structures are better positioned to maintain meaningful differentiation between roles while supporting long-term workforce sustainability.



ECONOMIC SNAPSHOT

Inflation ticked up in July and the economy returned to modest growth in May, supported by stronger services activity. However, the Bank of England expects inflation to rise again in the near term as higher energy costs continue to feed through the economy. Reflecting inflationary risks, the Monetary Policy Committee voted to keep interest rates unchanged.

UK CPI inflation rose to 2.9% in July, up from a 15-month low of 2.6% in June. The increase was driven almost exclusively by higher gas and electricity prices faced by UK households, as inflationary price impacts of the Middle East conflict re-entered the economy after an unstable truce in prior months. Inflation in basket items which have a comparable weighting to energy, including recreation and culture, hotels and restaurants, and transport, fell at the latest measurement. Core CPI (which excludes more volatile items such as food and energy prices) was 2.6% in July, unchanged from its June level, meanwhile inflation including owners occupying housing costs (CPIH) registered higher at 3.1%.

The latest figures on UK Gross Domestic Product (GDP) show the economy returned to growth in May. GDP rose 0.1% in May after a 0.1% decline in April: services output was up 0.3% over the month but was partly offset by a 0.5% decline in production, which includes manufacturing, and a 0.8% fall in construction. The strongest contributor to monthly output was scientific research and development, which was up 5.1%.

Over the three months to May – a period that tends to provide more stable data – GDP growth was up 0.7%, a modest slowdown from the 0.8% seen in the three months to April.

Figure 1: Inflation Indices
(change over 12 months)

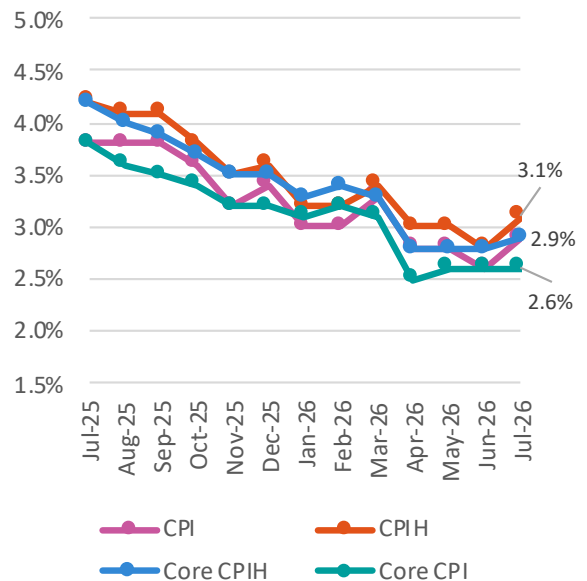
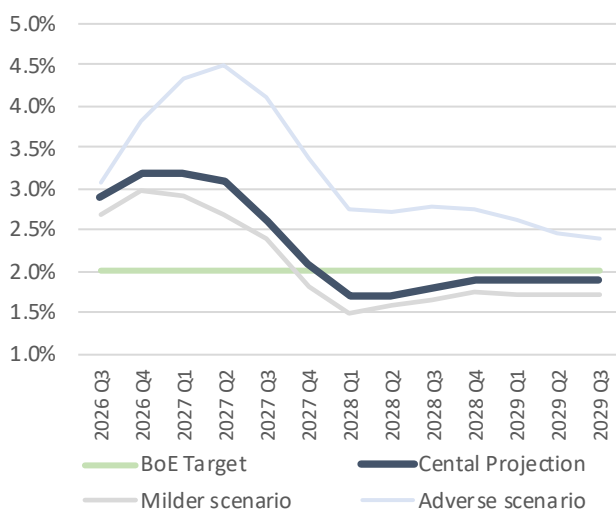


Figure 2: Inflation Forecast



While there are signs of disinflation in the underlying data, the Bank of England (BoE) has forecasted inflation to rise again in the short term as the impact of higher energy prices and volatility in crude oil prices continues to feed through the economy.

At its July assembly, the Bank of England's Monetary Policy Committee (MPC) voted 6-3 to keep interest rates unchanged at 3.75%, with three members voting for an increase to 4.0%, reflecting caution over upside inflation risks.

The MPC's medium term inflation forecast is shown in Figure 2. The forecast comprises a central projection that is judged to provide a reasonable baseline, alongside two scenarios that help to show how the outlook for UK inflation might differ given uncertainty about the path of global energy prices.

How Innecto can support: Pathfinder

Pathfinder is Innecto's digital career-mapping platform that transforms static job frameworks into interactive, personalised career journeys. It shows clear pathways, skills gaps and progression options for employees, while giving HR real-time talent mobility insight. When career progression is visible, engagement rises, performance improves and attrition falls.



AVERAGE EARNINGS

Earnings growth has continued to ease, with regular pay growth remaining flat and real wage growth remaining weak. With inflation expected to rise and wage growth forecasts remaining subdued, workers are likely to see further cost pressures on incomes.

Earnings growth has broadly flatlined according to the latest Average Weekly Earnings (AWE) report by the ONS. Growth in regular earnings was 3.5% in June, up from the 3.4% level which held for the three consecutive prior months. Meanwhile, growth in total earnings (includes bonuses) was 4.1%, down from 4.4% in the three months prior. This decline can be attributed to the conclusion of bonus award season.

Growth in regular earnings in the private sector was 2.8%, the lowest since October 2020. Growth is strongest in wholesaling, retail and hospitality, with regular earnings increasing by 3.6% and total earnings by 5.2%. In the public sector, regular and total earnings growth was 6.1% and 6.2%, respectively, both up on the month prior, as pay increases for public sector groups (i.e. the NHS pay deal) fed through to the data.

Adjusted for inflation, regular earnings growth across the whole economy improved to 0.5% in June, while total earnings weakened to 1.1%. With inflation expected to rise in the near term, real wage growth is likely to be even weaker, resulting in weaker purchasing power for workers across the UK economy.

Figure 3: Average Weekly Earnings
(3 month rolling average)

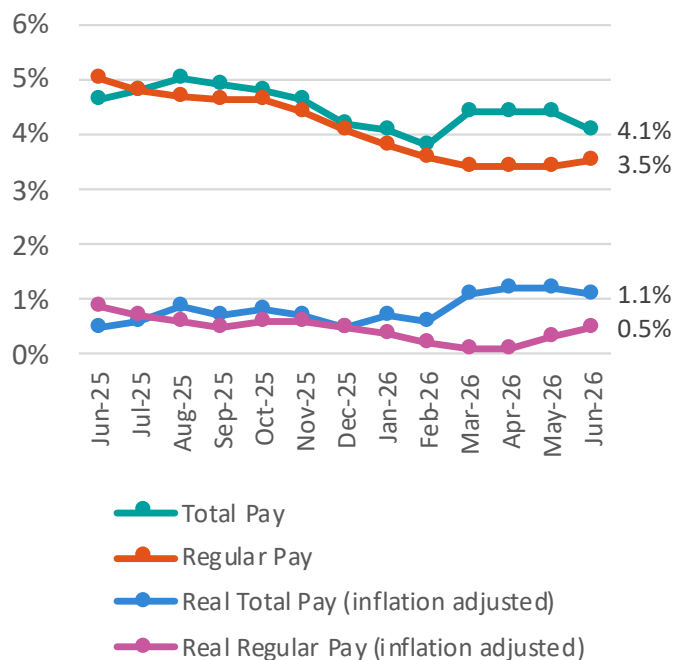
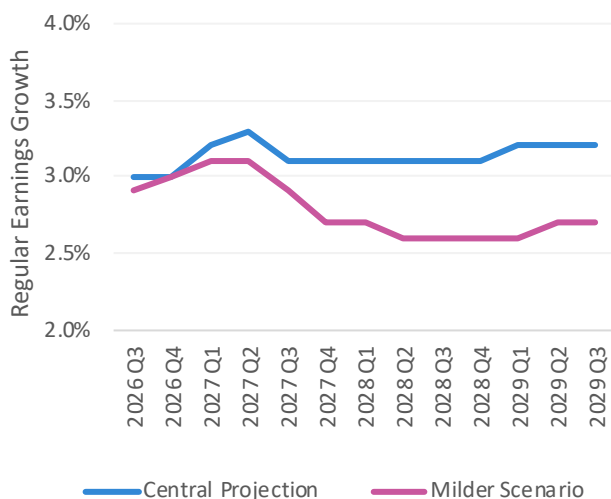


Figure 4: Regular earnings growth forecast



The BoE's MPC forecasts annual private sector AWE growth to average 2.8% in 2026 Q2 and around 3.0% in Q3. This is consistent with a level of slack in the labour market, driven by a slowness in hiring activity, continuing to weigh on wage growth. According to the BoE's research, there is little evidence the rise in energy prices will lead to higher wage growth. Most 2026 settlements were agreed before the Middle East conflict, and not many organisations expect to review pay again this year.

In the three months to July, respondents to the Decision Maker Panel (DMP) survey expected average wage growth of 3.4% one year ahead, below reported realised wage growth of 4% over the past year.

How Innecto can support: PayLab

PayLab is Innecto's revolutionary pay benchmarking solution, which allows you to gain complete clarity around your current and aspirational pay stance. PayLab's at-a-glance analytics, customisable dashboards and reporting suites enable you to track how pay is working for your business. You can look at market base pay and total cash stance, allowing you to get into the detail to understand your pay distribution.



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PAY AWARDS

Pay award growth appears to have stabilised, with median settlements holding at around 3% to 3.5% across sectors and employer expectations remaining anchored at 3% for the year ahead. Looking ahead, increased labour market slack is likely to constrain pay growth, although ongoing cost of living pressures will continue to influence pay decisions, raising the prospect of negative real pay growth as inflation increases.

Brightmine's latest analysis of pay settlements from 3.6m employees across all sectors shows a median increase of 3.3% in the three months to July 2026, unchanged from the previous two months. While the median and lower quartile of awards remained unchanged (see figure 5), the upper quartile of pay increase fell 0.1 percentage points to 3.8%. Around 62% of all settlements delivered increases between 3% and 4%.

Using a matched sample analysis, the Brightmine data also shows that around half (45.7%) of all settlements delivered a lower award than the previous year, while 30.6% were higher and 23.7% remained unchanged.

Over the 12 months to the end of June 2026, median pay award in the public sector was 3.5%, remaining unchanged across the three most recent rolling 12-month periods. In the private sector, the median pay award was lower at 3.0% and has stayed at this level throughout all 14 rolling 12-month periods. The award for charities/not-for-profit sector tracked lower against the whole economy average at 3%.

Figure 5: Base Pay Awards
(3 month rolling average)

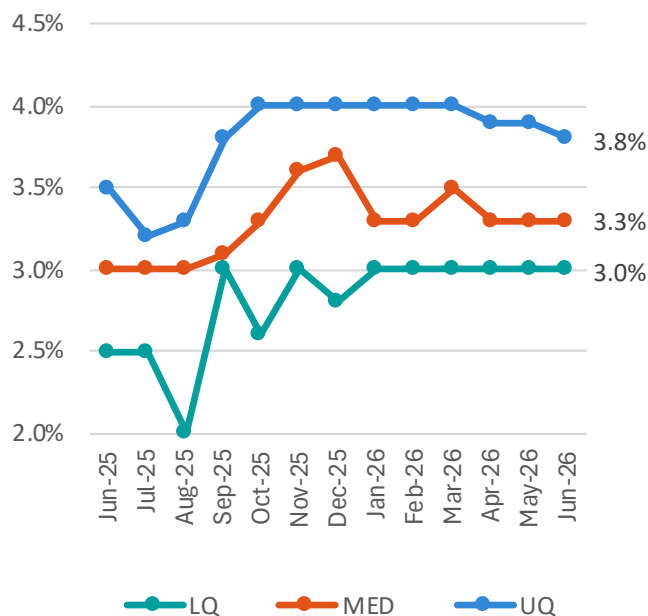
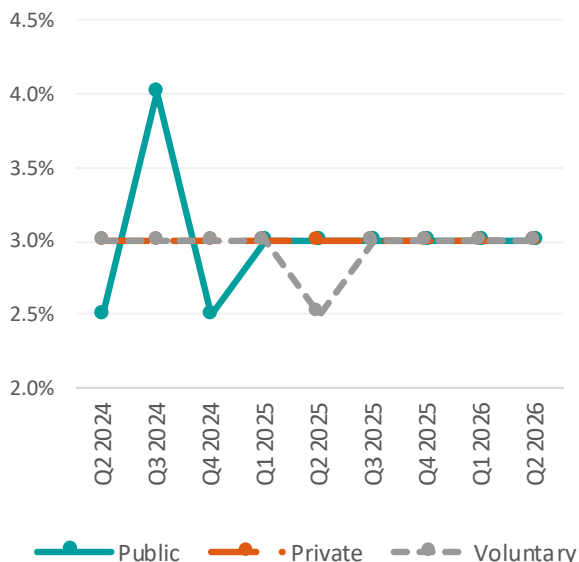


Figure 6: Median Pay Expectations
Split by Sector



According to research by the CIPD, the median expected pay increase for the next 12 months remains at 3% overall for the eighth consecutive quarter. The 3% level holds for the private, public and voluntary sectors. The CIPD also find a convergence of expected pay awards (for the 12 months ahead) in the 3-3.99% range. Compared with a year ago, a growing share of employers anticipate offering increases in this range, rising from 25% to 40%. While a year ago 24% of employers expected to award pay rises of 5% or more, this has since fallen to 15%. In addition, fewer are offering pay rises in the 2-2.99% range, from 23% last year to 16% this year.

Two opposing factors are influencing pay expectations. On one hand, increased slack in the UK labour market are reducing competition for workers, while ongoing cost of living pressures mean employers need to offer pay awards that help employees maintain their financial wellbeing. With inflation set to rise, it is likely we will see negative real pay growth in the coming months.

How Innecto can support: **Advance**

Anticipate cost implications and model impact on salaries with ease via Advance, our complete solution for pay review. Our user-friendly, fully customisable modeler removes the need for time hungry spreadsheets. By configuring the system to your internal pay practices and policies, you can keep track of spend and how proposed increases impact your pay position, whilst tracking progression year-on-year against your pay policy.



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PAY EQUITY

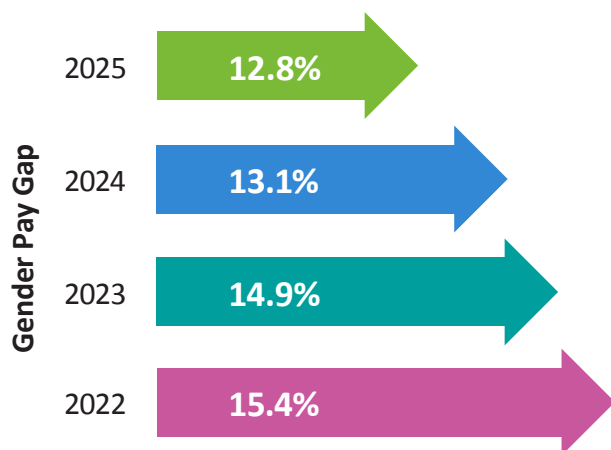
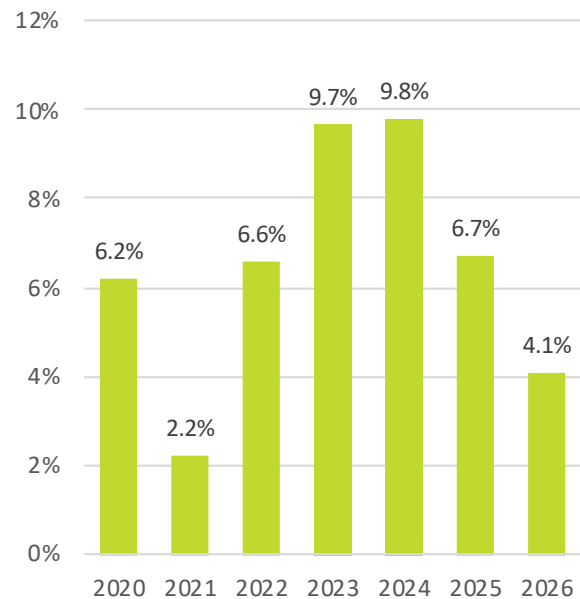
National Living Wage increased to £12.71 in April 2026, the lowest percentage increase since 2021. Above inflationary increases aim to deliver real-terms pay growth, while the gender pay gap continues its slow long-term decline.

Effective April 2026, the National Living Wage (NLW) increased by 4.1% to £12.71 per hour. This increase is in line with the Low Pay Commission recommendations to achieve two-thirds of median earnings. In parallel, the National Minimum Wage (NMW) which still applies to 18–20-year-olds, increased by a larger amount of 8.5% to £10.85 per hour. These changes translate to an increase in gross annual earnings of £900 for a full-time worker on the NLW and £1,500 for those on the NMW. The increases reflect prevailing economic conditions, and exceeds inflation expectations between April 2026–2027, giving workers a real-terms pay rise.

The new real Living Wage was announced in October 2025, at £13.45 across the UK and £14.80 per hour in London. The approximately 16,000 UK employers who have registered to voluntarily pay this rate had until 1st May 2026 to implement them.

As a result of changes to the wage floor, 2.5% of all employee jobs were low-paid in April 2025 (defined as less than two-thirds of median hourly pay), the lowest since the series began. At the upper end, the proportion of high paid jobs (1.5 times median hourly pay) increased to 23.2%, returning closer to its April 2023 proportion.

Figure 7: NLW Increases



The ONS headline gender pay gap (GPG) figure (which is based on median hourly earnings for full-time employees) has fallen by more than a quarter, and in April 2025, it stood at 6.9%, down from 7.1% a year earlier, and narrowed to 7% in April 2024, down from 7.5% in 2023. Among all employees, the gender pay gap narrowed to 12.8%, down from 13.1% in 2023. This gap is wider due to a larger proportion of women working part-time. The gender pay gap was largest in skilled trades occupations, where it was 13.9%. It was lowest for sales and customer service occupations, followed by caring, leisure and other service roles at 1.8% and 3.1% respectively.

Long-term analysis of the gender pay gap reveals a gradual decline in the median gap, which has fallen by around a quarter over the past decade. Despite the introduction of mandatory reporting regulations, progress has been slow — suggesting that additional action is needed from employers to drive meaningful change.

How Innecto can support: Evaluate

Ensuring consistent grading is a key foundation for ensuring pay equity. Evaluate is a job levelling tool that makes evaluating roles quick and straightforward, reducing the resource your department needs to commit to completing this vital yet often time-consuming task. Our robust system for evaluating jobs gives HR confidence that roles are being assessed fairly and consistently and enables HR to create a strong foundation to build an effective organisation.



FORECAST

RECRUITMENT & RETENTION

The labour market continues to soften, with payrolled employment and vacancies declining, while unemployment is expected increase over the remainder of 2026. On recruitment, employers are reporting fewer difficulties filling vacancies than a year ago, reflecting increased labour availability.

The UK unemployment rate (people aged 16 years and over) was estimated at 4.9% in April to June 2026. This is up by 0.2 percentage points in the same period last year but unchanged on the quarter.

This was accompanied by a decrease in the economic inactivity rate. The UK economic inactivity rate for people aged 16 to 64 years was estimated at 20.9% in April to June 2026.

Payrolled employment, a separate indicator of the number of people in work, has continued to fall. Early estimates for July 2026 indicate that the number of payrolled employees was 30.3 million, which is a fall of 0.3% from July 2025; this is equivalent to 94,000 fewer employees.

The estimated number of job vacancies has decreased on the quarter. Early estimates for May to July 2026 suggest a decrease of 3,000 to 707,000, compared to the prior quarterly measurement.

Figure 8: Unemployment rate by Age Group

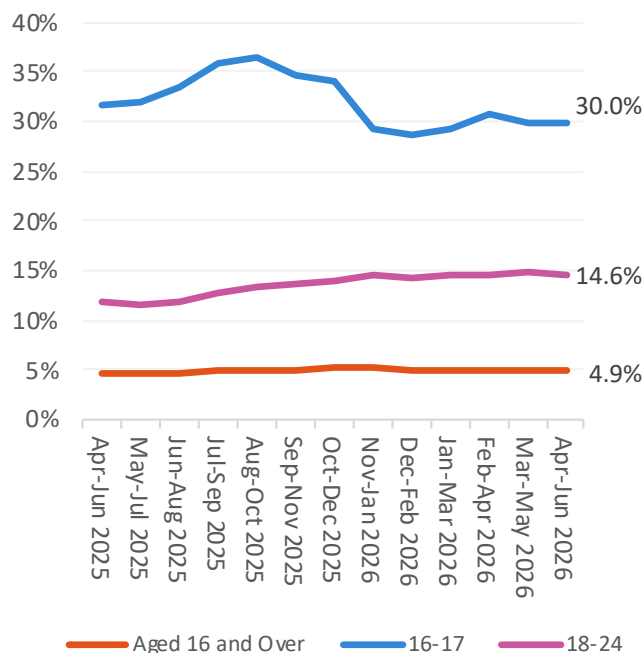
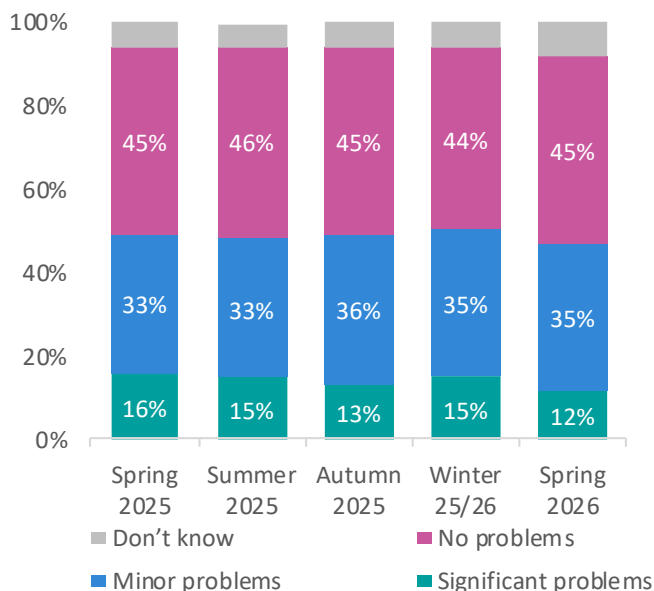


Figure 9: Anticipated problems filling vacancies



Looking ahead, the Bank of England projects the unemployment rate to gradually rise in the coming months to 5.0% in Q3 2026 and 5.1% in Q4.

At the employer level, the latest survey by CIPD found that fewer employers anticipate significant problems in filling vacancies that have been difficult to fill in the recent past. Just 12% of employers are anticipating significant problems in filling vacancies in the next six months, down from 16% a year ago.

Employers in healthcare and social work are most likely to expect recruitment difficulties over the next six months (20%), driven by recent changes to migration rules. In contrast, only 3% of retail employers anticipate significant hiring challenges, reflecting a larger pool of jobseekers and lower barriers to entry.

How Innecto can support: Hapi

The challenging labour market has increased the focus on how you can stand out amongst competitors. Innecto can support on developing your wider total reward package to elevate key benefits. Our industry leading mobile and web-based app, Hapi, also provides the perfect home for all components of your employee deal, making it visible and accessible to all. Hapi allows you to effectively communicate, manage and analyse your employee deal to drive engagement and retention.





INNECTO INSIGHTS **WHAT WE DO**

As the UK's largest independent Reward consultancy, we provide honest advice, support and practical help to solve any challenge relating to attracting, retaining and motivating people. Through our highly experienced team of Reward professionals we provide the insight and expertise to leverage your pay and reward spend and harness the power of your greatest asset – your employees.

In 2019, Innecto was acquired by AIM-listed Personal Group, providing us with expanded resources and support from an in-house development and tech team. This partnership has allowed us to enhance our offerings, including advanced tools like Evaluate, PayLab, and Advance, which empower our clients to make data-driven decisions with clarity and efficiency.

Our new digital product, Pathfinder turns static job frameworks into interactive, personalised career paths that give employees clear visibility of how to progress - boosting engagement, improving performance, and reducing attrition.

Our team of experienced consultants offers actionable insights across the pay and reward spectrum, from executive compensation to employee engagement and retention. Innecto is committed to driving organisational success through impactful reward solutions, seamlessly integrating consultancy and technology to help clients harness the power of their workforce.

Data Sources

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7. CIPD Labour Market Outlook; Spring 2026
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