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Benchmarking employment costs at Network Rail

A research report for the Office of Rail Regulation (ORR)

Final Report

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## 1 Introduction

This report presents the findings of research undertaken by Incomes Data Services (IDS) for the Office of Rail Regulation (ORR). The work on the project took place between December 2012 and March 2013.

In December 2012, IDS was asked by ORR to undertake a review of Network Rail's proposed total employment costs in CP5<sup>1</sup> and to determine their efficiency. The focus of the review was on total employment costs per employee, not on the level of efficiency of Network Rail's total expenditure on employment, for example whether Network Rail employs the correct numbers of staff in certain roles. The scope of the work was defined by ORR as follows:

- To examine current pay and other elements of the remuneration package (including pensions) for Network Rail's major groups of employees and to benchmark them against relevant comparators;
- As part of the review, to consider the findings of Network Rail's own recent benchmarking exercise;
- To consider whether there are differences in the efficient level of Network Rail's total employment costs across the organisation's ten operating routes, covering different parts of the country;
- To provide understanding of how other similar organisations manage their employment costs, particularly those that started from a position of inefficiency;
- To suggest ways in which Network Rail can improve its approach in areas where employment costs are found to be inefficient.

The outputs of the study will be used by ORR as one of the inputs to inform its PR13 draft determination in June 2013 and final determinations in October 2013.

To analyse the data and reach its conclusions IDS has drawn on the expertise of its in-house researchers, particularly on their experience and lessons learned in compiling reports on employment costs in other regulated sectors, as well as the expertise of IDS associates in key areas.

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<sup>1</sup> The next regulatory review period which will run from 2014-15 to 2018-19.

## **2 Executive summary**

### **2.1 Approach and methodology**

A series of data requests were submitted to Network Rail, with further requests submitted as additional queries arose during the course of the work. We should record our thanks to Network Rail staff for their efforts to provide information, while also noting that Network Rail systems often did not seem able to generate the data needed for effective analysis of work patterns and staffing.

The results from the 2008 Inbucon report and Network Rail's 2012 remuneration benchmarking report provided valuable background. Our approach to benchmarking draws on two main types of source:

- To assess broad trends in earnings and hours at Network Rail relative to the wider economy, we draw on data from the Office for National Statistics, supplemented by IDS data on the pattern of pay settlements over time;
- For the detailed benchmarking, we draw on the IDSPay database and a bespoke dataset of relevant jobs in reasonably comparable organisations.

### **2.2 Results from previous benchmarking exercises**

The 2008 Inbucon report and Network Rail's 2012 remuneration benchmarking report reached similar conclusions: namely, that Operations and Maintenance employees are paid more than comparable jobs in other organisations, while Role Clarity staff are paid reasonably closely in line with the market.

### **2.3 Key findings**

The findings from the different elements of our benchmarking exercise are outlined below.

#### **2.3.1 General economic overview and regulatory context**

- In most of the period 2007 to 2012, the quarterly median level of pay settlements across the economy was below the level of inflation as measured by the RPI;
- The median level of basic paid hours is 37.5 in the private sector and 40 hours in construction.

### **2.3.2 Network Rail bargaining and pay arrangements**

- For the Network Rail Operations and Maintenance bargaining units, all pay settlements in the period 2007 to 2012 have given increases above the level of the relevant RPI inflation rate;
- In five of the six pay reviews, the increases have been above the all-economy median level of pay settlements at that time;
- The picture has been more balanced for Role Clarity staff pay reviews;
- The 35-hour basic working week at Network Rail is in line with the median for rail transport but lower than the 37.5 hours median basic working week in the private sector;
- These findings on overall trends help to explain the results from our detailed pay and benefits benchmarking analysis.

### **2.3.3 Pensions**

- Network Rail operates four pension schemes, some defined benefit and some defined contribution
- On the assumption that the RPS 65 defined benefit scheme will evolve to become the main Network Rail pension scheme, we have based benchmarking on the current employer contribution rate of 10.5%, with an NI rebate of 3.4%;
- From 2016, that rebate will be ended, but it is too early to assess the likely impact;
- Introduction of the new RPS 65 scheme means that Network Rail's pension costs compare favourably with the general market: the headline contribution rate is lower than that found among other defined benefit schemes, further reduced by the State Pension offset and the exclusion of shift and other enhanced payments from pensionable pay.

### **2.3.4 Pay and benefits benchmark analysis**

- The report includes a series of graphs and tables comparing Network Rail employees with the external market in terms of basic pay, total cash and total reward;
- Calculating a weighted average of the variance from market in terms of total cash gives an average Network Rail lead of 36% for Operations grades, 4% for Role Clarity grades and 28% for Maintenance employees<sup>2</sup>.

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<sup>2</sup> If shift allowances are not included in the market data for those Network Rail jobs for which we received no corresponding payments data for working shifts then Network Rail's market lead would be 53%.

- In terms of total reward, the lead of Network Rail emerges as greater: 36% for Operations, 9% for Role Clarity, and 32% for Maintenance grades<sup>3</sup>. This is driven primarily by the value of the season ticket subsidy, particularly for lower paid staff, and by the adjustment for working hours for the Role Clarity staff at this stage;
- Our view is the remuneration lead of the Operations group and Maintenance group over the general market is likely to have increased since 2008 (because of the developments noted in above in 2.3.2), while any pay lead for the Role Clarity grades, in terms of total cash, is likely to be little changed;
- Our best (conservative) assessment is that Network Rail's employment costs are 20% to 25% above the market., compared with Inbucon's 2008 conclusion of 15% to 20% above the market;
- We believe it is appropriate to take a cautious approach to assessing the extent of Network Rail's lead above the market because of the extent of weaknesses in Network Rail's data (see 2.5 below).

### **2.3.5 Labour turnover**

- As an added check on our conclusions about the market position, we reviewed levels of labour turnover at Network Rail against the external market;
- The results show exceptionally low levels of staff turnover among the Operations and Maintenance groups, while turnover among Role Clarity staff is closer to the all-sector level (and above it for the Management support group);
- These results are consistent with the view that pay levels for the Operations and Maintenance groups are above the external market.

### **2.4 Issues around route-level and regional pay**

- The key variation in earnings by location in the UK is between London, and to a much lesser extent the South East, and other regions;
- The Network Rail pay system reflects this pattern to some degree through its payment of London and South East allowances;
- The great majority of employers operate a single pay structure outside London and the South East;
- Network Rail's operating routes tend to span multiple regions.

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<sup>3</sup> If shift allowances are not included in the market data for those Network Rail jobs for which we received no corresponding payments data for working shifts then Network Rail's market lead would be 55%.

## 2.5 Quality of Network Rail data

- Despite the readiness of staff to help, there seem to be major problems in the capacity of Network Rail data systems to generate employment and reward information in ways that are well suited to practical analysis;
- Problem areas included number of total paid hours by grade<sup>4</sup>, nature of the payment(s) for each hour worked, the nature of and rationale for extremely diverse levels of allowances and bonus payments<sup>5</sup>;
- Benchmarking was further complicated by shortcomings in the availability of job descriptions and uncertainties over the allocation of Hay points to a variety of roles.

## 2.6 Steps to manage employment costs effectively

- Quality of employment and reward data are fundamental to effectively managing change to identify how particular work patterns are affecting overall employment costs and, for example, to be able to model the potential impact of changes. Network Rail's current systems do not seem to support this type of effective management. An audit of both payroll and time reporting systems and procedures appears to be an immediate priority with a view to producing recommendations on changes to be made to ensure it is possible to record the different types of hours worked e.g. weekends and nights, whether they are worked as part of rostered hours or as overtime, and that the different payments are itemised;
- Network Rail's basic working week of 35 hours is shorter than the general level of basic hours elsewhere in the economy, which raises employment costs relative to other employers. A comprehensive review of working hours, rosters and fluctuations in staffing needs could lead to significant efficiencies;
- The diversity of terms and conditions applying to Maintenance grades must inevitably be more complex and costly to manage than a more streamlined system. Substantial rationalisation is needed and the introduction of more rigorous recording systems and reporting procedures will provide the data required to assess any possible changes;
- There is a strong case for reviewing the balance of the total package for Signalling and Maintenance staff as allowances and additions to basic pay seem to make up a much larger proportion of total cash earnings at Network Rail than is the norm elsewhere in the economy. It is not clear whether this encourages efficiency or runs the risk of encouraging inefficient practices;

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<sup>4</sup> For example, the weighted average total hours worked by the First Engineering group of Maintenance staff comes to less than 35 hours on the raw data even though they receive on average between £6,873 and £12,454 a year in overtime payments, depending on position.

<sup>5</sup> For example, in the Jarvis group of Maintenance staff an Overhead Line worker Cat E receives on average £8,802 a year in allowances but the Signals & Telecoms (S&T) grades receive less than £10 a year under the same allowances category. Network Rail were unable to offer an explanation for these variations other than to issue a 'health warning'.

- In a broad-banded system of the type applying to Role Clarity staff there is greater risk of pay drift than under other systems. Network Rail should be encouraged in its review of the operation of the broad banding pay system, which is currently underway.