OUTCOMES BEYOND PERFORMANCE

THE (NEW) WORKING WORLD

Part II: Facing up to the challenge of fair pay

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PART II: FACING UP TO THE CHALLENGE OF FAIR PAY

This is the second part of a four-part paper on SDG 8 – decent work and economic growth. In part one, we asserted that the challenges presented by increasingly tight labour markets provide opportunities to rethink hiring practices for mutual benefit. In this paper, we progress from our engagement on workforce diversity to the issue of fair pay.

Key points:

- **A living wage provides workers with enough income to support a basic – but decent – lifestyle in their local communities.**
- **Without living wages, workers can be captured in a cycle of poverty and some value chains may not be economically sustainable.**
- **Ensuring workers are afforded a decent income benefits companies: it can result in decreased turnover; lower absenteeism; wider economic benefits; and enhance companies' brand.**

In the first instalment of this paper, we demonstrated that our investment focus on SDG 8 intersects with a number of the other Global Goals. We engage with companies on four questions:

1. **Who are companies employing** – are there opportunities to provide mutually beneficial employment opportunities to individuals from deprived communities or from higher unemployment constituencies?
2. **How much do they pay** – are companies paying a fair and 'living' wage to direct and indirect workers to enable them to live dignified lives?
3. **What additional financial and non-financial benefits are provided** – are employees coming to work healthy, motivated and thus productive?
4. **Development and training** – with human capital a rented asset, are companies sufficiently developing their people by investing in opportunities for employees to advance their skills and careers?

By tackling the question of who companies are employing, we showed that among others, two portfolio companies – SSP and Cineworld – have significant potential to embrace an 'Opportunity Employment' mindset, expanding their frontline recruitment and retention efforts to reach under-tapped talent pools, such as youth (the disproportionate population of young people who are out of school and out of work), persons with disabilities or ex-offenders.

In 2018, some 700m workers lived in extreme or moderate poverty in low- and middle-income countries.

Such efforts could not only improve engagement and boost productivity but reduce costs while creating economic opportunities. We also asserted that companies have the power to improve the employment market beyond their own direct workforces by ensuring that there is no exploitation taking place among their suppliers and favouring suppliers that have inclusive recruitment policies.

In this instalment, we progress from our engagement on workforce diversity to the issue of fair pay. And although there is no simple solution to what is a systemic problem, we believe that engaging with companies can help them, their customers and suppliers further their efforts in the shift towards fairer pay outcomes. In so doing, we are supporting SDG 1 and SDG 8, with their objectives of ending poverty in all its forms and promoting decent work for all, respectively.

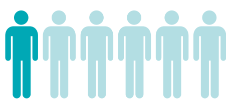
The fair pay challenge

In 2018, some 700m workers lived in extreme or moderate poverty in low- and middle-income countries, earning less than $3.20 per day (in purchasing power parity terms)[1]. That means that one in four persons in employment in these countries is living in conditions of poverty. And although, the global unemployment rate continues to decrease, more than 170m people are still unemployed. Indeed, poverty is not just an issue for developing nations. It has both an absolute and relative context and to that end, SDG target 1.2 aims to reduce, at least by half, the proportion of people living in poverty according to national definitions. For example, in the UK, people in relative poverty are those living in households with income below 60% of the median in that year.

The extent of poverty

12.3%

the official poverty rate in the US in 2017[2]



One in six people in the UK are in relative low income before housing costs[3]

1 "World employment social outlook: trends 2019," published by the International Labour Office in 2019.
2 "Income and Poverty in the US: 2017," published by the US Census Bureau in September 2018.
3 "Briefing paper – Poverty in the UK: statistics," published by the House of Commons Library in July 2019.

Of course, the most direct way to lift low-paid working people out of poverty is to pay them more. And international companies, at least, are facing increasing pressure to pay their own workers fairly and request that their supply chain firms follow suit.

Pay and fairness

The concept of 'fair pay' has been a growing theme in many markets, in particular with respect to high pay at the top of companies, and as a result pay-ratio disclosures are soon to be common place within European corporate reporting.

According to research by PwC[4], typically a quarter to a third of people feel that companies are not delivering the principles of fairness that they deem important. This reinforces our view that it is in all companies' self-interest to develop – and be able to articulate – a fuller, more complete narrative on fairness and how this is aligned to their approach to pay for all employees.

Interestingly, even where pay is not the dominant factor in determining job satisfaction, evidence suggests remuneration remains the first thing that prospective employees assess. Furthermore, research from Glassdoor (a website where employees and former employees anonymously review companies and their management) found that differences in pay levels influence job satisfaction more than absolute pay.

As remuneration transparency extends from the executive suite (where the ease of comparing one's pay with one's peers has led to pay inflation resulting from discussions around relative fairness), it is not surprising that similar questions of fairness are taking hold as all employees seek equitable treatment – a trend most vividly illustrated by the intensifying spotlight on the gender pay gap in all industries (see our commentary Mind the gap: confronting pay disparity in healthcare).

The living wage (SDG 1.2 and 10.1)

The concept of a 'living wage' is gathering global recognition as a minimum standard for judging employee pay. It has been championed by influential leaders from religion, politics and academia and, importantly, it is encapsulated in the SDGs. While a living wage provides workers with enough income to support a basic – but decent – lifestyle in their local communities, there is unfortunately little consensus as to how a living wage should be calculated. This complexity is in part borne out of a recognition that the 'need' is both time and location specific and, of course, is open to challenge. One framework put forward by global consultancy firm Mercer is that of a three-tiered definition comprising:

1. **Basic Living Wage:** The full-time wage to support the purchase of essential goods and services, at well-researched and discount prices, to allow for a healthy and functional standard of living. It meets the practical needs of the employees in utilitarian surroundings.
2. **Decent Living Wage:** The full-time wage to support the purchase of necessary goods and services, predominantly using planned (and some convenience) buying to provide a healthy and comfortable standard of living. It meets the needs of employees in modest surroundings.
3. **Good Living Wage:** The full-time wage to support the purchase of appropriate goods and services at reasonable prices (including some convenience buying) to support a healthy and comfortable standard of living, including access to inexpensive occasional pleasures, such as leisure and social activities. It meets the needs of employees in a comfortable but non-extravagant lifestyle.

In recognition of the complexity in this area, it is encouraging to see the Global Living Wage Coalition making progress towards a common understanding: to date, it has established benchmarks for 26 countries. In the same vein, ACT – an initiative on living wages – is a pioneering model worth watching closely. It has brought together brands, retailers and trade unions with a joint goal – to achieve a fair living wage for the workers in the textile industry. In the case of ACT, the involvement of trade unions is an instructive one in helping identify a way through the contested area of what constitutes, from a worker's perspective, a living wage.

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It's not all about the cake

It is easy to say that paying workers more should result in more engaged and, ultimately, more productive workers. Indeed, there is much evidence for this, especially in respect of entry-level roles. It is unrealistic however, to not also acknowledge that there is, of course, a direct financial cost to companies. For most companies this increase in wage budgets is relatively small, however, for those companies that employ large numbers of low-paid staff it can be significant.

This additional cost epitomises the challenges which result from the mechanism for accounting for human capital – i.e. increased wages mean an immediate increase in accounted explicit expenses. However, the resultant benefits to the company will likely occur over multiple years and be far less explicitly accounted for. There are many potential benefits, which include: [5]

1. **Decreased turnover:** an analysis of Glassdoor data suggests that a 10% higher base pay is associated with a 1.5-percentage-point increase in the likelihood that workers will stay at their current company the next time they move to a new role – a statistically significant link[6];
2. **Lower absenteeism:** a study by Professor Wills of Queen Mary's University found a positive impact on the psychological well-being of 'living wage' workers[7];
3. **Brand enhancement:** first-mover advantages initially may help win new business; and
4. **Wider economic benefits** as a result of additive consumer spending.

4 "The ethics of pay in a fair society," published by PwC in October 2017.
5 "The Living Wage Employer Experience," published by Cardiff Business School in April 2017.
6 "Why do workers quit? The factors that predict employee turnover," published by Glassdoor in February 2016.
7 "Investigating the effect of the London Living wage on the psychological wellbeing of low-wage service sector employees: a feasibility study," by E Flint, S Cummins and J Wills; published by the Journal of Public Health in 2013.

To illustrate the challenge, let's return to the stock example that we used in the first instalment of this four-part paper: current holding **SSP Group** happens to be the second-largest employer in our portfolio, with 38,000 direct employees (and also has a sizable indirect supply chain with respect to its own-brand confectionary products). In 2018, the firm's labour costs improved by 20 basis points year-on-year, driven by a broadly-based labour efficiency programme. These savings more than mitigated the ongoing labour inflation costs, which arose from increases in minimum wage levels and healthcare costs to be paid by the company, most notably in the UK and US.

The key phrase here is 'minimum wage'.

Many countries have for some time set a legal minimum wage in order to establish an earnings 'floor' for low-wage workers. In recent years, however, in recognition of the associated stronger reputation and brand value, a large number of employers in countries such as the UK, Canada, the US and parts of Asia have voluntarily adopted a higher living wage standard.

In the UK, the Living Wage – as set by the Living Wage Foundation – is 9% higher than the minimum wage (which is confusingly called the National Living Wage and set by the Government). Thus, if the company (in this instance, SSP) was to shift to paying a Living Wage to those workers in the UK currently earning the legal minimum wage, then extrapolating from reported 2018 figures, we assume a £799m wage bill for 2019 (and apply the increase to 50% of total UK employees), the company would experience a 40 basis-point increase in its labour/sales ratio and a £10m hit to gross profit. If the increase were applied, on the same assumptions across the group, this would result in a 110 basis-point impact on its labour/sales ratio and a £33m hit to gross profit.

We believe it right that corporate earnings are not generated at the expense of providing for a dignified standard of living for those workers producing or delivering the end goods and service.

While the above calculations rely on a number of assumptions (and are therefore for illustration only), the point is clear: for companies like SSP which rely on a large amount of low-paid labour and as a result operate with high labour costs, it is difficult to be a first mover unless they have some confidence in the positive payback. Although the immediate impact on earnings is evident, the gains from a reduction in the costs associated with unnecessary turnover are more speculative (although evidenced by research) and come through over time. In the case of SSP, it is interesting to note that Heathrow Airport has become an accredited Living Wage employer. It is not unreasonable to contend that high profile operators will face pressure to extend these principles to those whom they award commercial concessions contracts.

Ultimately, we believe it right that corporate earnings are not generated at the expense of providing for a dignified standard of living for those workers producing or delivering the end goods and service. To that end, we continue to engage with all companies in the Fund to encourage steps to be taken to understand the financial needs of their workers and respond accordingly.

Among the top 10 direct employers in the Fund, engagement on the topic of Living Wages is happening with at least half.

Top 10 (direct) employers in the Fund (as of 2018)

	Number of employees
Cineworld	37,641
SSP Group	37,296
Credicorp	34,034
Fortune Brands	25,300
Trelleborg	24,045
Techtronic Industries	23,279
Huhtamaki OYJ	17,663
Aalberts NV	16,452
Brunswick Corp	16,038
RPM Intl	14,957

Illustrating the complexity of what constitutes a 'Living Wage', Finnish packaging company **Huhtamaki**, uses the term 'basic needs wage'. Encouragingly, the company has explained to us that it is working with a third-party auditor to provide the basic needs wage calculations for the locations where it has manufacturing operations.

While the solutions are not straight-forward even when a company has control over the salaries, it is more complicated still when the wages of workers down through a company's complex supply chain are considered.

Swedish manufacturer **Trelleborg** sources natural rubber as an input material to its agricultural tyres business. We have been engaging with the company around the development of a sustainable natural rubber sourcing policy aligned with the need to reduce deforestation and improve the incomes and working conditions of farmers at the bottom of the value chain. This objective is in recognition of the reality that 85% of natural rubber is produced by approximately six million smallholder farmers. Presently, smallholder farmers can struggle to pay tappers a minimum wage, let alone a living wage. Self-evidently, this inability to pay a living wage is a risk to the sustainability of the value chain itself and necessitates collective action. In that context, it is pleasing to see the establishment earlier this year of the Global Platform for Sustainable Natural Rubber which brings together civil society representatives, alongside producers, processors, traders and tyre makers.

Short-changed: tackling pay inequity (SDG 5.5)

Economic inequity describes a system where in-built biases, such as the existence of practices that discriminate based on age, gender, or other innate differences, result in unfair remuneration.

For example, on average women across the world are paid just 63% of what men earn[8], suggesting that we are still a long way from realising the principle that work of equal value should be remunerated equally. What's more, there is not a single country where women are paid as much as men[9].

According to a Pew Research Centre Survey in 2014[10], more than three quarters of US women and 63% of men agreed that the US "needs to continue making changes to give men and women equality in the workplace". In the most recent iteration of the survey[11], one-in-

8,9 "The Global Gender Gap Report 2018," published by the World Economic Forum in December 2018.
10 www.pewsocialtrends.org/2015/01/14/women-and-leadership/
11 www.pewresearch.org/fact-tank/2019/03/22/gender-pay-gap-facts/

5%

of men said they have earned less than a woman doing the same job

There is not a single country where women are paid as much as men

four employed women said they have earned less than a man who was doing the same job while just 5% of men said they have earned less than a woman doing the same job.

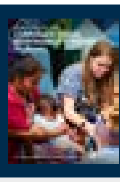
Indeed, as already mentioned, an analysis by Glassdoor found that differences in pay levels influence job satisfaction more than absolute pay. As such, companies that achieve equitable pay may enjoy higher employee morale and commitment and, in turn, an increase in productivity. A month-long research study[12] of Indian manufacturing workers, which was cited by The Abdul Latif Jameel Poverty Action Lab (J-PAL), a global research centre, evidences this link between (undeserved) pay inequality and reduced output (and lower attendance).

As well as breaching basic human rights, the inequitable pay and promotion of treatment of workers based on gender or age could result in companies losing employees, especially if such practices become highlighted on social media (a material business and reputational risk nowadays).

Gender pay inequality is an issue across professions, seniority and regions. Our engagement with **AMN Healthcare Services**, a healthcare staffing company, is evidence to this. While the company can be rightly proud of its own record, the industry in which it operates cannot. There is substantial evidence of sizable pay differentials across the healthcare professions between men and women, from male nurses out-earning female nurses by 10% despite being out-numbered by 10:1; or as research commissioned by AMN subsidiary Merritt Hawkins evidences a near 40% gap among physicians. It is therefore unsurprising to note that men also consistently report a marginally higher level of job and salary satisfaction[13]. We have been delighted by the response of AMN since we engaged with the company on this topic. Indeed, AMN's public commitment to take action – as documented in its latest corporate social responsibility (CSR) report – is further evidence of its intention to address the issue of gender pay inequality in healthcare.

But the gender pay gap doesn't tell the whole story of income inequality: companies need to extend their scrutiny to the ethnicity pay gap. According to the Institute for Women's Policy Research, black women in the US are paid 61 cents for every dollar made by a white, non-Hispanic male – that's a loss of more than $23,000 a year. To ensure the world of work is fair for all, companies must tackle structural and inbuilt biases in their workplaces.

AMN addresses the SDGs in its 2018 Corporate Social Responsibility Report



In 2018, Merritt Hawkins, an AMN company, released research that demonstrated the scale of pay inequality among physicians in the state of Maryland.

The report found that, even when controlled for hours worked, female physicians earned 37% less than their male counterparts. Unfortunately, these findings are not confined to physicians, as female nurses make 10% less than their male counterparts, according to data from the Bureau of Labor Statistics. The pay discrepancy in nursing exists even though women outnumber men 10 to one in the profession.

Recognizing our unique ability to lead the healthcare industry on this issue, AMN is working to not only highlight the scale of the pay discrepancy problem, but also take action to address it.

Encouraged by an investment community that values holistic financial returns, such as Hermes Investment Management, AMN is seeking ways to generate positive changes for three UN Sustainable Development Goals.

Note: the above text is an extract from the 2018 AMN Healthcare Corporate Social Responsibility Report.

Towards fairer pay outcomes

Although we are at nascent stages of engagement on the subject of fair pay, we are encouraging companies to play a more active role in tackling pay disparities worldwide. Specifically, we will continue to ask company management teams and boards:

- How does the company determine what is 'fair' pay, and how does this compare to an independently calculated 'living wage'?
- Does the company understand the drivers of pay inequality?
- Can the company roll-out unconscious bias training and/or positively discriminate to overcome diversity gaps and meet company set pay equality and diversity targets?

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12 The Morale Effects of Pay Inequality, Breza, E et al, The Quarterly Journal of Economics, Vol 133, 2, May 18
13 www.healthcareers.com/article/salary/gender-pay-gap-healthcare

CASE STUDY

ENGAGEMENT PROGRESS: AMN HEALTHCARE

AMN Healthcare is a healthcare staffing company. Its core business is the placement of nurses and allied health professionals on temporary assignments at hospitals and healthcare facilities throughout the US.

Engagement context

- AMN has been held since the inception of the SDG Engagement Equity strategy. The company is the largest healthcare staffing provider in the US, providing temporary and permanent staffing and workforce solutions to healthcare providers throughout the country. In more recent years, it has been deepening relationships with clients from purely staffing into broader workforce management. AMN's customers operate in various parts of the healthcare sector.
- AMN has made a concerted effort to focus on its own operations in recent years, and its commitment to high standards of governance, diversity and equality have been recognised through numerous deserved awards, such as the Forbes' Best Midsize Employers list, as well as its inclusion within the Bloomberg Gender-Equality Index and the Human Rights Campaign Corporate Equality Index. That the company is now willing to turn its attention to driving change outside its four walls is to be applauded.

Engagement timeline: March 2018 to June 2019

Milestones	1 Raise SDG issue at the appropriate level	2 Company recognises that the issue is valid
Pay equality in US healthcare	**March and April 2018:** Further to an introductory letter in January 2018, we spoke with the CEO about a range of matters, in particular pay equality in the healthcare profession and the potential for the company to use its insights and data to analyse the scale of any gender pay gap.	**August 2018:** We were pleased that the company has begun to take a thought leadership role on the issue of gender pay inequality through the publication of research undertaken by its subsidiary Merritt Hawkins. **October 2018:** We had another encouraging call with the CEO during which it was acknowledged that AMN is well positioned to highlight and address the issue of pay inequality among US physicians and nurses. We explored in some detail the need to educate and address the hiring practices of their clients as well as the need to support female candidates with coaching and career planning. Having first raised this issue with the company towards the beginning of the year, we were pleased to hear that the company recognises its ability to take a leadership position and its passion for doing just that.
Healthcare training (nursing)	**March and April 2018:** We discussed with the company the staff shortage across medical professions and the bottleneck for supply caused by a shortage of teaching faculty. We also talked through its existing annual, over-subscribed, Guatemala mission and questioned whether there might be more that AMN can do to support the development of healthcare services outside of the US while also supporting the development of skills and experience of US nurses and physicians.	**April 2019:** We facilitated an introductory meeting between the CEO of AMN and the executive director of a global campaign (which was launched in collaboration with the World Health Organisation to raise the profile of nurses worldwide) to understand and introduce the synergies between the organisations and scope out partnership opportunities.
Improve ESG reporting	**January 2018:** We wrote to the company Chairman to explain the objectives of SDG Engagement Equity and the potential to improve its ESG reporting (i.e. to take it beyond an internal focus and shift from bi-annual to annual reporting).	**March 2018:** During a wide-ranging discussion, we encouraged the company to go further in its current disclosures to better tell its story in more detail and on a more frequent basis as well as to continue to give thought to what more it can do to have a positive societal impact as a result of its position within the industry. The company acknowledged that it needs to change the frequency of the publication of its existing CSR report from a bi-annual to an annual basis.

Engagement themes

- Pay equality
- Decent work
- Healthcare training
- ESG reporting

Theory of change: AMN Healthcare

- In order for women to achieve full parity with men in the workplace, we must eliminate the conscious and unconscious biases that still play a significant role in influencing the gender differences in pay. The fact that a sizable pay differential exists in the nursing profession, where women massively outnumber men, is evidence that the problem is not one of supply. AMN are particularly well situated, interfacing as they do with both job candidates and recruiting customers, to take a lead in mitigating this structural inequality.
- Research[14] has concluded that as well as improving health globally, empowering nurses would contribute to improved gender equality – as the vast majority of nurses are women – and build stronger economies. Despite its US focus, AMN has led annual medical and community development missions to Guatemala for the past six years. Given the breadth of its connections and expertise, we believe there is an opportunity to have a more lasting impact by exploring a programmatic partnership to support local healthcare workforce education in lower- and middle-income countries, thereby leaving a sustainable legacy.

SDG alignment

3 Develop and commit to a credible plan for change

4 The plan succeeds and relevant impact metrics are disclosed

3 → 4

January 2019: We spoke with the Chair around a number of governance and other matters and again returned to the role the company can play in helping address the significant gender pay gap which exists within US healthcare. We were again encouraged by the response and the outline of planned next steps to be taken by the company at both an industry and company level.

May 2019: We were particularly pleased to note the public commitment that the company made in its recently published corporate social responsibility (CSR) report to lead the healthcare industry on the issue of pay equality. It also cited our dialogue as supporting it in this endeavour.

3 → 4

April 2019: Both organisations expressed a strong interest to collaborate and work together on the campaign, with AMN providing networks and contracts with nursing leaders in the US, as well as the potential to fund the training of nurses in developing markets.

3 → 4

August 2018: In its 2018 proxy statement, the company confirmed its intention to shift towards annual publication of its CSR report. The company also confirmed this message in a letter to investors.

May 2019: The company publishes its 2018 CSR report, demonstrating its shift to annual reporting and more detailed reporting. The report referenced our ongoing dialogue with the company on the SDGs and gender pay inequality in US healthcare.

Engagement commentary

Since 2018, we have spoken with the company's Chief Executive on multiple occasions while also speaking with the Chair, Chief Financial Officer, head of investor relations and other individuals through the business. We have been delighted by the response of AMN's leadership team since we began to engage with them on the topic of gender pay inequality in the US healthcare industry. Last year, AMN Healthcare was proactive in drawing attention to scale of gender pay equality. Merritt Hawkins, a subsidiary of AMN, conducted research on the scale of pay inequality in the state of Maryland and evidenced that even when controlled for the number of hours worked, female physicians still earned 37% less than their male counterparts. The company's public commitment within its CSR report this year (2019) to "lead the healthcare industry on this issue" is further evidence of its laudable intention to both shine a light on this area of inequality and take action to address it.

Investment context

The company is positioned to benefit from structural growth drivers in the healthcare recruitment market, namely rising demand as a result of the reduced number of health professionals in the US and the aging population. The company's shifting mix from traditional staffing contracts towards deeper customer relationships is building a less volatile, higher growth and margin business.

14 "Triple impact: how developing nursing will improve health, promote gender equality and support economic growth," published by the All-Party Parliamentary Group on Global Health in October 2016.

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