



Using Ethical Investment to Close the Gap: Fair Pay

An overview of key ethical issues in relation to pay inequality

October 2014



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The Ecumenical Council for Corporate Responsibility (ECCR) is a membership organisation working for economic justice, environmental stewardship, and corporate and investor responsibility. ECCR undertakes research, advocacy and dialogue with companies and investors. It seeks to influence company policy and practice and to raise awareness among the British and Irish churches, the investor community and the general public. ECCR's British, Irish and international members include representatives of many Christian denominations, faith-based investors, religious communities and orders, non-governmental organisations, ethical investment managers, and committed individuals. For more information, please visit www.eccr.org.uk.

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Executive Summary

The UK is set to become an increasingly unequal society¹. Economic inequality is a multi-faceted problem which, as the recent furore over Thomas Piketty's *Capital in the 21st Century* has shown, is attracting debate and concern across the political and social spectrum.

For many Christians this debate is long overdue. And one issue that deserves particular attention within it is the role of pay: specifically the difference in pay and conditions between those at the 'bottom' and those at the 'top' of the labour market.

In 2014 it emerged that one in five British workers are paid below a 'living wage'. In the same financial year the average FTSE 100 Chief Executive Officer (CEO) earned £4.7 million - approximately 358 times the earnings of a fulltime worker on the national minimum wage.

This situation is neither just nor is it good for us as a society.

This stratification of the labour market where pay and conditions at the bottom are evaluated on an entirely different basis from those at the top has prompted considerable public anger.

It raises some fundamental questions about how society perceives the relative importance of different roles within our economy and about the underlying values that such perceptions represent. Left unchecked it will continue to create divisions and undermine cohesiveness within our society. We all – including business – will be poorer as a result.

Under the UK's Corporate Governance Code large companies are required to "be sensitive" to pay and conditions throughout the business when making decisions about executive remuneration.² Recent regulations on directors' pay require companies to be more transparent and give shareholders of UK listed companies a greater say than ever before on executive pay.

Despite this there is little evidence that remuneration committees take the issue of pay inequality seriously. Nor, despite the good track record of some church and other investors of challenging companies on excessive remuneration and failure to pay the Living Wage³, is there any evidence that this is of concern to the majority of investors.

The time has come for both the business and the investment community to recognize that excessive inequality in the way rewards are distributed across companies are contributing to wider inequalities across society. We need an urgent debate about what else can be done to create fairer remuneration structures both within individual companies and across our economy as a whole. And we need to take decisive action to ensure that remuneration based on principles of fairness is able to contribute to the strengthening of the bonds of our society rather than stretching them too far.

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Recommendations

This briefing hopes to stimulate both debate and action. It highlights a number of proposals which we consider have the potential to reduce pay inequalities including tackling low pay and insecure work, pay ratio reporting, caution and transparency in use of remuneration consultants, including workers on remuneration committees and greater investment in employee development and succession planning. All of these have merit and deserve more serious consideration.

Underlying this however we suggest that a number of key principles should underpin the debate.

Low pay: There is an urgent need to tackle the growth of low pay. This will not in itself be enough to bring an end to the perverse inequality of rewards either within companies or within society at large. However the principle of “a fair day’s pay for a fair day’s work” is fundamental. Society, including the business community, cannot (economically, socially or morally) afford to let in-work poverty continue to grow. We need to take steps to halt then steadily reduce it without delay.

We want all companies to become Living Wage Employers. However as the UK’s largest companies, those in the FTSE 100 should take the lead. We can see no reason why the 85 companies in this group who are not yet certified as Living Wage Employers should not make such a commitment and publically set out a timetable for ensuring that living wages are paid to their employees and all those who work regularly on their UK sites. Companies should also redouble their efforts to review their own purchasing practices and engage with suppliers in order to facilitate the payment of living wages throughout their supply chains.

There is also a need to tackle insecure work, through the unjustified use of non-guaranteed hours contracts (NGHCS). These mean that workers lack certainty about their income which for many can compound the problems associated with low rates of pay.

Transparency: In order for shareholders and others to understand the rationale for, and make informed judgements about, the way rewards are distributed throughout a company meaningful levels of transparency is key. The new regulations on directors’ remuneration provide an opportunity for companies to be more explicit about the extent to which they consider inequality when deciding how to distribute pay across their entire work force. However progress has been largely disappointing, resulting in scepticism and, amongst some, a sense that senior executives are only interested in “feathering their own nests” regardless of what happens to the rest of society. Whether this sentiment is justified or not, it is another sign of division within our society and businesses must take heed of it.

At the minimum this means putting a greater emphasis on the legal requirement to “be sensitive” to general pay and conditions when setting executive remuneration. Morally it should require a greater cognisance of the wider community.

Knowing, understanding, and being able to explain the ratio between the highest paid and lowest and median paid workers/employees is a key metric that would enable companies to show a commitment towards this. Another would be for directors’ remuneration policies to follow the John Lewis model of setting a maximum ratio by which the highest paid member of staff can exceed the lowest. Companies should explicitly justify instances where executive pay, conditions and other benefits are significantly disproportionate to those enjoyed by other employees.

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Whilst we acknowledge the need for caution around the use of remuneration consultants, there does, at the very least, need to be greater transparency around their use.

Value and Values: The fact that pay inequality is now so extreme indicates the need to change the debate about what constitutes value. One aspect of this is the value for money that different categories of workers/employees bring to a company. The other is about wider value to society.

Effective leadership is fundamental and should be rewarded appropriately. But corporate success (or otherwise) depends on more than just the talent and insight of a handful of 'superstar' executives. It also depends on the contributions of shareholders and other financial backers and the wider economic and social infrastructure provided by the communities and governments in which companies operate.

We need to reassess what we mean when we ask what value an individual employee brings to a company. In some instances we may need to recognise that, rather than acting as stewards of a company, executives are actually exploiting it. It also makes it almost impossible to justify many of the vast pay differentials we are seeing today and suggests that they could actually represent an abuse of power - something that should be of concern not just to shareholders, but the whole of society.

Moving forward: Christian investors are particularly well placed to raise concerns about the current extreme levels of pay inequality within the companies in which they invest and with financial services firms who might manage those investments. We urge those who are not already engaging on remuneration issues to consider doing so and those who are to intensify their efforts and to ensure that pay inequality is brought to the fore of those discussions.

Such engagement can serve to hold individual companies to account, shining a light on the extent to which pay practices are contributing to wider inequalities and convincing companies that it is in their own, as well as society's best interests to distribute rewards more fairly.

However excessive pay inequality is more than a problem with 'one or two bad apples'. It is a market wide problem whose best hope for resolution lies in a market wide approach. Shareholder engagement with individual companies is vital – but perhaps even more so is for shareholders to join with others in trying to shape the wider debate around pay - so that pay inequalities are seen as important as absolute levels of remuneration.

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Introduction

The UK is set to become an increasingly unequal society. The Institute of Fiscal Studies (IFS) in its recent report⁴ expects the slight falls in income equality recorded since 2007-08 to be temporary and such falls are now being reversed. As the economy recovers, increasing real earnings will boost incomes for the top income earners, while ongoing cuts to benefits and tax credits will reduce incomes toward the bottom. Inequality is a multi-faceted problem. But one area that has emerged as of particular concern is the role of pay: specifically the difference in pay and conditions between those at the 'bottom' and those at the 'top' of the labour market

In 2014 it emerged that the average FTSE 100 CEO now earns approximately 130 times that of average employee in such companies and a huge 358 times the earnings of a fulltime worker on the national minimum wage. This situation is neither just nor is it good for us as a society.

Church investors have a good track record of challenging companies on excessive remuneration and have been playing a key role in leading the discussion on Executive Pay.⁵ They have also promoted the Living Wage. Increasingly many are also recognising the importance of engaging on pay differentials. This is valuable and welcome work.

However ECCR believes that the above statistics bring into stark focus the fact that more needs to be done to tackle pay inequalities. As such, all of us, including individual faith investors need to ask what else can be done. This briefing hopes to stimulate that debate.

Here we examine the moral, social and business reasons to reduce pay inequalities and give an overview of key current proposals that could help to do this. We look at the potential for shareholders to hold companies to account on pay and provide suggestions and questions that individual and Church investors could incorporate into their engagement strategies.

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1. Why Inequality matters

Growing national inequalities

The gap between rich and poor continues to widen. Britain is one of the richest countries in the world, yet 13.5 million people - 22% of the population - remain in relative poverty.⁶ Income inequality increased sharply in the 1980s and has been on a steady upwards trajectory since then. Despite some reduction during the recent recession, this trend is set to continue.⁷ Although comparable statistics are difficult to obtain, there is evidence that the level of inequality in the UK is similar to that seen in the 1930s.⁸ This is unjust. Britain has a proud record of creating a society which cares for all its members – inequality threatens to undermine this.

Christian reflections on human dignity

All people are created in the image and likeness of God: all are of equal worth. People have a fundamental human right to be treated with dignity, respect and equality regardless of social or economic status. This report does not argue against some variations of pay and conditions according to role and responsibility. However, in a tradition where each of us are equal in the eyes of God and where we are told to *love our neighbour as ourselves* extreme levels of inequality - as we are seeing now - appear inherently unjust. As the Church of England Ethical Investment Advisory Group points out,⁹ when material rewards become vastly unequal, it becomes harder for people to perceive the truth of equality before God since it is contradicted by their experience of the world. It also raises some fundamental questions about how society perceives the relative importance of different roles across our economy and about the underlying values that such perceptions represent.

The Common Good

Christians believe that the whole of creation is a gift from God for which we should care and use so that God's Kingdom may come. Faith is about more than individual spirituality – we are called to work with God for a world where people do not suffer from poverty or oppression. We need to be involved in political and economic issues, complex though they are, from this faith perspective. The churches have a duty to speak out prophetically and challenge unjust structures which deny people the God given opportunity to enjoy life in all its fullness.

Encouraging greater social cohesion in society

Fairness is the foundation on which a more trusting and cohesive society can be built. Studies looking across a range of countries suggest that whilst, particularly in developing countries, absolute levels of wealth can be important - there is actually a stronger correlation between incidents of social distress and levels of inequality than with levels of wealth. Correlation is not in itself evidence of causation. But *The Spirit Level*¹⁰ describes mechanisms of causation that include the social stress of competition and the erosion of social networks and trust in more unequal societies.¹¹ Inequality, aspirational consumerism and higher levels of debt are increasingly a barrier to cohesive relationships within society which makes us all poorer economically, socially and spiritually.¹²

2. Unequal Pay in the UK today

Inequality in pay is nothing new. However, in recent years the pay gap between those at the top and elsewhere within the labour market has reached worrying proportions.

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In 1970 the differential between a FTSE 100 chief executive's pay and that of an average worker in that group of companies was approximately 10:1.¹³ Today the average FTSE 100 CEO earns approximately £4.7 million per year, 130 times the average FTSE 100 employee.¹⁴ This is roughly 174 times that of the average UK worker¹⁵ and a huge 358 times the £13,124 earnings of a fulltime worker on the national minimum wage.¹⁶

Under the UK's Corporate Governance Code large companies have, for many years been required to "be sensitive" to pay and conditions throughout the business when making decisions about executive remuneration.¹⁷ Its most recent revision now also requires boards to ensure that executive remuneration is designed to promote the long-term success of the company and demonstrate how this is being achieved more clearly to shareholders.¹⁸

However there is little evidence, yet, that either of these are a priority. In particular, the statistics above are the latest indicator that we are actually witnessing a stratification of the labour market where pay and conditions at the bottom are evaluated on an entirely different basis from those at the top.

At a time of continued economic vulnerability, when many wages remain stagnant¹⁹ and as vulnerable forms of employment are growing, this trend has prompted considerable public anger.

3. Life 'at the bottom'

Low pay

In-work poverty²⁰ in Britain is growing. Today, two thirds of those in poverty live in working households.²¹ According to the Living Wage Commission, 5.24 million or one in five British workers are paid below a 'living wage', a figure that has grown by 9% since 2012. Some industrial sectors are particularly associated with low pay. For example 85% of bar and waiting staff and 70% of cleaners and retail assistants are paid below a living wage.²²

Low pay brings a myriad of problems which go beyond an immediate day-to-day struggle with living costs. It is also associated with marital breakdown, poorer outcomes for children, poorer diets, difficulty accessing financial services and insufficient time to spend with friends, family or to engage in community life. Many low income households are entitled to social security benefits to top up their income – in making such payments, society is therefore providing a subsidy which contributes to the transfer of wealth to executives and shareholders. It also means that the financial costs of low pay are also being borne by the whole of society.²³

Minimum wage vs Living Wage

The UK has had a legally enforced **national minimum wage** (NMW) since 1999. Since 1st October 2014 the current rate for workers over the age of 21 has been £6.50 per hour.²⁴ The NMW is set annually by government – based on the recommendations of the Low Pay Commission, whose remit is to "recommend levels ...that will help as many low-paid workers as possible without any significant adverse impact on employment or the economy"²⁵. Changes in the cost of living are not taken into account.

The **UK Living Wage** emphasises the cost of living and is calculated based upon the costs of items identified by members of the public as necessary for a minimum acceptable standard of living in the UK.²⁶ The concept²⁷ has gained significant support. And, although paying it is voluntary, over 850 employers have now become accredited 'Living Wage' employers meaning

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that they pay all directly employed employees a Living Wage and have plans to roll this out to contract and agency staff regularly employed on their sites.²⁸ Accreditation does not require payment of the Living Wage through a company's entire supply chain or for out-sourced services provided by workers offsite. However Living Wage Employers could play a positive role in encouraging the adoption of the Living Wage throughout their supply chain and in adapting their procurement processes to facilitate this.

The 2013 Living Wage in the UK is £7.65 but in London is set at a higher rate of £8.80. Rates for 2014/15 will be set on 3 November 2014.²⁹

Several listed companies, including 15 of the FTSE 100, such as Aviva, Barclays, HSBC, ITV, Legal and General, Pearson and SSE are now accredited as Living Wage Employers. These and other companies like them should be congratulated. Unfortunately, no large companies operating in sectors that are most likely to be associated with low wages³⁰ have sought accreditation.

Many of the UK's church denominations including the Baptist Union, the Catholic Bishops Conference of England and Wales, Church of Scotland, Church of England, Methodist Church, Religious Society of Friends (Quakers) and United Reformed Church have also adopted or support the Living Wage.³¹ Although there are costs to implementing the Living Wage³², there are also benefits. In one study over 80% of Living Wage Employers in London said that it had led to higher quality work and two thirds reported a positive impact on recruitment and retention.³³

Insecure work

Whilst low hourly wages are a key factor associated with poverty³⁴, insufficient or unpredictable working hours are also relevant. ECCR's 2009 report '*Vulnerable migrant workers: the responsibility of business*'³⁵ highlighted concerns about the growth – and misuse - of traditional forms of insecure work such as temporary/ seasonal contracts or bogus self-employment.³⁶ However, recently new concerns have been raised about 'variable', 'zero hours' or other types of non-guaranteed hours contracts (NGHCs). Under these, work is offered as and when required by the employer without any guarantees about its availability. In early 2014 it was estimated that some 1.4 million such contracts were in operation across Britain.³⁷

NGHCs can be beneficial to employers and some employees; providing flexibility to respond to peak periods or staff shortages, or the ability to work flexibly around education or family commitments for example. A recent survey reported that almost half of NGHC workers were satisfied.³⁸ However there is also evidence that NGHCs can be used irresponsibly - to avoid paying regular workers sick, maternity or on-call pay. Some contracts include "exclusivity clauses" which prevent workers seeking alternative employment. Many workers complain about previously arranged work being cancelled at very short notice. The Trades Union Congress claims NGHCs usually result in lower or unpredictable pay, leave workers vulnerable to exploitation and are contributing to a "climate of insecurity".³⁹

NGHCs are found in all sectors – including some church and voluntary groups. They are used for both high and low paid roles but with regard to the latter appear to be particularly prevalent in the retail, hospitality (bar, waiting and kitchen staff), leisure, cleaning and healthcare sectors. According to one survey some 80% of domestic care workers in the private sector are thought to be on NGHCs.⁴⁰ Most of the sectors where low pay and insecure working hours are prevalent tend to have a greater proportion of female staff leading to persistent gender-based inequality.

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Following a public consultation, the UK government has announced that it will ban “exclusivity clauses” and develop a code of practice for the fair use on NGHCs.⁴¹

4. Life at the top

Pay at the top of many of our largest companies has reached dizzying levels – the average pay for a FTSE 100 CEO in 2013 was £4.7 million. This year WPP’s Martin Sorrell became the FTSE100’s highest paid CEO, taking home almost £30 million in 2013.⁴²

Many companies say that high pay is necessary to attract and retain talented staff. It is also argued that high pay is fair if it is in return for outstanding performance which contributes to the long term success of a company. However, as the common strategy of paying slightly higher than the median ‘going rate’ has led to a ‘ratchet effect’, both arguments have come under scrutiny.

Concerns are growing that there is often no discernible link⁴³ between executive pay and company performance.⁴⁴ Furthermore as the Salz review on corporate culture at Barclays shows, evidence is emerging that excessive pay can have a negative effect – contributing to a culture of impunity. Such a culture led in part to the LIBOR fixing scandal in that particular instance, and risk-taking in a culture where potential to generate corporate revenues was closely aligned with personal benefits.⁴⁵ Other considerations include the opportunity cost of any excessive funds invested in a CEO and where such funds could have made better returns elsewhere within the business.

Components of executive pay

For most workers identifying what they are paid is a relatively simple matter. However for top executives similar calculations are incredibly complex. Their total pay often has several components which may include:

Basic Salary: A fixed sum which employers are contractually obliged to pay.

Bonuses: A variable sum, awarded annually according to targets and parameters set by remuneration committees. Bonuses are often in the realm of 200% of base salary – although can be much more. They can be paid straight away or deferred and in some instances can be guaranteed.

Long term incentive plans (LTIPs): Complex schemes under which executives receive shares in return for meeting targets. LTIPs are supposed to align employee and shareholder interests but have been criticised. Corporate governance consultants, PIRC⁴⁶ has called them “fundamentally flawed” and advises investors to vote against new schemes on the basis that they are insufficiently long term, do not incentivise and open to manipulation.⁴⁷

Pension contributions: The amount awarded is usually related to basic salary. Contributions are often more generous in percentage terms than those paid to other workers. According to one survey the average FTSE 100 executive director received £242,000 in 2013.⁴⁸

Other benefits: Senior executives may receive a range of other benefits, such as relocation, transport or housing allowances.

A note on banks

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Bankers' pay often attracts particular attention. The sector is unusual, not just because of the level of pay, but because the highest earning employees can be often found 'below' director level.⁴⁹ Many banks also set aside bonus pools before calculating profits, giving additional weight to claims about the gap between pay and performance and suggestions that bankers may benefit more than shareholders.⁵⁰

Under new European Union rules bonuses are now capped at 100% of basic salary or 200% with explicit shareholder agreement. Most major UK based banks have sought and, with the exception of RBS, received approval to pay at the higher rate. Some have increased basic salaries or have paid additional "role based allowances".⁵¹ Such allowances, which count neither as a bonus or salary, have attracted criticism from within parliament, trade unions and some shareholders,⁵² whilst the Bank of England has allegedly come under pressure from European regulators to explain why they have been allowed.⁵³

5. Value and Values

The fact that pay inequality is now so extreme indicates the need to change the debate about what constitutes value. One aspect of this is the value for money that different categories of workers/employees bring to a company. The other is about wider value to society.

We are often told that workers and executives are rewarded according to the value of what they bring to a company. There is some logic in that approach. However the excessive multiples that we are seeing today suggests that our collective notions of 'value' have become both skewed and too narrow.

Effective leadership is fundamental and should be rewarded appropriately. But corporate success (or otherwise) depends on more than just the talent and insight of a handful of 'superstar' executives. As many a corporate CSR report will tell you it depends on much more than that and is truly a corporate endeavour, reliant on a wider network which draws upon the input of all employees and workers. It also depends on the contributions of shareholders and other financial backers and the wider economic and social infrastructure provided by the communities and governments in which companies operate.

This wider perspective means we need to reassess what we mean when we ask what value an individual employee brings to a company. In some instances we may need to recognise that, rather than acting as stewards of a company, executives are actually exploiting it. It also makes it almost impossible to justify many of the vast pay differentials we are seeing today and suggests that they could actually represent an abuse of power - something that should be of concern not just to shareholders, but the whole of society.

6. Executive pay: the role of shareholders

Recent regulations give investors more information and a bigger 'say on pay' within UK listed companies than ever before.

Shareholders now get a binding vote on a company's directors' remuneration policy at least every three years. The policy sets the parameters for directors' pay and explains any differences between the directors' remuneration policy and the company's remuneration policy for other employees. It should state how pay and conditions of other employees were taken into account

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when setting the policy. Policies should also indicate whether and how any comparisons were made with pay for non-director level employees and give details on any consultation with them during policy development.⁵⁴

Shareholders also have an annual advisory vote on an 'implementation report' explaining how the pay policy was put into practice. This should give a single remuneration figure for each director along with proposals and rationale for pay in the coming year. The report should disclose the percentage by which the chief executive's pay and benefits changed from the previous year and how this compares to other employees in the group.

If shareholders reject the implementation report, the company must seek reapproval of its remuneration policy the following year.

Some campaigners wanted these rules to go further by requiring companies to disclose the ratio between the pay of the chief executive and the lowest and/or median paid worker. As suggested by the Church Investors Group⁵⁵ and advocated in ECCR's 2011 *Banks and Society report* we believe that additional disclosure of this type would be of value.⁵⁶ There are varying views about what constitutes an acceptable ratio.⁵⁷ However whatever one's opinion, such additional data, presented consistently over time, would enable stakeholders to understand how pay inequalities are changing and to make more informed judgements. European and US regulators are considering rules that would mandate pay ratio reporting, so this may become a reality in future.⁵⁸

Nevertheless, if implemented to the spirit as well as the letter of the law, the current UK requirements could still be useful to investors. Unfortunately, early indications show that few companies are prepared to make disclosures that would genuinely help investors understand how pay decisions are made and make informed judgements about whether or not pay is disbursed fairly across the company. Few remuneration policies seen by ECCR make anything other than a passing reference to 'pay and conditions' across the company and concerns have been raised that some companies may be giving misleading information by choosing unrepresentative groups of employees with which to compare CEO pay.⁵⁹

Another key factor determining the extent to which these new rules will be effective in constraining executive pay is what shareholders choose to do as a result of them. Shareholders need to question the data within remuneration reports and demand that it is meaningful. Furthermore it is vital that they register their opposition - both where executive pay is excessive and where evidence suggests that employee rewards are not being distributed equitably across the company.

However, historically, very few remuneration reports have been defeated at AGMs, despite executive pay arrangements which most people would consider excessive being commonplace. The question needs to be asked as to whether institutional reticence to oppose remuneration reports might have some linkage to the fact that those managing investments are also likely to have a higher level of salaries, so judgements of what constitutes 'reasonable' pay may well be skewed.

It is therefore vital that individuals hold those who manage their investments and pensions to account with regard to voting on remuneration policies and remuneration reports.

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The John Lewis Partnership and Centrica are amongst the few large companies that have been explicit about pay ratios. John Lewis's constitution limits the pay of the highest paid partner to no more than 75 times the average basic pay of non-management partners.⁶⁰ At its 2013 AGM it was announced that Centrica's CEO Sam Laidlaw earned 64 times the company's lowest paid employees.

Whilst these are useful disclosures, they still do not paint a full picture of pay inequality throughout these companies. John Lewis has been targeted by campaigners who note that the 75:1 ratio does not include contract cleaning staff, many of whom are paid below the living wage. In Centrica's case the ratio was based on Sam Laidlaw's basic salary, which amounted to around a fifth of his total remuneration.⁶¹ Such disclosures unfortunately were not repeated in 2014.

That there are so few examples indicate that regulation may be required before the majority of companies willingly report on pay ratios. They also show that in order to be meaningful ratios should be based on total remuneration and need to take into account outsourced roles.

7. Reducing inequality: a business case

Whilst there are clear social and ethical benefits of reducing inequality in pay and conditions there are also business benefits. Research is emerging⁶² suggesting that workplaces with lower pay differentials have less conflict, lower levels of staff turnover (with savings in recruitment & training costs) and sickness, greater workplace satisfaction and higher investment returns than less equal workplaces. Any gains from pay inequality (incentives for hard work, greater productivity etc) appeared to be lost at the point at which the highest earner within a workplace is paid more than 24 times the lowest paid.⁶³

Conversely, corporate indifference to growing levels of inequality could well be storing up problems. This year, for the third year running, the World Economic Forum cited inequality within countries as being one of the most significant risks facing the global economy. It suggests that this has a significant role in stoking social tensions and has become a source of both political and economic instability.⁶⁴ Furthermore, in an economic environment where pay for many in the UK and elsewhere has remained relatively stagnant and there is a sense that the recent recovery has brought about uneven benefits, politicians, investors and civil society are increasingly paying attention to and are sceptical of excessive pay differentials.

Failure to tackle high pay differentials could therefore become a source of future operational and reputational risk.

8. What can companies do? Recommendations for reducing pay inequality

Tackle Low pay

ECCR considers that all companies have a duty of care towards both their employees and other workers working on their premises. We would ultimately like to see all companies become Living Wage Employers. As the UK's largest companies, those in the FTSE 100 should take the lead. We can see no reason why the 85 companies in this group who are not yet certified as living wage employers should not make such a commitment and publically set out a timetable for ensuring that living wages are paid to all employees and to those working regularly on their UK sites.

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ECCR also considers that all companies should be examining their purchasing practices to facilitate the payment of living wages throughout their supply chain. Accredited Living Wage Employers could play a particularly useful role in this respect.

Tackle insecure work

Companies and other organizations should review and report to stakeholders on the prevalence of NGHCs as well as the use of temporary, contract and other forms of less secure work within their workforce. Such a review should have the intention of ensuring that these are only used in situations where they are genuinely required and where flexibility cannot be ensured by other means such as flexible working arrangements, annualised hours etc. and that employees are fully aware of their rights.

Companies can also engage positively with the government process to develop a code of practice on the responsible use of NGHCs.

Be more transparent about pay inequality

The new UK rules on directors' remuneration present an opportunity for companies to be more explicit about the extent to which they consider inequality when deciding how to distribute pay across their entire work force. As described above, progress on this respect has been largely disappointing and there is an urgent need for companies to uphold the spirit as well as the letter of the law in their reporting.

For maximum transparency, ECCR believes that companies also should explicitly report on pay ratios by comparing total remuneration of the highest paid employee to that of the lowest and median paid worker. Companies should explicitly justify instances where executive pay, conditions and other benefits are significantly disproportionate to those enjoyed by other employees.

Be more transparent about remuneration consultants

The majority of FTSE companies use external consultants either to provide information on pay and conditions within a particular 'market' or make recommendations about executive remuneration. Their role is to advise the remuneration committee, not to make decisions. Nevertheless their role has become controversial with critics suggesting that the comparative information and advice they provide has been a significant factor behind the ratchet effect pushing up executive pay described in Section 4. Last year PIRC⁶⁵ highlighted ongoing concerns that the industry had "a vested interest in creating complex and accommodating outcomes."⁶⁶ Another potential conflict of interest comes from the fact that some recruitment consultancy services provide other business services such as audit services. There is a risk that this could present a conflict of interest with the potential that remuneration advice is not genuinely independent.

ECCR considers that in light of these multiple conflicts of interest there is a strong argument to challenge the logic of companies using recruitment consultants. There is a need to ask whether better results might be achieved by remuneration committees taking greater responsibility for generating remuneration proposals and making decisions without relying on outside advice.

At the very least there is a need for greater transparency about the services provided by and fees paid to remuneration consultants. The new regulations on directors pay require companies to report on the use of external recruitment consultants, the fees paid for remuneration advice, the

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nature of any other services provided and how the committee satisfied itself that such advice was independent⁶⁷. However they do not require companies to disclose the value of any additional services rendered. Companies that provide such information voluntarily could help shareholders to make more informed judgements as to whether remuneration services were genuinely independent.

Include workers representatives on company boards and remuneration committees

It has been suggested that a lack of diversity on company boards is a factor in growing pay inequalities. Non-executive directors serving on remuneration committees receive fees far in excess of ordinary employees, with many having had executive roles in other major companies where they have also drawn large salaries. There is a strong argument that this limits a Board's frame of reference about what constitutes 'appropriate' levels of pay.

Some trade unions and campaign groups are calling for increased worker representation on company boards, arguing that involving 'ordinary' workers would bring a levelling influence that could, over the longer term, bring executive pay more in line with other employees as well as having longer term strategic benefits.⁶⁸

Although uncommon in the UK, employee representatives on company boards are more common in several other EU countries. In Germany, for example, there is the Hans Böckler Foundation⁶⁹ which includes within its activities training for employees to serve on company boards. First Group is one of the few major UK companies with an employee non-executive director on its board. However he does not serve on the remuneration committee⁷⁰ and it is noted that 30% of shareholders voted against the group's remuneration report in 2013 and 14.

Whilst employee board representatives have the potential to temper pay differentials, they can only do so given the opportunity, resources, respect and support that will enable them to affect pay decisions. There is a strong argument to suggest that more than one employee representative would also have a greater impact than a single employee voice.

Greater investment in employee development and succession planning

The argument that executive talent is in short supply, and that executive salaries need to be high to attract suitable staff or prevent them from moving elsewhere implicitly makes the assumption that the number of skilled executives cannot be increased. Whilst there may be some merit to this in the very short term, over a longer period it is resolutely false.

ECCR considers that all companies should prioritise and be able to demonstrate that they have a strong employee development programme in place. A key objective should be to identify, support and nurture a cadre of future leaders and to support effective succession planning at board level.

There is some evidence to suggest that developing talent from within a company is, in the long term, both cheaper and more effective than recruiting board level executives - particularly CEOs - externally.⁷¹

It is beyond the scope of this document to suggest how individual company boards should recruit in specific instances. Nevertheless ECCR considers that, in general, better – and potentially lower

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cost - outcomes will emerge where a board has a pool of putative internal leaders to select from and whose individual talents and limitations can be compared to external candidates.

9. Engaging for pay equality

Religious investors are well placed to raise concerns about inequality with the companies in which they invest and with any financial services firms who might manage those investments. Not only can this serve to hold companies to account where there is a sense that their pay practices are contributing to wider inequalities, but it can also help to shape the wider debate around executive pay so that pay inequalities are seen as important as absolute levels of remuneration.

Some ECCR members are already engaging on pay inequalities. We would encourage those who have yet to explicitly consider this issue to do so at the earliest opportunity. We hope that all church investors will look for additional opportunities to engage on these issues and to report on their activity to beneficiaries and other stakeholders.

Questions for companies

The following questions could be directed at companies by shareholders, pension fund investors or investment managers.

- What is the ratio between the total remuneration of your highest and lowest and highest and median paid employee?
- Do you pay all employees and contract staff working on your premises at least a Living Wage? Has the company considered becoming a certified Living Wage Employer?
- How many workers and what proportion of your workforce is employed on temporary contracts or contracts without any guaranteed hours?
- What is the company doing to ensure that living wages are paid throughout its supply chains?
- How are employee perspectives taken into account when developing company strategy and setting pay?
- What is the company doing to ensure that its leadership succession plans prioritise the development of internal talent?
- Does the company accept that there can be business risks associated with growing levels of inequality in the UK?
- Do you consider that you have any ethical responsibility to help reduce levels of economic inequality?

Questions for fund managers and pension fund trustees

If you have investments held through investment managers or pension funds, you could ask them the following questions to ascertain to what extent they are raising concerns about pay inequalities with the companies in which they invest your money and to encourage them to do more in this respect.

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- What are you doing to address low pay and insecure work within the companies you invest in on my behalf?
- How many companies have you raised concerns with or asked questions about pay inequalities?
- Do you publish information about how you have voted the shares/funds you manage in respect of company remuneration policies and reports?
- Do you specifically consider pay inequalities when deciding how to vote on company remuneration policies and implementation reports for the funds/shares you manage? If so, how?

1 See the report by the Institute of Fiscal Studies – Living Standards, Poverty and Inequality in the UK: 2014, Section 3 – Inequality.

2 *The UK Corporate Governance Code* Financial Reporting Council 2010 <https://www.frc.org.uk/Our-Work/Publications/Corporate-Governance/The-UK-Corporate-Governance-Code.pdf>

3 See for example the 2012 report of the Methodist Joint Advisory Committee on the Ethics of Investment <http://www.jointpublicissues.org.uk/wp-content/uploads/JACEI-Report-2012.pdf> and the Church Investors Group (CIG) report on the ethics of executive remuneration which was released in March 2010. <http://www.churchinvestorsgroup.org.uk/documents/ethics-executive-remuneration-guide-christian-investors>

4 *Living standards, poverty and inequality in the UK 2014*, Institute for Fiscal Studies p 56. Available at <http://www.ifs.org.uk/uploads/publications/comms/r96.pdf>

5 See for example 2012 report of the Methodist Joint Advisory Committee on the Ethics of Investment <http://www.jointpublicissues.org.uk/wp-content/uploads/JACEI-Report-2012.pdf>. The Church Investors Group (CIG) commissioned a report on the ethics of executive remuneration. This was released in March 2010. <http://www.churchinvestorsgroup.org.uk/documents/ethics-executive-remuneration-guide-christian-investors>

6 Figures refer to Britain and are based on the international standard definition of poverty which is “a household income that is 60% or less of the average (median) societal (in this case British) household income”.

7 See for example *Living standards, poverty and inequality in the UK 2014*, Institute for Fiscal Studies p 4f. Available at <http://www.ifs.org.uk/uploads/publications/comms/r96.pdf>

8 ‘income inequality at highest levels since 1930s says report’ *The Independent* 3 March 2013 <http://www.independent.co.uk/news/business/news/income-inequality-is-at-highest-level-since-the-1930s-says-report-8518073.html> and regarding health inequalities *In place of fear*, Danny Dorling for the Centre for Labour and Social Studies (CLASS) May 2013 [http://classonline.org.uk/docs/2013_05_Think_piece_-_In_Place_of_Fear_\(Danny_Dorling\).pdf](http://classonline.org.uk/docs/2013_05_Think_piece_-_In_Place_of_Fear_(Danny_Dorling).pdf)

9 Church of England Ethical Investment Advisory Group, Executive remuneration policy, April 2013, www.churchofengland.org/about-us/structure/eiag/ethical-investment-policies.aspx

10 See for example *The Spirit level* Kate Pickett and Richard Wilkinson. *The Spirit Level: Why More Equal Societies Almost Always Do Better* is a book by Richard G. Wilkinson and Kate Pickett, published in 2009 by Allen Lane. The book argues that there are “pernicious effects that inequality has on societies: eroding trust, increasing anxiety and illness, (and) encouraging excessive consumption”.

11 <http://www.church-poverty.org.uk/closethegap/closethegapbasiccase>

12 *The Joint Resolution of URC and Methodist Councils on Poverty* <http://www.jointpublicissues.org.uk/the-joint-resolution-of-urc-and-methodist-councils-on-poverty/>

13 *The ethics of executive remuneration: a guide for Christian investors* Church Investors Group, 2010 p 5 <http://www.churchinvestorsgroup.org.uk/documents/ethics-executive-remuneration-guide-christian-investors>

14 It is important to note that this ratio does not take into account contracted/outsourced staff. As many of the lowed paid jobs carried out on a company’s premises (such as cleaning, security and catering roles) are contracted out this figure is likely to underestimate pay differentials across a business.

15 High Pay Centre data <http://highpaycentre.org/blog/ftse-100-bosses-now-paid-an-average-143-times-as-much-as-their-employees>

16 Based on a 40 hour week for a worker on the £6.31 adult rate applicable from Oct 2013 - Oct 2014.

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- 17 *The UK Corporate Governance Code* Financial Reporting Council 2010 <https://www.frc.org.uk/Our-Work/Publications/Corporate-Governance/The-UK-Corporate-Governance-Code.pdf>
- 18 The Financial Reporting Council (FRC) has issued (17th September 2014) an updated version of the UK Corporate Governance Code (the Code). <https://www.frc.org.uk/News-and-Events/FRC-Press/Press/2014/September/FRC-updates-UK-Corporate-Governance-Code.aspx>
- 19 ‘ONS: After six years, wage rises match inflation’ BBC news 16 April 2014 <http://www.bbc.co.uk/news/business-27047966>
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- 21 *The Lies we tell ourselves: ending comfortable lies about poverty*, The Baptist Union of Great Britain, the Methodist Church, the Church of Scotland and the United Reformed Church p7. Available at <http://www.jointpublicissues.org.uk/truthandliesaboutpoverty/>
- 22 *Working for Poverty*, first report of the Living wage commission p 30. Available at <http://livingwagecommission.org.uk/new-report-from-the-living-wage-commission-sets-out-the-scale-of-low-pay-in-the-uk/>
- 23 Research from the Institute for Fiscal Studies in 2010 suggested that if the private sector started paying the living wage, government revenues would increase by between £5.9 and £6.3 billion through a combination of increased tax and national insurance receipts and through a reduction in social security benefits paid. See http://www.ifs.org.uk/docs/living_wage2010.pdf
- 24 <https://www.gov.uk/national-minimum-wage-rates>
- 25 <https://www.gov.uk/government/organisations/low-pay-commission/about/terms-of-reference>
- 26 <http://www.lboro.ac.uk/research/crsp/mis/thelivingwage/>
- 27 The living wage is currently calculated by the Centre for Research in Social Policy at Loughborough University, while the London living wage has been calculated by the Greater London Authority since 2005. It is promoted by the Living Wage Foundation - <http://www.livingwage.org.uk/>.
- 28 For latest figures see <http://www.livingwage.org.uk/who-accredited>
- 29 <http://www.livingwage.org.uk/living-wage-week-2014>
- 30 Such as retail, hospitality (bar, waiting and kitchen staff), leisure/theme park attendants, cleaners and hairdressers.
- 31 Denominational structures and employment relationships vary. For more information see. <http://www.church-poverty.org.uk/livingwage/churches-and-the-living-wage>
- 32 The Living Wage Commission cites research showing that bars and restaurants could face a 6.2% increase to their direct wage bill by paying living wages. The costs for sectors such as banking, construction and computing were lower at between 0.2% and 0.5%. *Working for Poverty*, first report of the Living wage commission p 30. Available at <http://livingwagecommission.org.uk/new-report-from-the-living-wage-commission-sets-out-the-scale-of-low-pay-in-the-uk/>
- 33 <http://www.livingwage.org.uk/what-are-benefits>
- 34 Living Standards, Poverty and Inequality in the UK: 2013, Institute for Fiscal Studies p52. Available at: <http://www.ifs.org.uk/comms/r81.pdf>
- 35 Vulnerable Migrant Workers: The Responsibility of Business - an overview and comparative analysis of food production, manufacture and retail companies <http://www.eccr.org.uk/module-htmlpages-display-pid-20.html>
- 36 *Vulnerable migrant workers: the responsibility of business*, ECCR May 2009. Available at: <http://www.eccr.org.uk/module-htmlpages-display-pid-20.html>
- 37 Office of National Statistics analysis 30 April 2014 page 5 Available at: http://www.ons.gov.uk/ons/dcp171776_361578.pdf. This refers to NGHCs which provided work over the fortnight from 20 January 2014.
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- 39 ‘Zero tolerance needed on abuse of zero hours contracts’ TUC media release October 2013 <http://www.tuc.org.uk/workplace-issues/employment-rights/working-time-holidays/zero-tolerance-needed-abuse-zero-hours>
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- 41 'Government crackdown on zero hours contract abusers' Department for Business, Innovation & Skills media release 25 June 2014 <https://www.gov.uk/government/news/government-crackdown-on-zero-hours-contract-abusers>
- 42 'WPP shareholders remain unhappy about Sir Martin Sorrell's pay' *Financial Times* June 25 2014 <http://www.ft.com/cms/s/0/bcc0c716-fc4a-11e3-86dc-00144feab7de.html#axzz3BI61LFHN>
- 43 "Performance for pay? The relation between CEO incentive compensation and future stock price performance" - January 2013. Michael J. Cooper - University of Utah, Huseyin Gulen - Purdue University and P. Raghavendra Rau - corresponding author: Cambridge Judge Business School, University of Cambridge. http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1572085
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- 45 Salz Review: An Independent Review of Barclays' Business Practices, April 2013 para 2.29. Available at: <http://group.barclays.com/about-barclays/citizenship/salz-review-report>
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- 48 LCP FTSE 100 executive pensions survey 2013 Available at http://www.lcp.uk.com/media/625996/lcp-executive-pensions-survey-2013_wigmore.pdf
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- 51 'Bankers adjust their bonus caps' *Financial Times* February 3 2014 Available at <http://www.ft.com/cms/s/0/b21a9df4-8d01-11e3-ad57-00144feab7de.html#axzz2tldldkWZ>
- 52 'Barclays' bonuses met with dismay in Westminster' *Financial Times*, February 11 2014. Available at <http://www.ft.com/cms/s/0/4c1df1c0-9311-11e3-b07c-00144feab7de.html?siteedition=uk#slide0>
- 53 <http://www.ft.com/cms/s/0/515438da-8d8e-11e3-9dbb-00144feab7de.html#axzz2tloel5rM>
- 54 The Large and Medium-sized Companies and Groups (Accounts and Reports) (Amendment) Regulations 2013 paras 38 and 39. Available at http://www.legislation.gov.uk/uk/si/2013/1981/pdfs/ukSI_20131981_en.pdf
- 55 These advocated that companies disclose a simple ratio comparing the highest paid employee and the average salary of the lowest 10% of employees. This could have some advantages over a simple highest to lowest ratio, but either, used consistently would be of value.
- 56 At present, it is possible for stakeholders to calculate the pay ratio between the CEO and mean employee, however this data would not capture situations where the CEO is not the highest paid employee and is more likely to be skewed by extreme variations in pay than a ratio looking at the highest earner compares with either the median or the average of the lowest 10% of employees.
- 57 For example in the Church Investors Group (CIG) paper, the *Ethics of Executive Remuneration*, the authors suggest that total executives remuneration should be no more, and preferably less, than 75 times the average pay of the lowest-paid 10% of employees in any firm. The Equality Trust however suggests that a ratio of 10:1 is achievable for many businesses and organisations, whilst in its 2014 voting guidelines PIRC suggests that investors should look more favourably on companies that limit fixed CEO pay to less than 20 times that of the average employee – see http://pirc.co.uk/news-and-resources2/files/copy_of_PIRCReleases2014UKShareholderVotingGuidelinesMediaRelease06032014.pdf
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- 59 For example, the High Pay Centre has highlighted examples of companies using misleading comparator groups with which to compare CEO pay increases. See <http://highpaycentre.org/blog/high-pay-centre-and-partner-organisations-write-to-financial-reporting-coun>
- 60 John Lewis Partnership constitution available at <http://www.johnlewispartnership.co.uk/about/our-constitution.html>
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- 61 High Pay Centre data <http://highpaycentre.org/blog/capita-promise-to-publish-pay-ratio-between-highest-and-lowest-earners>
- 62 In The Good Jobs Strategy, Zeynep Ton, a professor at the MIT Sloan School of Management, makes the compelling case that even in low-cost settings, leaving employees behind—with bad jobs—is a choice, not a necessity. Drawing on more than a decade of research, Ton shows how operational excellence enables companies to offer the lowest prices to customers while ensuring good jobs for their employees and superior results for their investors. <http://zeynepton.com/book/>
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http://www3.weforum.org/docs/WEF_GlobalRisks_Report_2014.pdf
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- 66 PIRC Media release 14 February 2014. Available at <http://pirc.co.uk/news-and-resources2/files/PIRCSVGsFebruary2013.pdf>
- 67 Large and Medium sized companies and groups regulations 2013 - Para 22
- 68 See for example *Workers on Board: The case for workers voice in corporate governance*, Trades Union Congress 2013. Available at <http://www.tuc.org.uk/economic-issues/corporate-governance/workers-company-boards-makes-sound-economic-sense-says-tuc>
- 69 <http://www.boeckler.de/36912.htm>
- 70 See first group director biographies. Available at <http://www.firstgroup.com/corporate/investors/directors.php?dir=mb>
- 71 See for example recent research from the Weinberg Centre for Corporate Governance at the University of Delaware.

ECCR corporate members

Apostolic Pastoral Association, Archdiocese of Birmingham Justice & Peace Commission, Australasian Centre for Corporate Responsibility (ACCR), Aviva Investors, Baptist Union of Great Britain , Boston Common Asset Management, Carbon Tracker Initiative, Carlisle One World Centre, Castlefield Gaeia Limited, CCLA Investment Management Ltd, Central Finance Board of the Methodist Church, Christian Aid, Christian Brothers Investment Services, Inc., Christian Concern for One World, Christian Council for Monetary Justice, Church of Scotland , Church in Wales, Churches Council for Industry and Social Responsibility (CCISR), Churches Dalit Support Group, Congregation of Jesus Charitable Trust, Congregation of La Retraite, Co-operative Banking Group, Daughters of the Holy Ghost, Diocese of Brentwood Commission for Justice & Social Responsibility, Diocese of Hallam, Diocese of Lancaster Faith & Justice Commission, Diocese of Oxford, Diocese of Shrewsbury Commission for the Promotion of Justice, Peace & Social Responsibility, Diocese of Southwark, Diocese of Worcester Board of Finance Ltd, Ecclesiastical Investment Management, ECCR Oxford Group, ECCR West Midlands Group, ECCR London/SE Group, EcoQuakers Ireland, EIRIS, Ethex (The Ethex Investment Club Ltd), Ethical Investors (UK) Ltd, Ethical Screening, Faith at Work in Worcestershire, Franciscan Missionaries of the Divine Motherhood, Henderson Global Investors, Holy Family of Bordeaux, IBEX, Industrial Mission Association, Interfaith Center on Corporate Responsibility (ICCR), Iona Community, JustShare, Kent Diocesan Area Justice and Peace Group, L&P Trustee Services Ltd., La Sainte Union, Lincolnshire Chaplaincy Services - Church in Society, Medical Mission Sisters, Methodist Church, Missionary Society of St Columban, National Justice and Peace Network (NJPN), North East Thames Quaker Area Meeting, Oikocredit International Share Foundation, PAX CHRISTI, Portobello and District Council of Churches , Quaker Peace and Social Witness, Quakers & Business Group, Rathbone Greenbank Investments, Sarasin & Partners LLP, School Sisters of Notre Dame, ShareAction, Shared Interest, Sisters of Charity of Jesus & Mary, Sisters of Christian Instruction (St Gildas), Sisters of Marie Auxiliatrice, Sisters of Our Lady of Apostles, Sisters of St. Joseph of Annecy, Sisters of St. Joseph of Peace, Social Responsibility Forum of Churches Together in Cumbria, Society of Jesus, Society of the Holy Child Jesus, South East Scotland Area Meeting, South Yorkshire Workplace Chaplaincy, St. Patrick's Missionary Society, Student Christian Movement, Swindon Churches Together, Telford Christian Council, Traidcraft Exchange, Triodos Bank NV, Trócaire, United Reformed Church, United Reformed Church Northern Synod, United Reformed Church Wessex Synod, United Reformed Church West Midlands Synod, Us: every person, every community, a full life.

ECCR also has about 100 individual members

The UK is set to become an increasingly unequal society. Economic inequality is a multi-faceted problem which, as the recent furore over Thomas Piketty's *Capital in the 21st Century* has shown, is attracting debate and concern across the political and social spectrum.

For many Christians this debate is long overdue. And one issue that deserves particular attention within it is the role of pay: specifically the difference in pay and conditions between those at the 'bottom' and those at the 'top' of the labour market. In 2014 it emerged that one in five British workers are paid below a 'living wage'. In the same financial year the average FTSE 100 Chief Executive Officer (CEO) earned £4.7 million - approximately 358 times the earnings of a fulltime worker on the national minimum wage. This situation is neither just nor is it good for us as a society.

This briefing hopes to stimulate both debate and action. It highlights a number of proposals which ECCR considers has the potential to reduce pay inequalities including tackling low pay and insecure work, pay ratio reporting, caution and transparency in use of remuneration consultants, including workers on remuneration committees and greater investment in employee development and succession planning. All of these have merit and deserve more serious consideration.

Underlying this we propose that a number of key principles should underpin the debate. This briefing makes the following recommendations and call to action:

- There is an urgent need to tackle low pay – we want all companies to become Living Wage Employers;
- There should be meaningful transparency in the way rewards are distributed throughout a company to enable shareholders and others to understand the rationale behind it;
- There is the need to reassess what is meant when we ask what value an individual employee brings to a business;
- Christian investors who are not already engaging on remuneration issues should consider doing so and those that are, should intensify their efforts.

This paper aims to inform investors about the key issues on pay inequality and to help them approach fund managers and companies with the knowledge and confidence to constructively engage and seek action on one of the key challenges facing society at this time.