

Fair Wages – a key to effective social capital management

Sustainability is more than climate change and protecting fragile environmental ecosystems, it's also about protecting the social fabric of which society is composed and supported. This means going further than meeting the bare minimum in wage levels required by law and embracing the concept of fair wages. Fair wages are those that cover the real cost of an employee's basic needs while also respecting the economic constraints of employers. Moreover, for many industries this involves not only evaluating their own wage practices but also being a "fair-wage" champion and resource for the companies within their supply chains as well.

Using case study evidence, guest author, Professor Daniel Whitehead-Vaughan of the Fair Wage Network demonstrates why addressing compensation using a fair wage approach is beneficial for employee well-being, company profits, and for helping companies and their respective supply chains achieve sustainable outcomes.

Investors, concerned about protecting not only the earth's natural resources but also its "human" resources, should push global companies for more accountability, transparency and action when it comes to fair wages and compensation for employees and their dependents.

Professor Daniel Vaughan-Whitehead

Professor Daniel Vaughan-Whitehead, is founder and co-chair of the Fair Wage Network, a Geneva-based non-profit organization focused on sharing, aligning and promoting wage-related research, methodologies and best practices via public sector partnerships, as well as direct consulting with corporations and their supply chains worldwide.

He is a Professor at SciencesPo in Paris, and at the University of Geneva as well as author of "Fair Wages: Strengthening Corporate Social Responsibility" (Edward Elgar Publishing, 2010).



A Growing Social Conscience

Over the past two decades environmental issues have tended to define and dominate discussions of sustainability, driven in large part by heightened awareness of climate change. More recently, however, public awareness and concern are also increasing in relation to the social dimension of sustainability. Workforce diversity, gender pay and sexual harassment at the workplace are all indicative of a society concerned with addressing injustices and inequalities of the social kind.

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These are just the most recent examples of a wave of concern that started to swell as far back as the 1990s. Unfortunately, it started not so much as a well-planned strategy but rather as a reaction to high-profile cases such as Nike's "child sweatshops" and the collapse of the Rana Plaza garment factory in Dhaka, Bangladesh, which killed over 1,100 workers in April 2013.

Cases like these cast a long shadow over the social sustainability of the global supply chains that dominate present-day business.

Similarly, the debate on the living wage that is gaining attention in Europe and around the globe is a continuation of this wave of concern for workers' well-being. What started as a grassroots campaign from civil society now ranks as an item on national and international agendas (most recently at the G20 and G7 meetings).¹ And it comes at a critical time.

"Decent work" involves job opportunities that are productive, deliver a fair income, consider workplace health and safety, provide social protection for families and ensure equal opportunity, among other principles.² However, International organizations have highlighted a current "decent work deficit" among global supply chains.³

The lack of decent work as defined above is troublesome in light of recent workforce statistics that show the percentage of people in vulnerable employment worldwide is steadily increasing (see insert entitled "Startling Statistics"). More effort is needed from corporate players and their global supply chains to improve both the quality of employment and wage levels.

The percentage of people in vulnerable employment worldwide is steadily increasing.

Startling Statistics

Vulnerable employment – defined as lacking formal work arrangements, inadequate earnings, difficult working conditions, and inadequate social security, voice and representation by trade unions and similar organizations.

1. Vulnerable employment represents 42 percent of total global employment (1.4 billion people).
2. Vulnerable employment is expected to grow at a rate of 11 million per year.
3. The "Working poor" — defined as those earning below US \$3.10 / day in terms of purchasing power parity—stands at 700 million workers, mainly in emerging and developing countries.

Source: World Employment Social Outlook, Trends 2017, ILO, Geneva; http://www.forschungsnetzwerk.at/downloadpub/wcms_541211.pdf; and also World Employment Social Outlook, Trends 2018, ILO: https://www.ilo.org/wcmsp5/groups/public/---dgreports/---dcomm/---publ/documents/publication/wcms_615594.pdf

¹ See G20 Leaders declaration, Hamburg, 8 July 2017. <http://www.g20.utoronto.ca/2017/2017-G20-leaders-declaration.html>

² Decent work definition of the International Labor Organization (ILO), <https://www.ilo.org/global/topics/decent-work/lang-en/index.htm>

³ Resolution concerning decent work in global supply chains, International Labour Conference, 105th Session, 2016, Geneva. https://www.ilo.org/ilc/ILCSessions/105/texts-adopted/WCMS_497555/lang-en/index.htm

The "race to the bottom" in terms of wage costs has also reached a clear limit. Depressed wages are increasing inequality, worker discontent and social unrest. In 2017, 9 million work-days were lost due to employee strikes or lockouts worldwide.

Wage discussions can be confusing not just because of the complexity of labor markets but also because of the different notions of what constitutes an adequate wage.

The "race to the bottom" in terms of wage costs has also reached a clear limit.

Minimum wages fall below living wages

Governments around the world have enacted minimum wages (see insert, “A wage lexicon”) to ensure a wage floor for all workers in their respective countries. In principle, the minimum wage could be expected

to ensure workers and their families the minimum threshold of pay required to cover basic needs. Over the past two decades, however, minimum wage policy has proven to be less effective than originally intended.

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A wage lexicon: minimum, living, and fair wages

| | |
|---------------------|---|
| Minimum wage | Statutory wage floor decided and fixed by the government in consultation with – or after negotiations with – employers and trade union representatives or even national/sectoral bargaining |
| Living wage | Minimum pay received for the basic number of working hours and required to ensure coverage of workers and their families’ basic needs |
| Fair wage | Wage practices (wage levels, wage adjustments and pay systems) required to ensure sustainable wage development in the company |

Source: RobecoSAM

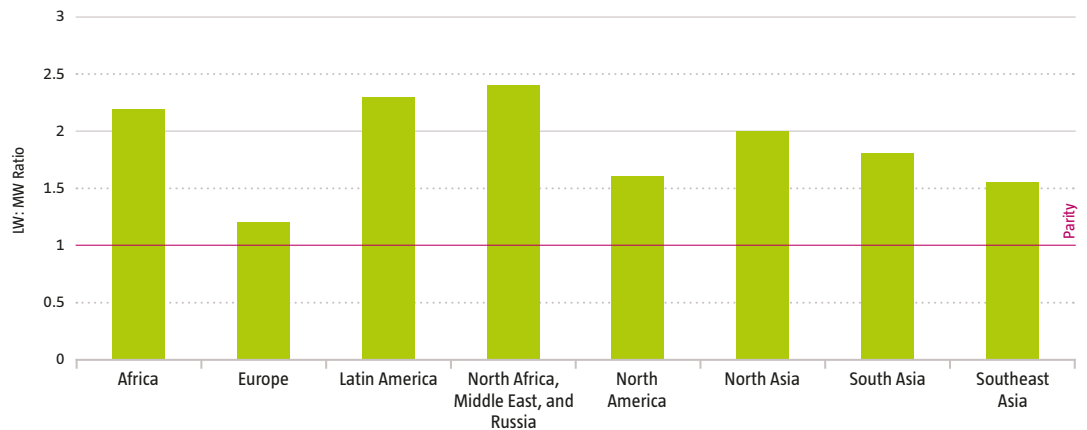
The main problem is that it is not fixed systematically at the living wage threshold but is rather a threshold borne out of political compromise between governments, trade unions and employer organizations, based on prevailing “economic and social considerations” (as stipulated in ILO Convention No. 131). As a result,

the minimum wage is often much lower than the living wage.

The gap between what workers earn as a minimum wage and what they actually require to support the basic needs of themselves and their families is stark. Figure 1 shows the extent of the wage deficit between the minimum wage and the living wage across all geographical regions. Unsurprisingly, the gap is higher in regions with weak labor institutions; among these, Africa, the Middle East and Russia stand out.

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Figure 1: The living wage deficit (living wage/minimum wage ratio)



In every geographic region the minimum wage is well below parity with the living wage—the pay workers actually need to support basic needs. Workers are better off as countries move closer to the parity line.

Source: Minimum wage and living wage thresholds; Fair Wage Network database.

The extent of the deficit in places such as Africa and many Asian economies have ignited living wage campaigns to pressure companies to go beyond legal compliance and towards meeting their workers' basic needs and improving their well-being.

By contrast, the gap is much smaller in European countries where labor institutions, minimum wage fixing and collective bargaining mechanisms that protect workers' wages and rights are strong. But even in Europe differences in wage setting policies persist between countries.

The living wage as the new target

The low minimum wage in the United Kingdom led, in fact, to the living wage campaign initiated and

coordinated by the UK Living Wage Foundation. The campaign called for a much higher threshold than the minimum wage to better protect workers and their families. Since then, more brands have committed to pay a living wage, with trade unions, too, working towards a framework within which this can happen.⁴

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⁴ See for instance the initiative ACT (Action, Collaboration, Transformation) supported by trade unions; <https://actonlivingwages.com/>

Variations on a Calculation

Living wages can be calculated either by governments, research institutes or national and international NGOs. They aim to define the prices of items contained in a basket of basic goods that cover basic needs

Living wages thresholds can differ substantially, depending on the organization involved.

These thresholds can differ substantially, depending on the organization involved. For instance, they are fixed at rather low levels when calculated by governments – because the relevant government would have to fix the minimum wage accordingly; but fixed at very high levels when calculated by NGOs or the research institutes of trade unions.⁵ Thresholds can also differ considerably due to differences in reference years (e.g. one threshold may have been calculated in 2015 and another in 2018), or because they use a different

standard size of households (e.g. one threshold may take the needs of one adult as the family unit, while others may use two adults plus two children).

For this reason, the Fair Wage Network established a methodology to collect all existing living wage thresholds and harmonize them to the same standard year and the same household size. Transparent thresholds and standardized benchmarks can be established which can be used to compare wages of companies, for instance, along a supply chain. The importance of common standards, unified methodologies and analyses tools have also been recognized by other groups seeking progress and equality within worldwide wages.⁶

Nevertheless, more work and tools are needed to help companies and governments develop protocols and policies to transition to more worker-centric models that are both realistic and effective.

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From a living wage to a fair wage: five keys to getting wages right

Fair wage:

Wage practices (wage levels, wage adjustments and pay systems) required to ensure sustainable wage development in the company

Living wage:

Minimum pay received for the basic number of working hours and required to ensure the coverage of workers and their families' basic needs

The fair wage approach is aimed at providing global companies with a more comprehensive methodology for examining wage issues. First, it takes into account all elements in the wage-fixing structure and process.

Once these have been identified, it assesses the root causes behind reported issues, making it possible to remedy them.

⁵ This is the case for instance of the AsiaFloorWage calculated by an NGO originally set up by trade unions in India.

⁶ "Living Wages Around the World: Manual for Measurement," R. Anker and M. Anker, (Edward Elgar Publishing, 2017).

The fair wage approach looks at five major areas: (see Figure 2)

(i) **legal issues:** such as proper wages, the minimum wage, compliance with the maximum working hours and payment for all those hours, including overtime;

(ii) **wage levels:** companies need to ensure good performance in terms of living wages, the prevailing wage (or relative to prevailing market rates), and pay equality (meaning no discrimination for gender, nationality or ethnic origin);

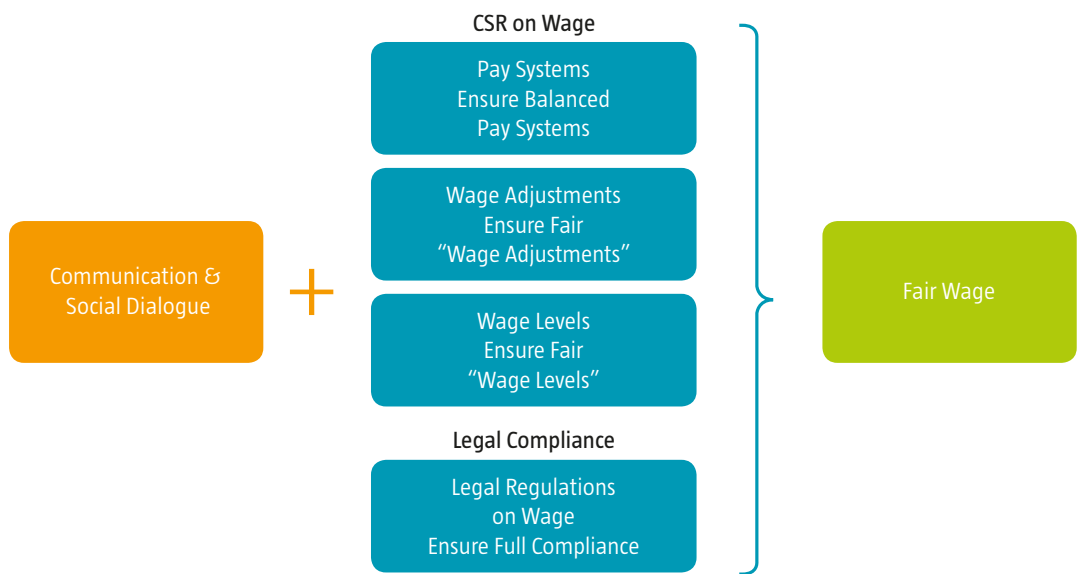
(iii) **pay systems:** how companies pay their workers can also have different effects on workers' motivation and productivity;

(iv) **wage adjustments:** a company can pay a fair wage today that might become unfair tomorrow, if not regularly adjusted for price increases or company results;

(v) **communication and social dialogue:** a company can have decent pay systems and even very generous bonuses but workers may not know about them. Similarly, it is important to have a dialogue with workers' representatives at the unit level to increase awareness of problems, avoid social discontent and even strikes.

There are a total of twelve fair wage dimensions in the fair wage approach which readers can reference further at the following link.⁷

Figure 2: A Fair Wage Framework



Source: RobecoSAM

⁷ See at <http://www.fair-wage.com/en/fair-wage-approach-menu/12-fair-wage-dimensions-menu.html>

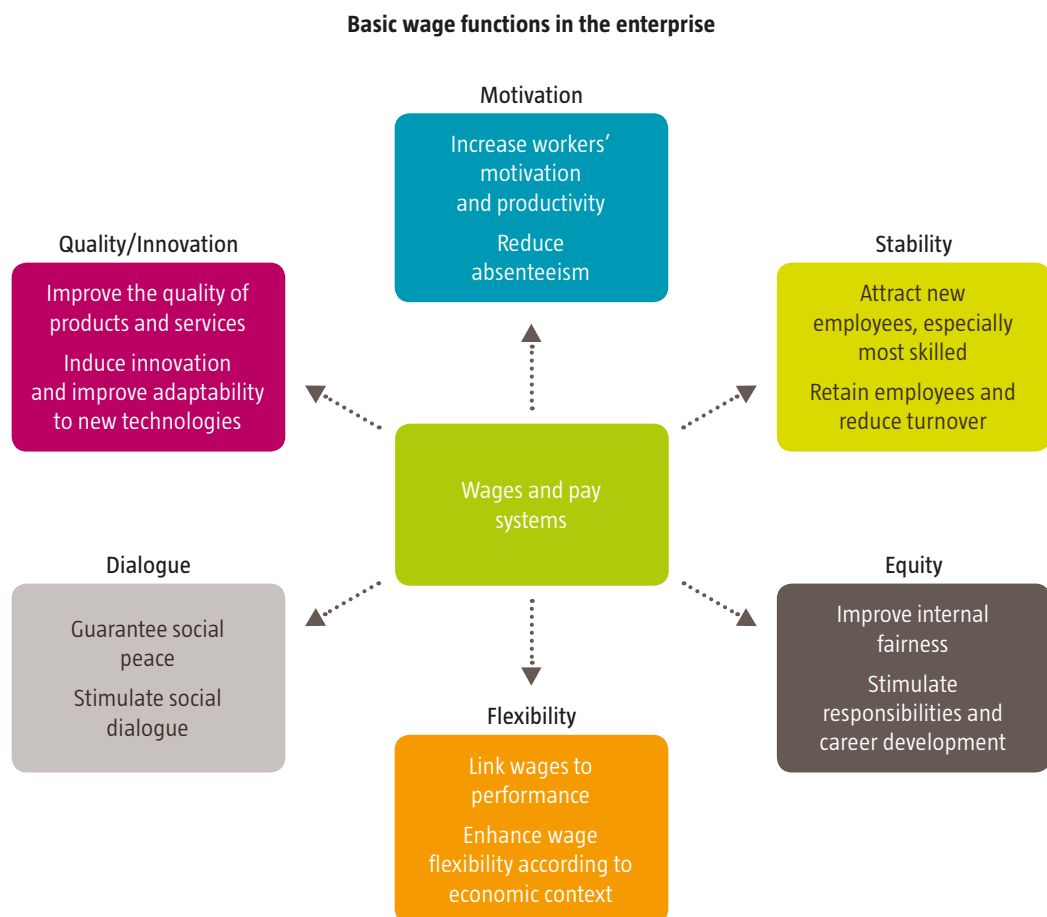
Fair wage benefits – promoting worker and company performance

Why is this approach different from the living wage approach?

1. It's not about one fixed number but rather a series of benchmarks across a number of indicators and dimensions.
2. It tries to consider not only the social side but also the economic side of wage trends, thus encompassing both workers' and employers' perspectives into wage issues. This is important as it helps companies begin moving in the right direction towards achieving sustainable development along a number of dimensions. See Figure 3, which shows the various benefits wages can play within an organization and how human capital development, innovation and productivity can be positively impacted by proper wage policies and practices.

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Figure 3: Benefits of Fair Wages within an organization



The benefits of fair wages go far beyond compensation. It promotes employee morale, inspires motivation and innovative thinking, lowers the costs and improves the effectiveness of recruitment, aids talent retention, and increases the focus on product and service quality.

Source: Daniel Vaughan-Whitehead, Fair Wage Network

Short-term Thinking vs Long-term Results

To lower costs and increase profitability, a company could give all workers the same minimum rate (either in the form of a living wage or a minimum wage). However, this is not an effective, sustainable, long-term strategy as it does not reward workers for skill and performance.

Profitability may increase in the short term, but ultimately, companies will lose out on key benefits that give a company its competitive edge. Profitability over the long run will suffer as worker motivation and productivity decline.

Improving wage practices can help employers optimize financial capital (compensation and personnel budgets) and social capital (human resource development) in a sustainable and cost-efficient way. Aligning pay with skills, as well as rewarding good performance

with bonuses can improve employee satisfaction and motivation without affecting company profitability. In the end, a virtuous loop is created – as companies address wage practices in a sustainable way, the greater their chances of increasing profitability which provides the economic resources for further wage improvements.

Our experience with several Chinese companies that have implemented fair wage systems confirms its effectiveness in contributing to higher value-added products, even as wage levels and wage costs increased.

Similarly, and in a context in which it can be difficult and risky for the company to increase wage costs, improving non-monetary benefits can be a less expensive way to relieve employees' and their families' daily difficulties. For instance, companies can provide free meals or subsidized accommodation, transport facilities and even medical services in regions where medical expenditures often represent the main source of families' unexpected outlays.

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Fair wages in practice – steps to successful implementation

An essential prerequisite for creating an effective fair wage policy is acceptance and support from top management. Second, decision-making should be open, transparent and inter-departmental, with input from key internal departments such as human resources, compensation & benefits, sustainability and procurement, as well as external managers in the global supply chain. The involvement of all departments and also of all companies and suppliers can best be assured if there is a new and clear wage policy enshrined in the

company's sustainability strategy—a wage policy that identifies goals and targets, scope and methodology, as well as addresses potential risks that could arise in the framing and implementation process.

Having an effective fair wage policy as a fixture within a company's corporate sustainability program is an effective way of involving all departments and winning the confidence and cooperation of external supply chain partners.

Examples of Fair Wage Policy Deployment Strategies:

Unilever – looked inward first, improving its internal wage practices prior to approaching suppliers on wage policies.

H&M – looked outward first, examining the wage policies mainly of its suppliers.

IKEA – moved on both fronts right from the start, both in its own stores as well as with its suppliers.

Source: Daniel Vaughan-Whitehead, Fair Wage Network

Company experience has shown that effective multi-stakeholder commitment and participation can best be ensured when wage policies are part of the company's

overall sustainability strategy. Basic steps for company management to consider when implementing a fair wage policy are listed in Figure 4 below.

Figure 4: The different steps forward

| Commitment | |
|-----------------------------------|---|
| Step 1. | Define the commitment of the company to improve its responsibility on wages |
| Assessment | |
| Step 2. | Get an overview of wage practices in the company's units and/or suppliers |
| Step 3. | Identify the issues, risks and needed changes |
| Strategy | |
| Step 4. | Include wages in company's sustainability strategy (could also be step 1) |
| Step 5. | Extend this policy to all company business units and suppliers along with the necessary indicators, benchmarks and monitoring process |
| Implementation/Remediation | |
| Step 6. | Define a long-term plan to pay a living wage and develop a fair wage policy (remediation) |
| Step 7. | Eventual certification and continuous monitoring process |
| Step 8. | Ensure the feedback of (expected and effective) outcomes to shareholders and investors |

Source: Daniel Vaughan-Whitehead, Fair Wage Network

Fair wage benefits: a strategic opportunity in sustainable development

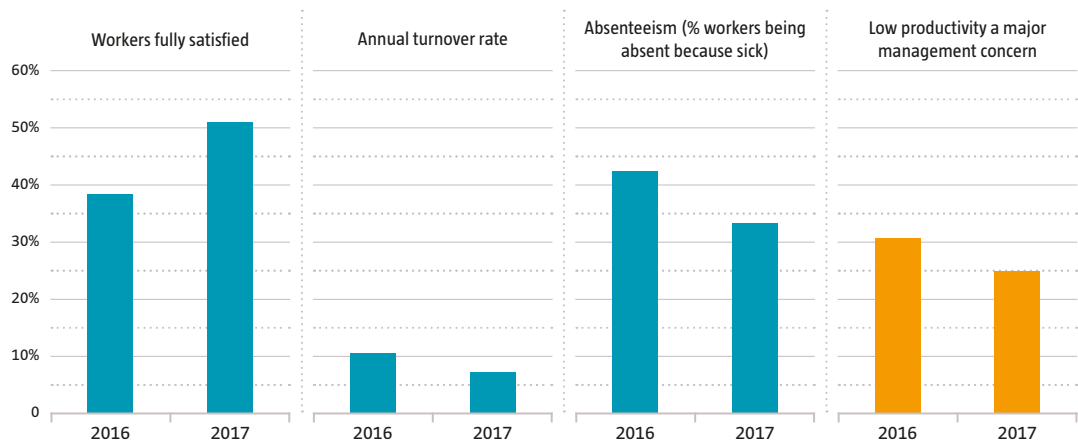
Although often viewed purely as a cost, the advantages of a fair wage policy are becoming clearer as more research on fair wage remediation is conducted including:

- significant fall in turnover rate
- declines in absenteeism
- greater employee satisfaction

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Figure 5 shows the results of fair wage assessment and remediation exercises carried out among 81 suppliers of a major brand.

Figure 5: Fair Wages Makes Happier Workers



The results of a one-year fair wage remediation program covering 81 suppliers of a major global brand. After fair wages implemented, employers reported higher rates of worker satisfaction, lower absenteeism and employee turnover; and managers themselves worried less about overall productivity.

Source: Daniel Vaughan-Whitehead, Fair Wage Network

A number of well-known brands have now put wages and the concept of a fair wage at the core of their sustainability strategy.

⁸ For H&M, see: <http://about.hm.com/en/media/news/hm-fair-living-wage-strategy-update.html> and <https://www.shiftproject.org/sdgs/living-wages/hm-fair-living-wage-strategy/>
For UNILEVER, see: <https://www.unilever.com/sustainable-living/enhancing-livelihoods/fairness-in-the-workplace/fair-compensation/> and pages 1-3 of: https://www.unilever.com/Images/unilever-framework-for-fair-compensation-2015-final_tcm244-502647_en.pdf
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For AstraZeneca, see p. 5 of: <https://www.astrazeneca.com/content/dam/az/our-company/Sustainability/great-place-to-work/Our-people---May-2015.pdf>
For the Standard Chartered Bank, see p. 84 of: <https://www.sc.com/annual-report/2017/>

It is encouraging that a number of well-known brands have now put wages and the concept of a fair wage at the core of their sustainability strategy. Notable among them are H&M in retail with its “fair living wage strategy”, Unilever in food with its “fair compensation strategy”, IKEA in furniture with its “Fair Wage” policy, but also AstraZeneca in the pharmaceutical sector, Vodafone in telecommunications, as well as Standard Chartered Bank with its “Fair Pay Charter”, in the financial services sector.⁸

These companies recognize that sustainable wage practices are important not only to avoid the risk of reputational damage, but also because of their crucial role in boosting employees’ motivation, competition for talented recruits and retention of skilled employees. Furthermore, they are also effective tools against social conflicts along the global supply chain. On the economic side, fair wage policies improve productivity, stimulate innovation and enhance human capital development.

Advantages don’t just accrue to global conglomerates but also to local manufacturers within their supply

chains. This is especially crucial for encouraging workers’ rights and fair wages in developing regions whose industries are benefitting from an increase in international trade but whose labor policies still adhere to archaic structures. International companies working with regionally-based suppliers, as well as local workers would benefit significantly from fair wage review and remediation processes.

Better retention of skilled employees was also observed after the introduction of a wage grid that helped to better reward skills. Here, China is a good example. The competition for skilled workers is rising thanks to tight labor markets. But many companies still operate a “piece-rate” compensation system in which employees are essentially paid based on each unit produced rather than the time needed to complete it.

Exposure has raised interest and awareness among China’s manufacturers, who are now more receptive to flexible compensation systems and wage structures that include a basic wage determined and differentiated around objective criteria such as work experience, education and skills, complemented by a series of bonuses. This has generated better wage practices and also wage levels that are more in line with living wage thresholds.

On the economic side, fair wage policies improve productivity, stimulate innovation and enhance human capital development.

The introduction of wage remediation processes has led to:

Better compensation systems – through implementing wage grids that align worker skills with rewards and pay

Retention of skilled workers – through improved worker motivation and satisfaction

Reduction of excessive wage costs – through reduced overtime costs

Improved worker well-being – through decreased overtime, improved health and safety

Better human resource management – through efficiency gains via workforce re-organization and resource planning

Fairwage certification

These positive effects, together with growing demand from business leaders (first from the garment sector, but increasingly from other sectors, including furniture, pharmaceuticals and banking) and investors led the Fair Wage Network to develop a fair wage remediation structure, fair wage indicators and dimensions into a formal certification process. Upon successful completion, companies receive the fair wage label as a sign of

their commitment to worker well-being, efficient wage structures and internationally accepted wage standards.

The Fairwage trade mark is legally protected and retained by the International Trade Center (ITC) for its sustainability map project.⁹



Company management and investors alike need to understand the short- and long-term benefits of including wages as part of a comprehensive sustainability strategy.

The responsibility of the investment community

Wages are moving in the right direction but not fast enough. This may be, in part, due to a bias that sees wages as a cost rather than a tool to engage employees, reduce turnover, stimulate innovation and improve overall efficiency. Company management and investors alike need to understand the short- and long-term benefits of including wages as part of a comprehensive sustainability strategy.

Investor pressure can help to push the pace of progress forward. Access to investor capital via global markets gives corporate leaders the incentives needed to make sustainability issues such as worker well-being and compensation a priority in their own companies, as well as in their global supply chains. And it brings visibility and action on a global scale.

⁹ The International Trade Center (ITC) works to connect with international value chains in order to support developing countries design trade strategies that enable them to be more competitive internationally and facilitate local growth and employment. See Fair Wage standard in ITC Sustainability Map: <https://sustainabilitymap.org/standard-details/539>

Prominent investors are already forming alliances in favor of living wage/fair wage strategies.

Prominent investors are already forming alliances in favor of living wage/fair wage strategies. Under the umbrella Platform Living Wage Financial (PLWF), a group of global institutional investors (which includes Robeco) with combined assets of €725 billion, are using their influence to engage companies to develop fairer wages.¹⁰ No doubt more initiatives of this type will emerge, especially as the importance of the UN's Sustainable Development Goals (SDGs) grows within the investment community.

Investor demand for better wage indicators and wage-related benchmarks for sustainability indexes would also be an effective way of signaling companies to take wage policies and practices seriously or run the risk of negative publicity, lower stock valuations and

investor censure. Wage cost competitiveness can go hand-in-hand with a more coherent, transparent and fair framework on wage practices and pay systems. Long-term strategies on wages and sustainability would help to highlight their potential leverage effect on key aspects of competitiveness.

As companies reconcile employees' needs and well-being with other competitive aspects such as human resources, innovation, reputation and investment, wages will increasingly be at the heart of companies' future sustainability strategy.

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¹⁰ <https://apparelinsider.com/investors-call-for-living-wages-for-garment-workers/>

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