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REWARD CONSULTING

Responsible Reward Guide

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INTRODUCTION

From Justine Woolf, Director of Consulting

Thank you for downloading our guide to responsible reward.

This isn't a new concept – it's been around for a while in one guise or another. Our aim in producing this guide is to share knowledge around what responsible reward means today and bring it to life with practical examples which you may want to explore at your organisation.

Links to our sources can be found throughout the text. As ever, if you'd like advice on any area of pay and reward, you can email us at **enquiries@innecto.com** or call **020 3457 0894** to speak to a consultant.

Best wishes, Justine

So, first things first…

What is responsible reward?

In basic terms, responsible reward means considering the wider impact of how your organisation does business, and then aligning your reward package to this vision. The aim is to create long-term sustainability by moving beyond purely financial goals and incentivising the business – and its people – to generate a positive impact on society.

The other point to make is that responsible reward is a catch-all phrase for lots of different elements. Some of these may already be underway at your company, even if they don't form part of an overarching strategy.

As I already suggested the idea of rewarding responsibly is not new, but there are a number of external factors that have forced the idea to the top of Board agendas and are pushing many companies to in effect rebrand and realign their reward practice.

At its heart is the fact that no business operates in isolation and that we are all part of a global ecosystem, one that isn't sustainable in the long term if we carry on consuming at the rate we do now.

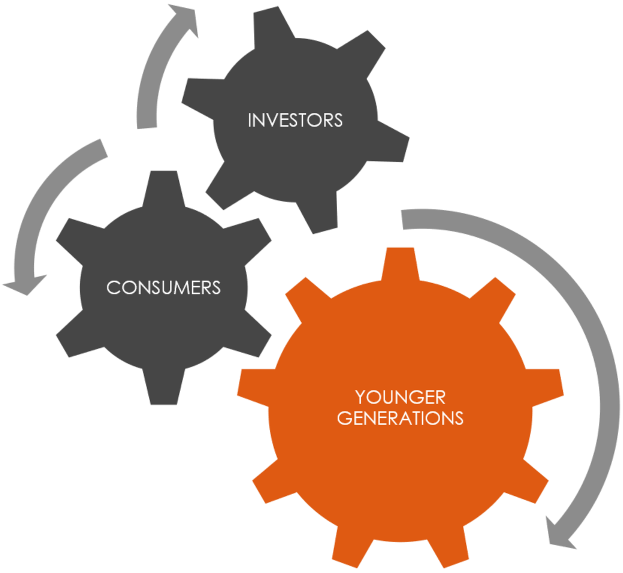
The UN have developed several initiatives, including their Sustainable Development Goals, to protect the environment and people which demand a change in behaviour. And in the same way that David Attenborough and the 'Blue Planet effect' forced the conversation on plastic pollution, the tide has now started to turn as investors, consumers and employees place more pressure on organisations to act in a more sustainable and accountable way.

PRESSURE IS MOUNTING

Demographic shifts

A lot of ideas around responsible reward are being driven by younger generations who appear to have higher expectations for corporate and social responsibility than many of those currently heading up organisations and government.

We've all seen the societal shift that 16-year-old Greta Thunberg has made in accelerating accountability on climate change, and the majority of millennials believe employers should play a key role in alleviating concerns around income inequality, hunger and environmental impact.



Impact on business

But this isn't just about expectations – it translates into business impact when we think about attraction and retention of our employees. A study by Neilsen found 67% employees prefer to work for socially responsible companies and further studies show that millennials who believe their employer supports the local community are more likely to stay at that employer for five years.

As consumers, we're increasingly aware of how a product's social and environmental implications can affect our purchasing decisions. There is evidence that the public's perception of brands is determined largely by their commitment to social causes they believe in; and that the social stance a company takes now influences buying decisions more than price.

A company's stance also impacts its performance, with studies showing a direct correlation between Corporate Social Responsibility (CSR) index ranking and profitability. Investors are now paying significantly more attention to how a company operates, with many forming alliances in favour of living wage / fair pay strategies, and others using Glassdoor to evaluate how its quality of hiring and retention measures up with the brand's stated values.

ESG

What does it mean?

Many will already be familiar with the term ESG, which stands for Environmental, Social and corporate Governance. The graphic below provides a quick summary of what each aspect relates to:

- Environmental - the energy we use and the consequences of this
- Social – the relationships we have with others and
- Governance – the controls and practices in place to ensure we comply with requirements

Source: McKinsey, 5 ways ESG adds value, 2019

Inclusion of ESG criteria started out as a way to bring non-financial factors into investment decisions and help investors find companies with values that either match their own, or avoid companies that might pose a greater financial risk due to their practices. There are now many organisations and initiatives promoting the widespread adoption of such ESG factors, including the Principles for Responsible Investment, which supports a global network of over 2,000 signatories to incorporate ESG factors into their investment and ownership decisions.

When you start to explore what ESG is and how companies are using it, you will see quite a wide variety of applications, but fundamentally it is being used to describe the longer term sustainability of a company's approach to its people, suppliers, customers and investors. The challenge for many organisations is understanding what it really means for them.

Some examples

Some businesses like HSBC and National Australia Bank have created specific ESG reports that detail their approach to sustainable growth. NAB for instance have a scorecard of commitments that link directly to their sustainability goals - including environmental operational goals like reducing energy and water use, to social goals such as achieving 40 – 60% of either gender represented at all levels of the business by 2020 and 50% increase in volunteering days on previous year.

Other organisations such as Bloomberg have created dashboards with specific ESG indices and metrics where you can compare your company to your peers on metrics such as ratio of women in management or average age of board members. However, bear in mind that there is no right or wrong when which choosing areas of focus or which metrics to use, as they will vary by organisation depending on their long-term priorities.

ESG – PRACTICAL APPLICATIONS

ESG isn't just something that matters to investors; it impacts all of us. We'll look now at some examples of responsible reward in practice, because it has been proven that embedding environmental, social and governance factors not only makes good business sense, it creates better outcomes for people.

Governance

This boils down to organisations having systems in place to check we are doing what we are supposed to be doing. This can be evidenced in the form of the Board committees, or making sure we adhere to regulations and legislation – like complying with minimum wage legislation or gender pay reporting requirements.

One specific aspect of governance that has come to prominence recently, particularly in regard to responsible reward, is Executive pay.

We've seen increasing regulation around measures like CEO ratio reporting and strengthening the UK Corporate Governance Code, which aims to ensure listed companies strongly link their strategy and culture with their purpose. In a similar vein, the Wates Principles encourage private organisations to follow governance principles, such as ensuring that they align remuneration with the long term success of the business.

We've also seen some changes in the design of incentive plans, with a move away from purely financial targets in the form of ESG metrics aiming to demonstrate a focus on long term sustainability.

However, it's not as straightforward as pulling a few metrics out the air and expecting a round of applause from investors / stakeholders or a change in culture. Aligning ESG metrics doesn't, on its own, create the desired long-term change. For their inclusion in any incentive plans to really work and be meaningful, you need to understand:

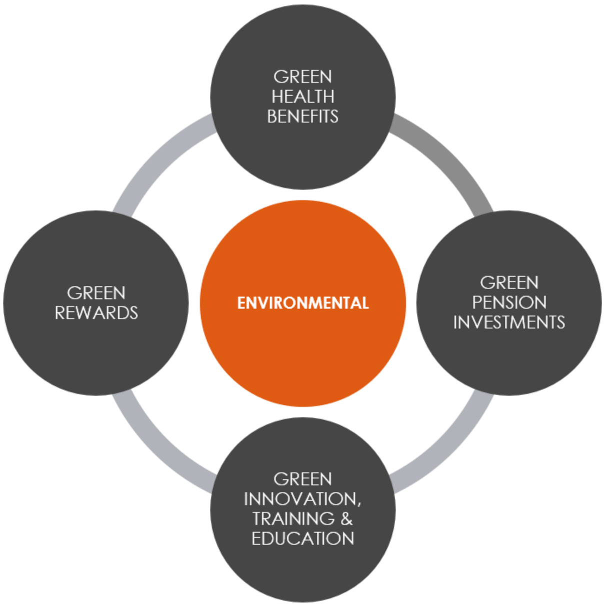
- **Purpose** — Why does your organisation exist, and how do ESG factors support this purpose?
- **Accountability** — Who are the key stakeholders of your organisation, and what ESG factors are important to them specifically?
- **Alignment** — How can you align your incentive plan participants with material ESG factors to ensure clear line of sight between their actions and behaviours and performance? For example, are measures better addressed at an individual or team level, or corporate-wide?
- **Engagement** — How do we ensure that participants remain engaged? How do we communicate the measures, ensure participants understand how important they are, and how well the organisation is tracking against them?

Other areas of high-profile governance issues relate to diversity and inclusion, with many institutional shareholders demanding better representation of women and ethnic minorities on corporate boards and in executive ranks. In this instance, simply publishing your gender pay numbers is not enough – to demonstrate true commitment you need to show what progress you are making with your diversity and inclusion ambitions.

Environmental

We've seen a wide variety of reward initiatives with environmental aims, which aim to change behaviours from individual actions all the way up to corporate level.

Some aim to link employees' personal choices to company success. One method is using tools like Greenrspace, an engagement platform that rewards employees for making behaviour changes which support wider corporate environmental goals. When employees undertake desired behaviours, they earn vouchers or can give a donation to charity.



Other initiatives aim to align organisational green agendas with employee wellbeing, creating a buzz and momentum at the same time.

Some engagement platforms reward employees for taking positive steps that both improve the environment and enhance personal health and wellbeing. Modules in the programme include cycling to work, recycling in the workplace, volunteering in the community, and monitoring personal fitness levels. Employees are rewarded with points, so for each positive step such as cycling a mile to work, an employee earns points that can be donated to selected charity projects or spent in the platform's shop.

Other organisations are looking to create broader responsible investment strategies with their pension funds, by considering ESG issues when making investment decisions. This doesn't just mean withdrawing from or avoiding certain companies or sectors, but also engaging with them to push for change, and taking part in shareholder activism.

We are seeing more high-profile challenges around the mismatch between what companies say and what they do in practice. See the recent case of an employee of the League Against Cruel Sports (an animal welfare charity) who raised concerns that the League's pension scheme invested in funds which seem antithetical to its purpose – including in companies that experimented on animals. These types of challenges have significant reputational impact and we expect this trend of increased accountability to continue.

Social

The Social part of ESG encompasses all aspects of the employee / employer relationship, but when we think specifically about responsible reward there are many different illustrations of how it can play out in practice.

There is evidence that making reward or recognition more inclusive has better results. Analysis of schemes where colleagues can nominate each other for rewards based on good performance shows that usually nominees derive more value from the communal recognition that the reward itself. The social acknowledgment makes the experience a more meaningful and constructive one than if it were based on material benefits alone.

This idea of social recognition can really help to improve motivation and job satisfaction. For example, a study showed that randomly selected employees at an Australian bank who received bonuses in form of company payments to local charities reported greater and more immediate job satisfaction than colleagues who didn't get the same opportunity.

Charitable giving is often the most visible way companies demonstrate social impact, with many now linking their financial performance with positive social outcomes in response to pressure to act responsibly.

Salesforce donates 1% of their profits to charities and also gives employees a full week off a year to volunteer. BrewDog go even bigger and donate 20% of their annual profits.

But it's not just about the money you are seen to give away or the good you do in the world. How you take care of your people and look after their overall wellbeing is also becoming a transparency issue. Whether it's investors, employees, trade unions or the media, there are increasing calls to demonstrate that you are living up to your reputation.

Tell us:

- What importance does your organisation place on improving mental health?
- What proportion of employees are on zero-hour contracts, and how are you managing your gig economy workers?
- What is really behind the gender pay numbers?
- What are you doing when it comes to employee wellbeing?
- What is your commitment to diversity?
- Do you pay above the living wage? If not, why not? … etc

Essentially what people want to know is this: how do you show you are doing the right thing? We'll focus on this perspective in the next section, since one of the core elements of responsible reward is how we treat our people.

FAIR PAY

What does this really mean?

Fair pay is a key part of responsible reward.

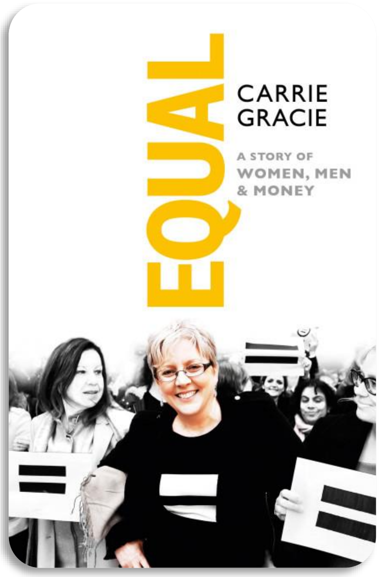
As a principle, none of us set out to pay unfairly; however, most reward frameworks are seen by employees as unfair. The recent CIPD Reward management report suggested that whilst 75% of HR professionals think all or most people in their organisation are paid fairly, only 33% of employees would agree. Quite a worrying statistic, especially when you consider how much work goes in to deciding levels of pay.

Obviously fairness can mean different things to people. It can relate to:

- Direct comparison to others, either inside or outside the organisation
- How processes are managed, or rewards are allocated
- Interactions with others such as line managers
- Messages that are communicated or are perhaps left unsaid around pay

Those who get it right do well – there is evidence that companies who are seen to pay fairly perform better, and organisations that treat their workforces with fairness, integrity and sensitivity are more likely to find increased levels of commitment and productivity. We know that companies that pay above the living wage are more likely to be rated highly in terms of perception of being a good employer.

But when you aren't seen to pay fairly, it can be detrimental – a Payscale study showed employees who don't understand their company's pay process are 60% more likely to leave the organisation. It's also likely to lead to a decline in productivity and reputation, but more fundamentally in trust levels.



Carrie Gracie, *Equal*
(Virago, 2019)

Someone with direct experience of the importance of fair pay is Carrie Gracie, the former BBC China Editor who took an equal pay claim against her employer and won.

In her book *Equal* she describes how "Pay is about how others value us, and if we suddenly discover they value us less than we thought, it feels like a betrayal… we have fury at oneself for being fooled". She also described the reaction of her colleague Samira Ahmed – on discovering the facts about the inequality of her pay to male peers, it "felt as though bosses had naked pictures of you in their office and laughed every time they saw you."

As noted above, rarely does an organisation actively choose to pay their employees unfairly – but we are often so caught up in the management of processes that we sometime lose sight of that human impact and how unfair pay practice can feel on an individual level.

What makes reward fair?

So what can we do to ensure that pay practice is fair, and build trust with our employees that we take pay fairness seriously?

A recent study of reward fairness and equity seems to suggest that external benchmarking is a key factor in enhancing perception of fairness (see summary table below). Conducting benchmarking certainly is a way to ensure parity with the external market, but it's what we do with this information that is key.

Factors that enhance rewards fairness	**%**
Market survey benchmarking	81%
Reward strategy & design	43%
Communication of internal rewards fairness	41%
Culture of openness & transparency	36%
Non-financial recognition internal	32%
Communication of market benchmarking	20%
Non-financial recognition	11%

Source: Worldatwork & Korn Ferry, Pay Fairness: Insights from Rewards Leaders, 2019

Our experience as consultants indicates that it's the combination of communication of reward, and a culture of openness and transparency that are the big game changers in building trust in pay fairness.

This is the main reason we developed our PayLab and Advance tools – helping organisations gain real insight into market data and using these to create a reward strategy that works for their organisation.

Too often benchmarking is conducted and then not shared with managers or employees, or it's kept under lock and key by the reward team and the insights are lost. Or pay review decisions are made but other than hearing about their own pay increase, employees have no concept of how their pay compares to that of their peers and they are left to fill in the blanks with rumour or hearsay.

ADVANCE
YOUR PAY REVIEW SOLUTION

PAYLAB
Powerful & dynamic pay benchmarking

Be more open

Pay that is unfair, but is not because of discrimination on the grounds of protected characteristics, is not easy to challenge using the courts and tribunals. There is no fair pay law.

Transparency alone will not tackle pay gaps – government and employers must address the structural drivers of these inequalities. But in terms of what we can do day to day as HR professionals, it's a good place to start.

Practical examples

Some organisations have really embraced openness as fundamental to their identity. US brand agency Buffer has 'Default to Transparency' as one of their core values, and this includes publishing their formula for salary decisions as well as every employee's actual salary. Their website details how they use market data to inform their career framework and then apply a regional modifier to establish individual salaries by location. While

Buffer only have 82 employees so total transparency is easier to manage, the principles of openness can apply to bigger organisations too. We just have to be brave enough to embrace it.

The Institute for Public Policy Research (IPPR) have recommended that all organisations should look at the idea of producing a fair pay report. The idea being that we build on some of the recent legislative requirements around gender pay reporting and CEO ratios, but look to extend that by including aspects such as proportion of the workforce earning below the living wage; ethnicity and disability gaps; but most importantly, a fair pay narrative that sets out your understanding of any pay gaps, and your plans to ensure fair pay.

The Nordic countries provide some good examples of how embedding transparency can make talking about pay a lot easier. Norway publishes everyone's income and taxes on a national database – any citizen can look up another's information (although not anonymously). Finland and Sweden also share tax returns, and Iceland have introduced an equality pay standard that means all organisations need to prove they are paying equitably. Perhaps unsurprisingly, these countries also score highly when it comes to gender pay parity.

Our Innecto colleague Emer Bucukoglu has been working with a taskforce in Ireland as they look to establish gender pay reporting there. She has encouraged them to focus not just on the headlines, but also to look at the data in more detail – to understand what internal practices continue to unconsciously drive pay gaps, and also to have a mandatory narrative, explaining to employees and external stakeholders what is creating the challenges and what they plan to do about it.

The IPPR also suggested that all large employers should be required to publish their pay ranges internally to employees and that the EHRC should produce an annual fair pay review, based on the all data produced by individual employers, including analysis of trends in the data and recommendations both for employers and government.

The aim of these examples is to give you an idea of the direction of travel on increased transparency, and some ideas for how greater openness around pay might work in practice at your organisation.

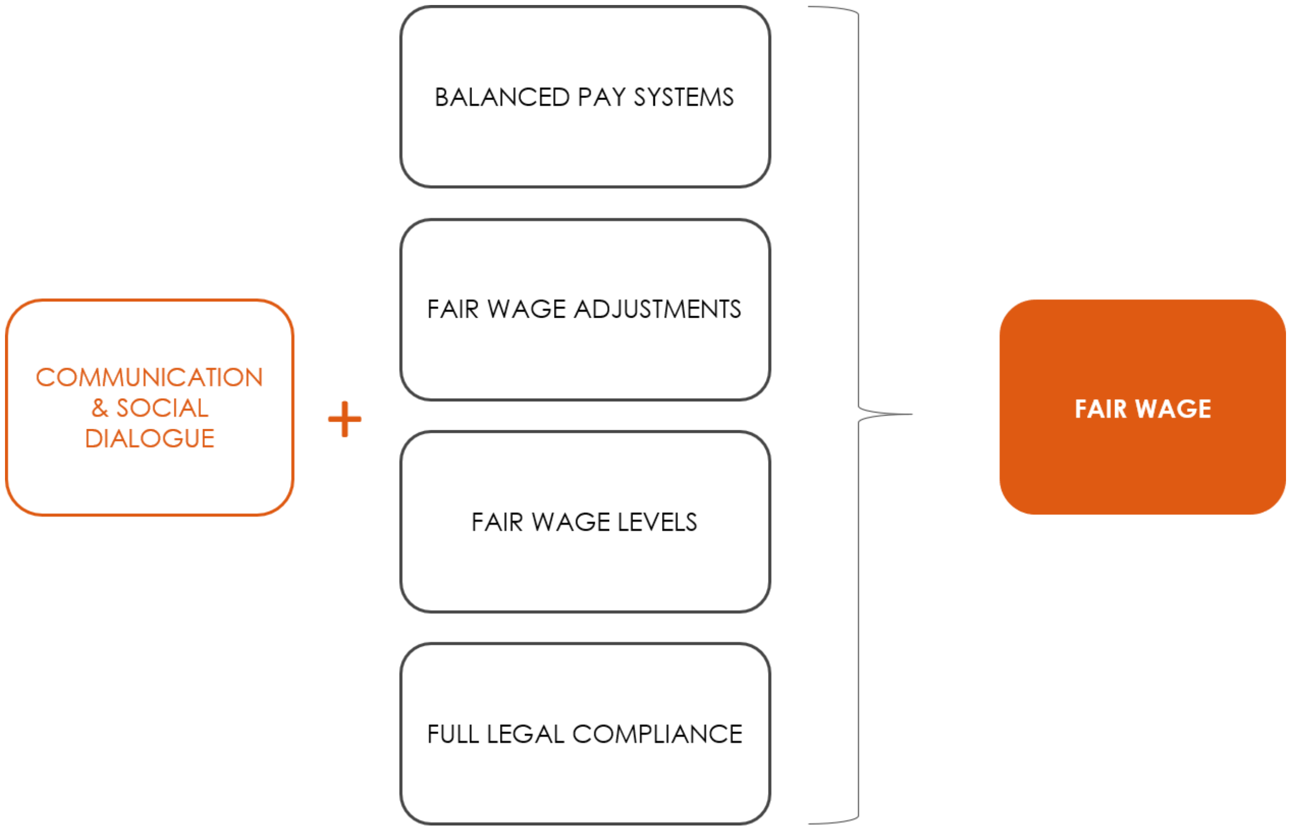
GROWING A CORPORATE CONSCIENCE

Whether the IPPR's specific recommendations ever become law or not, the principle of communicating openly about your approach to fair pay shouldn't just about ensuring that you fulfil legislative requirements.

When we think about fair pay, we typically think of it in isolation – whether about gender pay reporting or paying the living wage. However, with reference to the section above on changing expectations of organisations and their ESG considerations, we need to create a strategic intent around fair pay so it is more than achieving a single number and ensure that it fits into the wider agenda of responsible reward, to help companies achieve sustainable progress on a number of fronts.

A framework for fairness

One way of doing this is to create a fair wage framework – the one below is taken from work done by Daniel Vaughan-Whitehead, the founder of the Fair Wage Network. The idea is that you pull together various factors, not just ensuring minimum legal compliance, but enhance it with pay equality and paying at market rate, ensuring pay systems are fair and adjusted so that fair pay today does not become unfair tomorrow. But most importantly, supporting this with communication and social dialogue.



Source: Fair Wages – a key to effective social capital management, Daniel Vaughan-Whitehead (Founder of the Fair Wage Network)

An example – Unilever

To highlight what this looks like in practice, Unilever have created what they call a ‘framework for fair compensation’.

In essence, it’s a set of reward principles but the underlying concept is fairness. They talk about ensuring that the pay for employees is set at a level that is both fair and liveable, and provides equal pay for equal work. It covers their overall compensation processes and provides a structured way to outline how the various elements of their reward package deliver fair pay to all employees.

The Unilever framework for fair compensation

Compensation based on over-arching principles:

- Fair and liveable
- Market-based
- No discrimination
- Performance focus, providing alignment to our business
- Open and explainable

The aspect we like most however is that they have set themselves targets to achieve within it and they publish their progress on their website. For example, one of their earliest ambitions was to ensure that all employees have sufficient guaranteed fixed earnings to ensure they earn the living wage and bar 611 employees, they achieved this ahead of schedule.

RESPONSIBLE REWARD - WHAT CAN YOU DO?

We think it is vital to look at reward holistically and take a strategic perspective when you consider fair pay.

But before you dive and in write a new set of fair pay principles, we would suggest that you stand back and look not just at the different numbers legislation requires us to define, but think about the true application of reward in your organisation as it stands right now.

Ask some thought-provoking questions about how reward is really perceived. Is that CIPD statistic (p.8) true in your organisation?

Some starting points

- What do you communicate? Most often a sense of unfairness comes from lack of understanding about the true picture
- What do your employees feel about reward in your organisation? Do they really understand how things work? How well do you listen to employee concerns that things are unfair?
- Confidence and trust in the intent – has the intent been explained? What has been put in place to engender confidence that fairness is important in your organisation?
- Have line managers been trained to manage the process fairly? Do they understand it and can they explain to their teams on what basis pay or bonus is decided?
- Ability to influence the outcome – anything seen as a foregone conclusion will always seem unfair. Do employees understand how they can influence their pay? Do managers feel their input matters?

Focus on addressing some of these through open communication. Only when people really understand how pay works will they trust it is fair.

GET IN TOUCH

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