FROM ETHICAL CONSUMER for CO-OPERATIVE RENEWAL

One Society is a new campaign group, set up in 2009, with the aim of "raising the issue of income inequality higher up the political agenda."

According to its statistics, the pay gap between the boardrooms of Britain's top companies and the shop floor nearly doubled between 2000 and 2009.(2) This mean that, in the current recession, people at the bottom will be hit far harder than those at the top.(1)

"One of the things that's very shocking is that, within the space of about ten years, the multiple of chief executive pay to average pay for FTSE companies, has moved from 69 times, to 149 times,"(3) says Duncan Exley, One Society's Campaign Director. And that's just a comparison with average pay, not those paid at the very bottom of the scale.

This increase has happened despite the fact that there seems to be very little evidence supporting the "existence of a meaningful relationship between executive high pay and [long-term] company performance".(4) The New Economics Foundation (NEF) has also argued, in its comprehensive 2010 report on pay ratios, that unless the pay discrepancies are tackled, "by 2030 the UK will have returned to Victorian levels of inequality."(4)

## The problem

Many of us think that it's morally wrong to have people at the top paid so much more than those at the bottom. However, whatever your moral position, there are also plenty of other reasons why huge pay discrepancies are important. "These huge differences between pay are behind a whole range of destructive trends in society" says David Boyle, one of the co-authors of NEF's report.(5)

Exley agrees. "There are direct correlations between high income ratios and various social and health problems, as documented in a recent book called "the Spirit Level: Why More Equal Societies Almost Always Do Better." The Spirit Level describes how health and social problems, including everything from life expectancy and infant mortality to imprisonment, teenage births and mental health issues, are worse in more unequal countries.(6)

One Society also points to a range of other ways in which high pay ratios negatively impact on companies and on society.(7) These include:

A correlation between high income inequality and low social mobility. (7)

Damage to company performance:

The assertion that high pay is necessary to motivate, recruit & retain 'top people' is contradicted by evidence, says a One Society briefing.(7) In fact, Exley claims that "there is a proven correlation between high pay ratios and lower company performance".(3)

Productivity is reduced by high pay ratios.(7)

Low pay costs the tax payer around £6billion a year in benefits and foregone revenue. (7)

Low pay contributes to poverty-related negative health impacts, costing the NHS in excess of £5.5 billion a year. (7)

## What are pay ratios & how are they worked out?

There isn't one way of working out pay ratios, but the simplest is to look at the difference in pay between those at the top of the company, and those at the bottom. "The problem with this is that you could just sack all of your lowest paid workers and that would immediately lower the ratio" says Boyle. To prevent that from happening Boyle says that there needs to be "some sort of agreed rule on how it's worked out, and it needs to include everyone – not just employed staff, but contract staff too".(5)

Another way of calculating pay ratios is to look at the difference between the CEO's pay and the rate at the midpoint of a company's pay range. This ratio is enshrined in US law and would allow direct comparisons between UK and US companies. However, the disadvantage of this calculation is that "it takes the attention away from the lowest paid in the company". It's also harder to calculate. However, even a median to top ratios can produce "eye-watering ratios", says NEF.

A third way of calculating pay ratios is to look at the lowest tenth to the highest tenth of those in a company. However, NEF thinks that this compromise position combines the disadvantages of the first two methods, and the complex formulation required "seems unlikely to capture the imagination of the public".(4) This method will also not reveal "the full extent of organisational inequality" says NEF.(4) What's important, says NEF, is that "however ratios are worked out, they should include only UK-based staff and also report on salaries of those earning more than chief executives". (4)

## What are the recommended ratios?

"We don't have a position on a one-size fits all pay ratio" explains Exley. "Some companies, because of the industries they work in, will always have higher pay ratios than other.

For example, a complex company like Tesco, which has a lot of low-skilled and unskilled workers would expect to have a higher paid CEO and lots of people on lower pay".(3) Meanwhile, a small investment bank where most employees are highly skilled will have a smaller ratio. Instead, Exley recommends that we look at a company's ratio and compare it to other, similar companies. (3)

However, although there is no general agreement of what an ideal pay ratio is, there are some recommendations. The US Church Investor's Group recommends that the ratio between the chief executive and the average pay of the lowest 10% of employees should never be higher than 1:75.4

A much smaller ratio has been adopted by the GLA, which has committed itself to a ratio of 1:20 – with a long term goal of making this even smaller at 1:10.2 The banker JP Morgan is quoted as saying that no one at the top of a company should earn more than 20 times those at the bottom. "We're a long way off that", says Exley, pointing to the current rates in FTSE companies of being around 149 times average pay.

## What should be done

However pay ratios are worked out, what is agreed is that a move towards more transparency is important. Disclosing ratios can be useful for shareholder activists and for investors who wish to avoid companies with the largest gaps between those at the top and the bottom. However, at this point, companies are still too 'embarrassed' says Boyle, to publish their ratios. "They're aware that there's a problem, but it's hard for them to act alone to reduce those pay ratios", he says.

One Society has been trying to gather pay ratios from the FTSE 100 companies and top high street companies. This information will feed into a campaign with the Equality Trust later on in the year. However, Exley confirms that companies aren't proving too keen to respond to such requests. "Only a minority of companies have responded with the information" he reports.(3)

One Society, The Equality Trust and NEF all agree that expecting companies to voluntarily disclose the information is going to be tricky and all support legislation forcing companies to be more open. "We propose that legislation does not just require disclosure", (and include contract staff) "but that the ratio should be published on the front of the annual report in a common and comparable format" says NEF.(4)

The Future

Of course disclosing pay ratios is only the first step towards tackling the problem. “It’s necessary so that we can monitor the scale of pay ratios, see where they are highest and see where high executive pay is at the expense of low employee pay, but it’s not sufficient” says Exley. “Once they’ve revealed the pay ratio, it will take pressure on those companies, from everyone from the media through to investors and consumers”.(3) NEF believe that disclosure of pay ratios would potentially shame or guide the corporate world “into more equitable arrangements”.(4)

Even though the UK has one of the biggest pay gaps in the developed world, and there’s still a long way to go, “there’s still potential for making moves in the right direction” says Exley optimistically.

He argues that it wouldn’t need thousands of companies to address ratios in order to have a positive effect. “The benefits could be very quick” he says. “Addressing pay ratios is not just about cooling the extremely high pay at the top, but also about making sure there’s fair pay at the bottom of the scale. A small amount of money put in the pay of someone at the bottom of society, will make more of a difference than a few more pounds would to a company chief executive”.

Improving pay that will not only mean people will have a better standard of living but also have a positive impact on the rest of society. Exley says that, according to the Equality Trust, “even a quite small decrease in inequality has quite a large impact on things like the levels of violence, for example”.(3)

“The real crux of this is that people who are chief executives probably aren’t worth a couple of hundred times more than the worth of someone else.

To say that someone who is stacking the shelves at the supermarket is worth less than half a percent of someone is worth – really? Is any human being only worth half a percent of what another one is worth?”(3)

## Examples of pay ratios

Thumbs up

The Royal Navy used to have a ratio of lowest-to-highest of just 1:84

Scott Bader Commonwealth (a type of co-operative) has a maximum differential between highest and lowest of 1:74

Software firm Autonomy’s chief executive’s salary was just 9.5 times larger than the firm’s average. (1)

US chain Whole Foods has a ratio of 1:19.4

Thumbs down

Bart Becht, chief executive of Reckitt Benckiser: 1,374 times the average pay of its workers.(1)

Reckitt Benckiser brands include Airwick, Cillit Bang, Dettol, Disprin, Finish, Gaviscon, Harpic, Lemsip, Nurofen, Sweetex, Vanish, Veet and Woolite.

Frank Chapman, CEO of British Gas: 1081 times the median national wage. (1)

Bob Diamond, CEO of Barclays: 1,042 times the median national wage. (1)

Sir Terry Leahy, boss of Tesco: more than 900 times more than Tesco's average worker. (1)

Nick Buckles of security business G4S: 328 times the company's average staff salary. (1)

## Taking action

75 MPs in the new parliament have signed the Equality Pledge committing them to 'narrowing the gap between rich and poor'. Contact your MP and encourage them to sign up. You can do this through the Equality Trust website.

Avoid the products of Reckitt Benkiser (see above) and tell the company why you're doing it. (103-105 Bath Rd, Slough, Berkshire SL1 3UH) Also check Ethical Consumer's Anti-social finance column on its buyers guides for high director's pay.

## Ethical Consumer's position on pay.

At Ethical Consumer, we have been including excessive directors' pay in all our 180 buyers guides through a negative mark in the 'Anti-Social Finance' column - and thus our ethiscores - since 1997. This records, where the information is available, any director paid more than £1 million per annum.

Although a campaign to force disclosure of pay ratios via legislation is absolutely right, its likelihood of success is not high precisely because of current levels of corporate influence over the regulatory process (witness the recent failure to enforce environmental reporting through company law in the UK).

Because of this we urge the campaign not to forget the key role that organised consumers can play as 'key decision-makers and influencers' and to consider running such an awareness campaign in tandem. We have suggested avoiding the products of Reckitt Benkiser as a symbolic first step above.

At Ethical Consumer we also track absolute pay - across the world's supply chains - with negative marks appearing in our 'Workers Rights' column for 'payment of wages below that of an adequate living'. Although pay ratios in the UK are important, even greater discrepancies can exist between workers for the same company in different countries. Contemporary ethics is moving away from a concern solely for those with our own national boundaries and towards all people globally.

## Contacts and more information

NEF's report, The Ratio

One Society works with policy-makers, employers and other decision-makers and influencers who have significant power to affect rates of income inequality. www.onesociety.org.uk It was set up by the Equality Trust and Network for Social Change. Its report on pay ratios is now available to download.

Read "The Spirit Level: : Why More Equal Societies Almost Always Do Better" Wilkinson, R. & Pickett, K. (2009). London, Allen Lane.

**References**

**1 Guardian Pay gap widens between executives and their staff, Guardian 16/9/2009 http://www.guardian.co.uk/business/2009/sep/16/guardian-executive-pay-survey-ratios**

**2 Top Pay/Income Inequality Issue Mapping PDF, One Society, downloaded Aug 2011 www.onesociety.org**

**3 Interview with Duncan Exley of One Society, 18th August 2011**

**4 NEF The Ratio Common Sense Controls For Executive Pay And Revitalising UK Business, July 2010.**

**5 Interview with David Boyle 23rd August 2011.**

**6 The Spirit Level, Wilkinson, R. & Pickett, K. (2009). The Spirit Level: Why More Equal Societies Almost Always Do Better. London, Allen Lane.**

**7 One Society briefing, "Policies For The Good Company: Managing the adverse effects of excessive pay inequality on business, society & economy"**

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