Why the Living Wage Pays Dividends: The Case for the Living Wage

This briefing provides information for investors on the benefits of the Living Wage. The new Living Wage rates announced in November 2017 are £10.20 / hour for London and £8.75 / hour for the rest of the UK.

The application of real Living Wage standards by UK companies leads to increased business performance, reduced staff turnover and enhanced corporate reputations. Since the turn of the century it has also lifted over 150,000 families out of working poverty.[1]

Since 2011, ShareAction has co-ordinated a collaborative investor initiative to encourage all FTSE 100 companies to apply Living Wage standards in their UK operations (the Investor Collaborative for the Living Wage). While only two of the FTSE 100 were Living Wage employers in 2011, today that figure stands at 34 fully accredited employers, with an additional 12 fully applying the Living Wage standard but that have not yet accredited. 15,000 employees have positively benefited as a result of FTSE 100 Living Wage accreditations.

This briefing provides information on: the Living Wage standards; the impact for investors; benefits to businesses of being an accredited Living Wage employer; the macro-economic benefits arising from the application of Living Wage standards; and the opportunities to participate in the Investor Collaborative for the Living Wage.

The Living Wage

What is the Living Wage?

The Living Wage is the minimum hourly wage necessary to provide housing, food and other basic needs for an individual and their family. The rates are calculated annually by the Resolution Foundation and are overseen by the Living Wage Commission, based on the best available evidence about living standards in London and the UK.[2] The London Living Wage is currently £10.20 per hour. Outside of London, the UK Living Wage is currently £8.75 per hour. These provide workers with a better standard of living than the mandated minimum wage, which ranges from £3.50 for apprentices through to £7.50 for those over 25 year olds.

Living Wage employers

Living Wage employers ensure all their own staff and those of on-site contractors working on their premises are paid at least the real Living Wage across the UK. The Living Wage Foundation (operating independently of ShareAction) provides technical support and advice on implementation of Living Wage standards and administers the accreditation scheme for compliant employers. Accreditation fees are charged on a sliding scale. The highest fee is £3,000 per annum.

Since the launch of the Living Wage Foundation in 2011, momentum has been rapidly building for the Living Wage. Over 3,600 employers in the public, private and voluntary sectors have become accredited Living Wage employers, including 34 of the FTSE 100. The earliest Living Wage accreditations were London-based employers in professional and financial services. However, Living Wage standards are increasingly becoming a norm for socially sustainable business behaviour and today are applied across the UK in a wide range of sectors, including household names such as Unilever, Nestlé and ITV. ShareAction anticipates further high-profile accreditations in the coming year.

> “Why should we give our drivers, mechanics, guys who sweep the yard and wash the equipment much better pay? Because we are dependent on every single one of them doing relatively routine tasks on a very regular basis. There is no substitute to that.
>
> GEOFF DRABBLE, CEO, ASHTEAD[3]

ShareAction’s initiative began when only two of the FTSE 100 were accredited Living Wage employers. Through investor engagement and dialogue with the Living Wage Foundation, 34 of the FTSE 100 are now accredited as Living Wage employers; while another 12 state that they apply the standards but have not yet accredited. A majority of the FTSE 100 firms are now in dialogue with investors on the issue. The case for investor engagement as explored in the next section is based upon a combination of corporate risk management, business benefits, commitment to corporate citizenship, and wider societal and economic benefits.

The political landscape

The Living Wage has widespread public support from across the political spectrum. Former Prime Minister David Cameron said: “Where companies can afford to pay the Living Wage, I think they should.”[4] In the 2015 Summer Budget, then-Chancellor George Osborne announced a new compulsory wage-floor for workers over 25 years of age as the ‘national living wage’. Since April 2016, this has taken effect as a minimum wage, which in 2017 increased for over 25s to £7.50 per hour. Thereafter, it is expected to reach 60% of median earnings by 2020. Under current forecasts this means a rise to less than £9 an hour by 2020 for those over 25.

There are a number of key distinctions between this national wage-floor and the real Living Wage standard. Firstly and most significantly for investors, the Living Wage standard as established by the Living Wage Foundation is a voluntary measure. Compliance with the government’s ‘national living wage’ is compulsory. So, while a company’s publicly stated views may be relevant for reputational risks and non-compliance is clearly a legal risk, compliance at this level does not provide the same insight for investors as a differentiator between different firms’ levels of investment in staff and thus wider human capital management.

Secondly, there is a clear difference in the impact of the two standards. The calculation of the ‘national living wage’ is not based on the costs of living, but is rather an aim to match 60% of average earnings by 2020. At no point so far forecast will the rates cover the costs of living as determined by the Minimum Income Standards.[5] There is also no distinction made for London’s higher costs of living, while the lower levels of pay for apprentices and those under 25 sets a large portion of those in-work at a financial disadvantage.

The investment case for the Living Wage

Investor interest in the Living Wage

Investor interest in the Living Wage can be broken down into several factors:

1. The Living Wage can be viewed as a wider indicator of a firm's comprehensive approach to human capital management.
2. The operational benefits to a business, which can translate into increased returns for an investor with a long-term perspective. These benefits primarily affect productivity through improvements in morale, absenteeism and retention.
3. The reputational benefits to a business and accompanying reputational risk management. The reputational benefits are primarily through increased consumer and staff awareness of a company's commitment to their workforce and society, leading to increased consumer loyalty, improved recruitment and retention.
4. The macro-economic level benefits from increases to consumer spending. These are particularly relevant to asset owners that have a stake in the wider economy.

The Living Wage and human capital management

The materiality of human capital management practices has been quite widely accepted among the investor community. As a report by the Pensions and Lifetime Savings Association suggests:

> *"Good management of, and investment in, a company's workforce should enable a company to be more stable, lower risk and have higher expected future cash flows. Conversely, a negative organisational culture, poor people management and inadequate training are widely recognised as having played significant roles in numerous corporate failures over past decades."*[6]

But despite this widely held understanding, investor engagement on this issue was limited due to the lack of available data and comparable reporting.[7] The Living Wage has thus been a useful indicator for a company's wider approach to investing in staff, as adopting the Living Wage is often an indicator of a corporate culture which values human capital management.

In particular, accompanying the higher wages with other investments in operations management has been shown to create productivity benefits. For example, Zeynep Ton, of the MIT Sloan School

THE ONLY UK RATE BASED ON LIVING COSTS

Explaining UK Wage Rates

	THE MINIMUM WAGE Government minimum for under 25s	NATIONAL LIVING WAGE Government minimum for over 25s	REAL LIVING WAGE The only wage rate based on what people need to live
WHAT IS IT?	£7.05	£7.50	£8.75 across the UK and £10.20 in London
IS IT THE LAW?	Statutory	Statutory	Voluntary
WHAT AGE GROUP IS COVERED?	21 and older	25 and older	18 and older
HOW IS IT SET?	Negotiated settlement based on recommendations from businesses and trade unions	A % of medium earnings, currently at 55%, it aims to reach 60% of median earnings by 2020.	Calculation made according to the cost of living, based on a basket of household goods and services
IS THERE A LONDON WEIGHTING?	No London Weighting	No London Weighting	Yes - Separate higher rate for London

Information and image courtesy of the Living Wage Foundation of Management, documented the advantages for large retailers which have moved away from the typical retail sector model of low pay and low levels of training. She found that companies which invest in employees as an asset rather than focusing solely on minimising the cost of wages, can realise benefits to labour productivity, customer service, cost-cutting, innovation, and flexibility.[8] The improvement that the UK Living Wage brings in operations flexibility is confirmed in key surveys of employees impacted.[9]

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>
> THE PENSIONS AND LIFETIME SAVINGS ASSOCIATION

The GLA Economic survey, for example, found that half of those employees surveyed said that they “felt that the Living Wage had made them more willing to implement changes in their working practices; enabled them to require fewer concessions to effect changes; and made them more likely to adopt changes more quickly.”[10] A study of the implementation of the Living Wage at Queen Mary University London by Jane Wills and Brian Linneker, likewise reported that staff were more able to “facilitate workplaces changes.”[11] This increase in flexibility was also confirmed in an earlier study by Jane Wills with Nathalie Kakpo and Rahima Begum which found that 61% of respondents reported that they now “do a broader range of tasks.”[12]

Zeynep Ton of MIT Sloan School of Management notes:

> *“Highly successful retail chains … not only invest heavily in store employees but also have the lowest prices in their industries, solid financial performance, and better customer service than their competitors. They have demonstrated that, even in the lowest-price segment of retail, bad jobs are not a cost-driven necessity but a choice. And they have proven that the key to breaking the trade-off is a combination of investment in the workforce and operational practices that benefit employees, customers, and the company.”*[13]

Business benefits – operational

Adopting the standard has been found to create benefits at all levels of company operations, which can offset costs of adoption and lead to long-term improvements. It has been challenging to measure long-term improvements as companies have, until recently, not had the Living Wage in place long enough for the benefits to be measureable and, as mentioned above, the Living Wage often accompanies wider workforce management practices making the effects of the Living Wage alone difficult to separate.

However, evidence in support of the business case for the Living Wage is beginning grow. Recent figures from Cardiff Business School, which conducted a survey of over 840 accredited Living Wage businesses, found that 93% reported they had gained as a business after becoming a real Living Wage employer.[14] 80% of employers surveyed in a GLA Economics survey of Living Wage employers believed that the Living Wage had enhanced the quality of work performed by staff.[15] In the survey, all employers reported that they would, if faced with the same choice today, implement the London Living Wage.

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>
> GLA ECONOMICS

One of the key areas where employers have seen benefits from Living Wage implementation is in recruitment and retention. 53% of companies surveyed by Cardiff Business School this year noted improved recruitment of employees into jobs covered by the Living Wage.[16] The GLA Economics survey of 11 accredited employers found a positive impact on recruitment and retention of staff for all but one employer consulted.[17] Two-thirds reported that the Living Wage had a significant impact on reducing staff turnover.[18] KPMG for example found that "turnover has more than halved" for contracted staff.[19] Wendy Cuthbert, head of UK corporate real estate services for Barclays Group, reported that catering staff retention rates increased from 54% to 77% following an introduction of the Living Wage and cleaning staff retention rates jumped from 35% to 92%.[20] One Living Wage accredited employer surveyed by ShareAction, for instance, found that particularly for their housekeeping services it had a positive impact on retention. In comparison to the industry average for attrition of 60%, at this firm it is 8%.

For service-providing or consumer-facing businesses, as well as reducing the costs of recruitment and training, a lower turnover helps ensure customers are satisfied and return. Kevin Prince, the general manager at Space Station Group self-storage centres reported that: "Every time we lose a member of staff it costs us around £20,000 in lost business." Space Station pays above the Living Wage because, "if you have to spend evenings short staffed because people come and go and you can't recruit good quality, and people use your service just once and then never come back, then suddenly that [extra] pound an hour seems very cheap business."[21]

Similarly, the Living Wage has been shown to reduce absenteeism and improve morale in the workplace. A study by Jane Wills and Brian Linneker of Queen Mary University concluded that the Living Wage leads to reduced reports of sickness in Living Wage workplaces.[22] One employer surveyed by GLA Economics reported that following the introduction of the Living Wage for workers employed through contractors, absenteeism fell by as much as 25%.[23]

On the related issue of employee engagement, Dominic Johnson, Employee Relations Director of Barclays describes the impact: "When you look at employee engagement and what drives organisational performances, there's a rational dimension and an emotional dimension. Pay is part of the rational dimension, but it is the emotional dimension of 'do I feel valued' that drives people behaviour… Paying at or above the Living Wage is a key part of that."[24]

Cardiff Business School's 2017 survey found that Living Wage accreditation increased the commitment and motivation of Living Wage employees in 57% of companies. The 2013 study, Investigating the effect of the London Living Wage on the psychological wellbeing of low-wage service sector employees: A feasibility study, showed that 50.3% of Living Wage employees had above average wellbeing compared with 33.9% of non-Living Wage employees.[25] In the Wills and Linneker survey of staff who were working at a company when it transitioned to the Living Wage, the most common impact reported was that "people are happier about the work."[26] GLA Economics similarly found that the Living Wage "significantly boosted worker morale and motivation."[27] Elaine MacLean, Group HR Director at Legal & General noted: "The big difference was the impact on morale across all employees … it just made everybody feel good about working for a company that had taken the time to address the issues of the Living Wage."[28]

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DOMINIC JOHNSON, EMPLOYMENT RELATIONS DIRECTOR, BARCLAYS

These benefits can materially translate back to investors. For instance, Schroders Asset Management calculated that the retail sector – with both the most costs and most exposure to the productivity issues associated with low pay – would have material costs to implement the Living Wage. However, "the potential savings achieved through lower absenteeism and lower turnover offsets between 16% to 36% of these additional costs."[29]

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>
> ELAINE MACLEAN, GROUP HR DIRECTOR, LEGAL & GENERAL

A survey of Living Wage employers in the FTSE 100

As a part of the engagement with the FTSE 100 over AGM season of the Investor Collaborative for the Living Wage led by ShareAction, accredited Living Wage employers were surveyed about the impacts adopting the Living Wage has had on their business in terms of:

- Numbers of staff affected
- Changes in headcount
- Changes in numbers of hours in staff scheduling
- Use of zero-hour contracts
- Absenteeism, turnover, retention, productivity, consumer relationships, and attraction of candidates in recruitment
- Morale
- Reputation of the firm.

Across the 12 companies that participated, clear patterns emerged. Regarding the positive impacts, many firms emphasised that these metrics did not explain their rationale for becoming a Living Wage employer, rather this decision formed part of a wider corporate culture of valuing staff and giving back to the community. Thus, many did not collect this data or found it difficult to attribute causation to their decision to adopt the Living Wage. Several firms noted that their implementation of the Living Wage was too recent to have generated real data. But despite this, all companies except one felt distinct positive impacts and no negative impacts were found, including changes in headcount, reduction in hours, or use of zero-hour contracts.

The overwhelming impact noted was in morale, described often as a reinforcement of pride amongst staff. This is clearly difficult to measure but firms indicated that they believed this assisted in attracting candidates in recruitment, and employee engagement. Particularly amongst contracted staff, it was noted that they felt that the Living Wage assisted in improving service levels, productivity and retention. Several employers also noted that they had received positive feedback from their stakeholders, including shareholders.

Business benefits – reputational

The increase in momentum for the Living Wage is arguably connected with growing concerns over income inequality by citizens, the media and policy-makers. In particular, the disparity in earnings between top executives and low-paid employees has been increasingly making headlines. The Living Wage serves as a tool to mitigate the associated reputational risk. Proactive management of this risk is being welcomed by many shareholders, particularly those investors that have managed their own risk exposure to the same concerns by becoming a Living Wage employer. As one SRI Fund Manager stated: “Failing to provide a decent living wage and safe working conditions is unacceptable for any company in any sector. Consumers understand this. There exists a clear financial opportunity for companies that take a lead, and considerable risks for those who do not.” Moreover, the up-front cost of this mutually beneficial risk management can be seen to be relatively modest in comparison with the potential risk of pay-related reputational damage, particularly for consumer-facing businesses.

Being an accredited Living Wage employer is fast becoming an established mark of commitment to corporate social responsibility, bringing powerful reputational benefits. A record number of people are employed in the UK[30] yet, 60% of those experiencing poverty are in working families.[31] 58% of Londoners in poverty live in a working household; a 50% increase over the past ten years.[32] KPMG has calculated that nearly 1 in 5 UK workers (21%), an estimated 5.5 million people, were not paid the real Living Wage in 2017.[33]

With a growing public debate over the cost of living, companies which publicly become Living Wage employers can improve their relationships with consumers and attract higher quality candidates for recruitment.

In contrast, those in the spotlight for low pay are increasingly facing reputational damage. Speaking to the particular attention on the retail sector and the debate about broader rewards versus base hourly rates, Maureen Hinton, Global Research Director at retail research agency Conlumino, said "The top line figure is how much you are paying staff. From a PR point of view, it's putting the traditional [supermarkets] who have offered all these benefits in a tricky position."[34]

Cardiff Business School found that accreditation increased the reputation as an employer for 86% of companies surveyed.[35] The reputational benefits, in addition to the higher wages offered, contribute to attracting higher quality candidates for positions as described by the FTSE 100 companies surveyed. For example, the decision of Gap to increase hourly wages in the US is reported to have grown the number of applications by at least 10% overall and more so in some stores.[36] Sandy Begbie, Group Operations Officer of Standard Life, similarly reported that: "Being a UK Living Wage employer has supported us in attracting high quality candidates who want to stay and we are also seeing a positive impact on our employee engagement and the overall quality of the work we do."[37]

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>
> SANDY BEGBIE, GROUP OPERATIONS MANAGER, STANDARD LIFE

By collaborating as shareholders to call for the UK's largest listed companies to apply the Living Wage standard, institutional investors are making clear that application of such standards is an important practical demonstration of the corporate citizenship values espoused by most FTSE100 companies.

Economic growth

The remuneration practices of employers impact the wider UK economy by determining consumer spending power. Paying wages that meet the rising costs of living stimulates the economy by adding materially to consumer spending power and confidence at a time when this is a particularly vital determinant of business success and profitability. Investors with a well-diversified portfolio of UK stocks therefore have an interest in promoting the payment of Living Wages.

It is argued that increasing wages for those with low spending power stimulates the economy more than stimuli at other income levels because consumers on low wages spend the vast majority of their income immediately.[38] The Bank of England for instance found that the marginal propensity to consume out of income is higher for lower income households than for high income households.[39]

Moreover, this spending tends to support the local economy. A U.S. study showed that low-paid Chicago workers spent their entire minimum wage increases in the local economy while a 2005 study by Staffordshire Business School showed that for every extra £1 per hour paid to low-paid workers in Stoke on Trent, the local economy benefitted by an additional £0.63 of income creation.[40] This multiplier of £1.63 found in Stoke on Trent is consistent with studies in other regions of the UK.

Perceived Barriers

The cost of implementation

Assuming a 37.5 hour week for a 25 year old, their annual pay would increase from £14,625 at the national living wage of £7.50 to £17,062.50 at the UK-wide Living Wage rate of £8.75. Thus excluding costs in additional National Insurance and pensions contributions, the cost to an employer is £2,437.50 in additional wages. Companies which outsource cleaning, catering and other facilities services must require their contractors to pay at least the Living Wage to qualify for accreditation. Where low-paying services are outsourced, the cost of introducing Living Wages is often shared between contractor and client. The research cited above has shown that implementation costs can be offset by a range of cost-saving strategies.

Employment effect

The Living Wage is a voluntary commitment made by employers who choose to make it a priority and can afford it. This mitigates against the risk of negative employment effects. As stated above, the payment of Living Wages helps to increase spending power in the economy, which also boosts job growth. Modelling by the Resolution Foundation has shown that even in a scenario in which all private sector employers in the UK were forced to pay the Living Wage, the impact of the Living Wage on employment would then be less than 4% of the four million employees in the private sector that would benefit from the pay rise.[41] They state that this figure represents a worst case scenario for employment and it does not take into account the beneficial macro-economic impacts nor the business benefits earlier discussed. The Resolution Foundation notes that this same predictive model would have foreseen that the introduction of the national minimum wage led to the loss of 22,000 jobs, but in fact Low Pay Commission research suggests that there were no job losses associated with the introduction of the National Minimum Wage.[42]

Contractor relations

For most of the FTSE 100, the great majority of direct employees are paid above the Living Wage rates. It remains the case, however, that staff employed by contractors on a non-Living Wage employer's UK premises, such as cleaners, security guards, and catering staff, are likely to be paid below Living Wage rates.

Some listed companies have raised concerns over their capacity to ensure Living Wages for staff employed through contractors, given the indirect employment relationship. Though implementation for contracted staff requires an extra step of contract renegotiation, the Living Wage Foundation provides considerable support in the practicalities of this. The 3,500 accredited Living Wage employers, including those with complex supply chains such as National Grid, which have extended the standard to their contracted staff, illustrate that this is clearly possible and any complications are surmountable. Many accredited employers stated in their responses to the ShareAction survey that they found introducing the Living Wage was received very positively by their suppliers and discussions with companies working towards the Living Wage have shown often that these conversations can be very positive in building the relationship between a supplier and the client firm.

Moreover, the impact of implementing the Living Wage standard for on-site contracted staff has been shown to stimulate benefits across all levels of company operations. In the case of cleaning staff in particular, a 2014 report by the Equality and Human Rights Commission cites that cleaning firms consulted on the impacts of the Living Wage reported that they benefited from reduced absenteeism and staff turnover. They add that, "Some firms reported that since paying the Living Wage their turnover has reduced to less than 1 per cent. This has a positive impact for clients, who also reported that payment of the Living Wage has led to an improved service, with higher productivity rates."[43]

The Investor Collaborative for the Living Wage

The Investor Collaborative for the Living Wage is a group of institutional investors who encourage UK-listed companies to adopt the Living Wage standard across their UK operations. Since the launch of this ShareAction-led initiative in May 2011, strong progress has been made. Investors in the Collaborative receive from ShareAction regular updates on engagement taking place with firms on the Living Wage, opportunities to participate in engagement, and details on new accreditations and notable developments towards implementations of the standards. We would be pleased to provide interested investors with these progress reports on FTSE100 companies.

Throughout 2016 and 2017 ShareAction has coordinated institutional investors to write jointly signed letters to the CEOs and other top executives of the FTSE 100 about the Living Wage in advance of their Annual General Meetings. Coupled with questions at Annual General Meetings on the topic of the Living Wage, this initiative sparked engagement with a majority of FTSE 100 companies on the issue, along with substantive progress in dialogue and implementation of the standards. The goal of the Collaborative is to have 75% of FTSE 100 firms become accredited Living Wage employers by 2020. The progress seen thus far is an encouraging indication that this is on track to be achievable. With nearly all of the FTSE 100 in constructive dialogue on the issue, it is important for coordinated engagement to understand past dialogue and sector dynamics. We would be very pleased to share this information on a confidential basis with investors seeking to engage to understand and promote the Living Wage.

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