



Pay ratios and income inequality

Risks, opportunities and best practice for voluntary & community sector organisations

1) Why should voluntary and community sector organisations (VCSOs) adopt a policy on pay ratios?

Reputation

There is growing public and political concern over what are seen as 'excessive' pay ratios. In 2010 the Prime Minister commissioned a review to consider ways of “*tackling disparities between the lowest and the highest paid in public sector organisations*”ⁱ and there are regular media articles exposing large pay gaps and high CEO salaries in the private sectorⁱⁱ.

Most VCSOs already have relatively narrow pay ratios, and therefore have an opportunity to promote this fact to potential supporters, funders, staff and others (further implications of this for securing income are explored below). The sector as a whole has significantly lower pay ratios than both the private and public sectors, as these figures show:

*Ratios of top pay to bottom pay*ⁱⁱⁱ

FTSE 100 companies	232:1
Local authorities	15:1
Charities with income over £50m	10:1

However, pay ratios in VCSOs are vulnerable to negative publicity^{iv}. Discussions about issues surrounding internships^v and the Living Wage^{vi} also have the potential to lead to scrutiny of VCSO policies (and possible legal challenges), especially in those organisations who provide public services, whose work is connected to poverty or inequality, or who are otherwise vulnerable to attack from those who disagree with their activities or beliefs.

Adopting a clear policy on pay and pay ratios can be a valuable tool in encouraging positive perceptions. It is also a crucial tool for enabling a swift and convincing response to any hostile scrutiny of pay issues.

Productivity

There is growing evidence that staff are less productive in organisations that have big gaps between top and bottom pay and where decisions on pay are felt to be unfair. A recent independent report for the Treasury found that “*A wide range of academic studies [...] suggest there is a strong correlation between narrower pay dispersion within an organisation and improved organisation performance [...] wide gaps between top and bottom pay within an organisation harm performance [...] there will be gains to morale and productivity in organisations where everyone is seen to be paid according to their contribution*”^{vii}.

Other studies show that staff who feel that their manager makes unfair decisions on pay are much more likely to feel disengaged from their work^{viii}, and that people with low relative status in the workplace (associated with low relative pay) are more likely even than people without jobs at all to suffer declining mental health^{ix}.

Although there are strong arguments that pay in VCSOs should not be linked to productivity measures (outputs often do not have measurable monetary value and/or may take years to realise, and there is a risk that targets reduce individuals' focus on the wider needs of the organisation) there is evidence that organisations with pay ratios that are seen to be proportional and fairly decided have staff who are happier and more engaged.

Alignment with organisational aims

There is obviously a very strong argument that any organisation which seeks to not contributing to the problem which it seeks to solve (or seen to do so).

However, pay is a major factor in general income inequality, and there is now increasing evidence that this is a strong driver of a range of health and social problems, including poor mental health, drug use, obesity, poor educational attainment, teenage pregnancy and violence^x.

VCSOs collectively have considerable influence, as employers and customers, to make a direct positive difference. The sector also has a vital role to play in setting a positive example that is later taken up in other sectors (Fairtrade being a good example of an idea that was first taken up by “churches & charities” and now has widespread participation from mainstream businesses).

Public contracts or statutory funding

Following the publication of the final report of the Fair Pay Review^{xi}, now being considered by Government departments and agencies, there are likely to be requirements or expectations that “organisations delivering public services” conform to elements of the “Fair Pay Code”, which makes recommendations on “Fair and Appropriate Pay Levels” and “Fair and Transparent Process for Setting Executive Pay”.

Other funders

Other funders have begun to discuss pay ratios and pay policies, which may therefore become criteria in funding decisions or requirements.

Legal

Some pay matters (e.g whether staff receive equal pay for work of equal value) have legal implications.

2) Elements of a pay ratio policy - recommendations

Calculating and reporting pay ratios

Organisations should report pay ratios annually, in line with the recommendation for public sector organisations as outlined in the Hutton Review of Fair Pay (“*publish their top to median pay multiples each year*”^{xii}). Median pay is the pay of the person who would be in the middle if all employees were ranked in order of earnings (as opposed to mean pay, which is the total pay of all employees divided by the number of employees). In organisations with an even number of staff, where the two employees either side of the mid-point earn different amounts, the average of those two employee's pay is the median. There is a link to a website which outlines a suggested method for calculating median salary in the endnotes to this document^{xiii}.

We recommend that organisations should also report on the ratio of top pay to bottom pay (for organisations with over 100 staff, preferably the average pay of the lowest-paid 10%). Pay ratios should be reported in the organisation's annual report, and made available on the organisation's website.

To avoid the production of misleading data, it is recommended that:

- ratios should include only UK-based staff
- rates of pay should be expressed in hour-for-hour terms (so that part-time staff do not distort ratios)
- expenses-only volunteers, apprentices and others exempt from minimum wage legislation should not be included in the calculation
- figures should include all pay that is received by the employee during the year, including any employer's contribution to defined-contribution pension schemes, bonuses etc.

(We understand from inquiries made to leading payroll software providers that the necessary calculations are not onerous).

We do not recommend a standard maximum pay ratio, due to the vast differences in the size and nature of VCSOs.

Low pay

Organisations should pay staff at least the current Living Wage^{xiv}. (Staff being anyone with set hours and duties).

Procurement and contractors

When awarding large contracts (and any contract which includes external staff working in the organisation's premises), organisations should ask suppliers if their pay ratios are reported and if staff are paid at least the Living Wage. This information should be considered as a factor in tendering decisions.

Pay policy

Organisations should adopt a pay policy, available to the public through the organisation's website, which outlines:

- Whether the organisation reports pay ratios
- Any policy for *managing* pay ratios (such as a current and/or target maximum ratio)
- Any policy on low pay
- Any policy on procurement
- Whether the organisation recognises a trade union and/or decides pay through collective bargaining.

Reviewing pay policy

Pay policy, including pay ratios, should be discussed annually at trustee / board meetings.

Other guidance

We recommend that organisations, especially those which currently or potentially deliver public services or receive statutory funding, should read the “Summary of full recommendations” and “Fair Pay Code” sections of the Hutton Review of Fair Pay in the Public Sector^{xv}.

For more general information and guidance for employers, the website of ACAS is recommended. (the independent Advisory, Conciliation and Arbitration Service “aims to improve organisations and working life through better employment relations” www.acas.org.uk)

3) Examples of good practice

There are no perfect examples, (though we expect practice to improve shortly as the recommendations of the Fair Pay Review are considered and implemented, especially by VCISOs) but the following are examples of some elements of good practice:

The Greater London Authority has policy to “*commit themselves to reducing the difference in pay between the lowest and highest paid staff to no more than 20 times, with a long term goal of no more than 10 times*”^{xvi} and reports its highest and lowest pay rates^{xvii}. All GLA staff, contractors and interns are paid at or above London Living Wage.

The Religious Society of Friends (Quakers)^{xviii} has a pay policy which commits them to ensuring that there is no more than a 4:1 ratio between the mid-point of the lowest and highest grade of their pay band.

We are keen to hear examples of good practice. See contact details below.

4) About One Society & LVSC

One Society's work is based on a wealth of research which shows that large divides in income at the top and bottom of society - beyond 'proportional rewards' - are damaging to our economy and society, not just those at the bottom but right the way up. We work to promote policy and practice which reduce excessive income inequality. One Society works in partnership with The Equality Trust.

32-36 Loman Street, London, SE1 0EH
020 7922 7922
www.onesociety.org.uk

LVSC is the collaborative leader of London's voluntary and community sector. We support London's 60,000 voluntary and community organisations to improve the lives of Londoners through policy, influence, training and advice.

London Voluntary Service Council, 4th Floor, 88 Old Street, London EC1V 9HU
020 3349 8900
<http://www.lvsc.org.uk/>

- i HM Treasury website: http://www.hm-treasury.gov.uk/indreview_willhutton_fairpay.htm
- ii One of the more notable was the *Guardian's* "Pay gap widens between executives and their staff"; (16 September 2009) Which revealed that the Chief Executive of Reckitt Benckiser in 2009 was paid 1374 times the average pay of the company's employees. (<http://www.guardian.co.uk/business/2009/sep/16/guardian-executive-pay-survey-ratios?intcmp=239>). Similar articles appear regularly, including one on the day this briefing was written ("How 299 CEOs earned more than 100,000 of their own workers put together: Executive pay skyrockets 23% in 2010" Daily Mail, 20 April 2011 (<http://www.dailymail.co.uk/news/article-1378649/Executive-pay-rose-23-2010-299-CEOs-earned-100k-workers-together.html#ixzz1KAtV2JWk>))
- iii Source: "How much is the big boss worth?" *Total Investor* (website) February 2011. (<http://www.totalinvestor.co.uk/i/press/show/701>) The figure for FTSE 100 companies is an estimate, based on CEO pay data from Companies House, compared with National Minimum Wage.
- iv For example, see "Excessive City pay culture seeps into charities" *Charity Times* (website), 10 November 2009 (<http://www.charitytimes.com/ct/charitypay.php>)
- v For example, see "Nick Clegg's social mobility scheme targets unpaid internships" *The Guardian*, 5 April 2011 (<http://www.guardian.co.uk/society/2011/apr/05/nick-clegg-social-mobility-strategy>)
- vi The most prominent campaigner for the Living Wage has been Citizens UK: (<http://www.citizensuk.org/campaigns/living-wage-campaign/>)
- vii "Hutton Review of Fair Pay in the Public Sector; Final Report", HM Treasury, March 2011, page 74 (http://cdn.hmtreasury.gov.uk/hutton_fairpay_review.pdf)
- viii Towers Watson, "2010 Global Workforce Study" (available from <http://www.towerswatson.com/global-workforce-study>)
- ix Butterworth, Leach, Stazdins, Olesen, Rodgers & Broom: "The psychosocial quality of work determines whether employment has benefits for mental health: results from a longitudinal national household panel survey" *Occupational and Environmental Medicine*, 2011 (<http://oem.bmj.com/content/early/2011/02/26/oem.2010.059030.abstract>)
- x A summary of the evidence is contained in Wilkinson & Pickett's "The Spirit Level", which cites "around 200 papers in peer-reviewed academic journals testing the relationship between inequality and health in many different settings, more than 50 papers on violence and inequality and quite a few on inequality in relation to trust and social capital". Wilkinson & Pickett; "The Spirit Level"; 2010 (second edition), Penguin, page 279
- xi "Hutton Review...", 2011
- xii "Hutton Review...", 2011, page 79
- xiii eHow.com: "How to calculate a median salary": http://www.ehow.com/how_5074590_calculate-median-salary.html
- xiv From May 2nd 2011, The Living Wage stands at £8.30 in London and £7.20 elsewhere in the UK. More information is available from Citizens UK (www.citizensuk.org)
- xv "Hutton Review ...", 2011, pages 79-83 and 85-92
- xvi "Assembly calls for cap on GLA senior pay" GLA press release, 16 June 2010. http://www.london.gov.uk/media/press_releases_london_assembly/assembly-calls-cap-gla-senior-pay
- xvii See under "Fair pay" at <http://www.london.gov.uk/jobs>
- xviii See <http://www.quaker.org.uk/>