Understanding business behaviour that supports inclusive growth

IGAU Responsible Business Report 1 of 2

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Contents

About this report: This report is the first in a series of two reports examining responsible business in the context of inclusive growth, produced by the Inclusive Growth Analysis Unit. A shorter Policy Briefing also accompanies the reports. All are available to download at www.mui.manchester.ac.uk/igau/research/reports

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1. Inclusive Growth: Why responsible business?

1.1 Overview

Business activity is central to economic growth and wealth creation. This means that any genuine model of inclusive growth needs to involve businesses. The promotion of responsible business behaviour through Environmental, Social and Governance (ESG) monitoring involves two main activities: screening and engagement.[1] Whereas screening involves assessing organisations against a given set of standards, engagement involves working with organisations to help the attainment of standards. This report, part of a series of two, considers the first of these topics through examining how responsible business behaviour can be defined from an inclusive growth perspective. To undertake this task, we reflect on the relationship between inclusive growth and existing social responsibility frameworks. Through this work we propose an Inclusive Growth (IG) Responsible Business Framework. Using the example of Greater Manchester, the second report goes on to consider what influencing strategies can be used in order to promote engagement with an inclusive growth responsible business agenda locally.

The research in these reports is based upon a series of consultation meetings in Greater Manchester on the topic of inclusive growth that were followed up by in-depth interviews with key local stakeholders. The reports represent a first effort to link the notion of inclusive growth to responsible business. As such, rather than a definitive account, they represent a work in progress intended to facilitate a broader conversation on the topic. Similarly, the reports do not claim to exhaustively cover existing social responsibility frameworks, or support available in Greater Manchester.

1.2 What is inclusive growth?

Inclusive growth is a relatively new term gaining traction because of growing evidence that increasingly prosperous nations or cities are not necessarily decreasingly poor or more equal. The key idea is that if we want to have societies that are more equal and have less poverty, we need to focus on the economy and the connections between economic and social policies. Strategies for investment and economic development, productivity, skills, employment and wage regulation are integral to attempts to achieving greater fairness and inclusion. Likewise, enabling

[1] Colison, D. et. al. (2009). FTSE4Good: Exploring its implications for corporate conduct. Accounting, Auditing and Accountability Journal, 22(1), 35-58.

more people to participate fully in economic activity is fundamental to developing prosperous and sustainable economies.

In this report inclusive growth is consequently defined as being about economic inclusion. It is important to differentiate this term as used here from social inclusion. Social inclusion debates in the UK in relation to economic inclusion predominantly have focussed on the margins of the economy such as increasing labour force participation or reducing poverty. Although important issues to an inclusive growth agenda, a discussion of growth and productivity requires a broader understanding of the ways in which economic value is created in the economy. From such a perspective, economic inclusion is concerned with how wealth is both created and distributed in society, such as through profits and pay, or redistribution via taxation, welfare and other public spending.

While the reduction of current levels of poverty must be a central objective of inclusive growth strategies, greater economic inclusion needs to be a majority concern, not just one for people who are currently on the margins of society[2]. This is important for a number of reasons. Firstly, inequality over the last four decades has seen the very richest move away from the rest in terms of their wealth- it is not just the poor who are being left behind[3]. Moreover, work is no longer providing a guarantee of economic inclusion. There are now more people living in poverty in working than non-working households in the UK[4], meaning the topic of poverty concerns not just those outside of employment. Furthermore, people in employment face the risk of increased precarity in their employment conditions such as through the rise of self-employment, whereas ongoing technological advancement and automisation raise broader questions regarding future economic inclusion affecting a broader section of the population. Inequalities and poor social outcomes (such as poor health and education) affect productivity and growth potential. So building a more inclusive economy is in everyone's interest.Economic inclusion therefore concerns the distribution of rewards in the labour market and broader economy, as well as social mobility and progression in employment. For example, this implies that an understanding of the pathways that can be formed between lower level and higher-level occupational positions is important, meaning a recognition of the overall structure of opportunities afforded by the economy is necessary.

Whereas a 'growth plus' definition of inclusive growth sees the current economic model as relatively unproblematic and economic inclusion just requires greater connection between people and the economy, we describe our approach as an

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[2] Grimshaw, D., Rafferty, A., & Whittaker, M. (2018) "Inequality and inclusive growth: The case of the UK" in B. Nolan (ed.) "Generating prosperity for working families in affluent countries," Oxford: Oxford University Press.

[3] Grimshaw, D., Rafferty, A., & Whittaker, M. (2018) op cit.

[4] McBride, J., Smith, A., & Mbala, M. (2017). 'You end up with nothing': The experience of being a statistic of 'in-work poverty' in the UK. Work, Employment and Society, 32, 210-218.

‘inclusive economy’ perspective (Figure 1). Such an approach suggests a fuller engagement with current business models and practices or ‘demand side’ activity is required to achieve inclusive growth, as well as acknowledging how broader institutional context and regulation can facilitate responsible business behaviour or place ‘beneficial constraints’ on negative behaviour[5].

Many businesses want to do the right thing and make a difference anyway. A commitment to inclusive growth is a way in which businesses can fully integrate social and environmental responsibility into the heart of their practices. At the same time, it is recognised that some aspects of the proposed framework will be beyond the immediate reach of many businesses or the concept of ‘inclusive growth’ will not necessary gain traction with some organisations. A process of effective business engagement is therefore required that identifies priorities and what is achievable on a bespoke basis, as well as packages up inclusive growth objectives in a manner communicable to businesses. We consider these issues further in the second report in this series.

[5] Streeck, W. (1997). Beneficial constraints: on the economic limits of rational voluntarism. *Contemporary capitalism: The embeddedness of institutions*, 197-219.

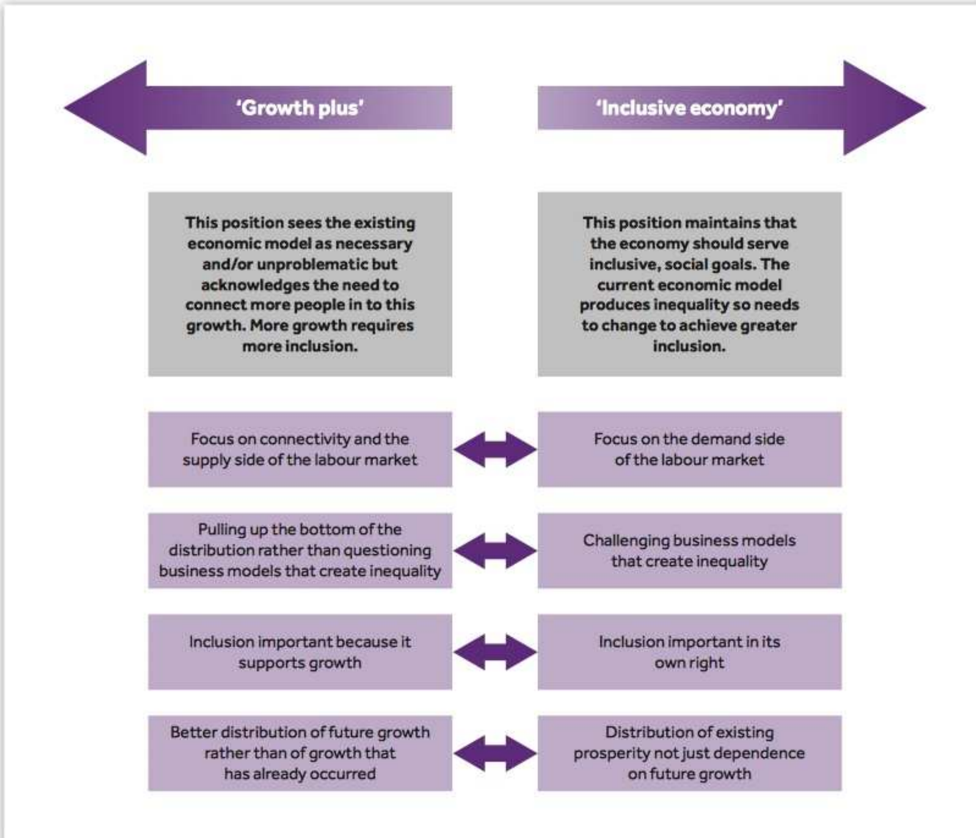

***Figure 1:** Different interpretations of the term 'inclusive growth'*

1.3 Environmental, social and governance (ESG) performance

This section outlines some of the terminology used in the report. A variety of terms can be found around the responsible business agenda. Perhaps the most well-known, Corporate Social Responsibility, refers to the movement aimed at encouraging companies to be more aware of the impact of their activities on the rest of society, including their own stakeholders and the environment[6]. A related term, Environmental, Social and Governance (ESG) Performance concerns the monitoring and engagement of organisations on their social and environmental performance. An associated concept is corporate sustainability, defined as the capacity of companies and organisations to remain productive over time and to safeguard their potential for long-term maintenance of profitability.[7] This latter definition locates risk management as a central concern to CSR and arguably implies that longer-term sustainable growth requires the active negotiation and management of broader stakeholder

[6] http://lexicon.ft.com/Term?term=corporate-social-responsibility--(CSR)
[7] http://effas.net/pdf/cesg/KPIs_for_ESG_3_0_Final.pdf

interests and risks. All of the above terms also link to the notion of social disclosure or social accounting, referring to the practice and development of screening or accounting procedures to report on the wider societal and environmental impact of organisations. This agenda has focussed on the need for such information for Socially Responsible Investment (SRI) to provide information for investors to incorporate ethical considerations into their decision-making.

Despite the orientation towards investors, the idea that in pursuing ESG objectives organisations must give account to the interests of broader stakeholders beyond investors is central to CSR so organisations can avoid risks associated with CSR violations or seek market opportunities from their CSR activities. Stakeholders may be defined in a variety of ways but include investors, employees, customers, supply chains, the broader community and local and national government.

Given the variety of terms, for present purposes, we define responsible business simply as a broad concern with the environmental, social, and governance (ESG) performance of organisations. The term ESG performance is preferred to CSR in that responsible business is not just an issue for larger corporations. Within the social enterprise and public sector the term social value[8] [9] rather than CSR has taken more traction, part of which includes a focus on issues such as calculating the Social Return on Investment (SROI) in financial terms[10]. In the current context the ESG performance of companies is taken to include subjects considered by the social value agenda but also has a broader remit such as by extending more towards issues of stakeholder involvement and corporate governance.

1.4 Overview of report

In terms of the structure of the report, Section 2 drawing on the consultation exercise and a review of existing ESG performance frameworks first attempts to establish conceptually what responsible business practice might look like from an inclusive growth perspective. Here we seek to establish what a more embracive definition of economic inclusion could look like through the lens of economic growth and productivity. Based on this work we propose an Inclusive Growth Responsible Business Framework that highlights key topics that come under the remit of such an undertaking. Examining existing frameworks helps raise methodological issues regarding how the different identified dimensions can be defined operationally and measured. Section 3 consequently goes on to consider CSR/ESG Performance frameworks in more detail to examining the extent to which they currently cover

[8] New Economics Foundation (2008), Investing for Social Value: Measuring social return on investment for the Adventure Capital Fund London: New Economics Foundation.
[9] Cabinet Office (2015, February). Social Value Act Review.
[10] Wood, C. (2010). Measuring social value: The gap between policy and practice. London: Demos https://www.demos.co.uk/files/Measuring_social_value_-_web.pdf .

issues of inclusive growth, identifying potential gaps, and considering key methodological issues in ESG monitoring. The frameworks considered outlined in Box 1 are:

- FTSE4Good
- Global Reporting Initiative (GRI)
- The European Federation of Financial Analysts Societies (EFFAS)
- ISO (SR)

We identify a considerable degree of overlap between existing ESG performance frameworks and the inclusive growth agenda. At the same time some gaps are notable. For example, such gaps relate to issues surrounding more firmly defining minimum employment standards and the requirement for a greater focus on issues surrounding responsible profit-taking and investor behaviour.

Box 1. Example ESG frameworks

FTSE4good. Launched in 2001 the FTSE4Good Index measures the environmental and social performance of companies listed on stock exchanges worldwide. Issue areas covered by the FTSE4Good include environmental impact, human rights and labour standards, supply chain labour standards, bribery and climate change. The index seeks to mainstream socially responsible investing. FTSE4Good operates on process of engagement where organisations looking to be included in the index are initially assessed and where they do not meet the inclusion criteria engaged to help bring their activities up to standards.

Global Reporting Initiative (GRI). GRI is a leading international ESG reporting framework. The GRI provides a modular reporting system meaning that over and above a foundation set of standards (GRI 101), General Disclosure (GRI 102) and Management Approach (GRI 103) standards, which constitute the 'universal standards', organisations may select from a broad range of topic based standards on Economic (GRI 200), Environmental (GRI 300), and Social (GRI 400) issues.

European Federation of Financial Analysists Societies (EFFAS). EFFAs produces a set of Key Performance Indicators (KPIs) for the monitoring of the ESG performance of organisations. Although directed towards investors it is presented as suited to a range of stakeholders. The framework is designed to be used by organisations of varying sizes[11]. The framework is designed in an industry sector specific manner to tailor to different ESG risk exposure across industries.

ISO 2600: 2010. ISO 2600 is a voluntary guidance standard released in November 2010 and as such does not constitute a formal ESG reporting framework. The ISO is based around a number of principles suggested to be the root of socially responsible behaviour, these being accountability; transparency; ethical behaviour; respect for stakeholder interests; respect for the rule of law; respect for international norms of behaviour; and respect for human rights.

[11] http://effas.net/pdf/cesg/KPIs_for_ESG_3_0_Final.pdf

2. An Inclusive Growth (IG) responsible business framework

2.1 Introduction

This section of the report attempts to define what responsible business practices might look like from an inclusive growth perspective. The notion of an inclusive economy and economic inclusion are arguably at the heart of such an approach. This provides the conceptual link to broader issues of economic growth and productivity through understanding how businesses can help include their workforces and broader stakeholders in the benefits of economic growth and prosperity. In addition to positive social impact, it also means organisations avoiding negatively affecting stakeholders through their business activities and so links to environmental sustainability.

Based on a review of existing ESG frameworks and consultation with organisations in Greater Manchester we propose an inclusive growth responsible business framework. This identifies four pillars that outline what we think responsible business activity might look like from an inclusive growth perspective. These are:

- Economic Inclusion in Prosperity Created by Growth
- Inclusion of Stakeholders in Decision Making and Governance
- Inclusion Through Diversity and Equality
- Environmental Sustainability

It is recognised that based on size and resources the extent to which different organisations will be able to fully meet the different pillars will vary considerably. At the same time the framework presented below seeks to present a broad account of what responsible business practice may look like from an inclusive growth perspective.

We present the framework first (Figure 2), then drawing on the consultation exercise go on to explain the underlying rationale for the pillars, and links to existing ESG monitoring frameworks.

FIGURE 2. The 4 Pillars of the IG Responsible Business framework

1. Economic inclusion in prosperity	
Inclusive business model	**Positive growth mind-set.** Inclusive businesses avoid growth through over-aggressive downsizing, asset stripping, workforce or R&D under-investment, or increasing profit through excessively squeezing labour costs below minimum standards (discussed below). Investors seek long-term sustainability of a business. **Ethical strategic management.** Business ethics are a living part of strategic management and risk analysis process. **Performance beyond profit.** Performance is not just measured in financial terms but in terms of social and environmental impact (e.g. Triple Bottom Line) as well as the long-term sustainability of a business model (e.g. Balanced Scorecard). ESG performance related KPIs are built into performance management systems. **Financial transparency:** Company reporting procedures on financial performance provide a transparent indication of how value created is distributed by the company (including wage costs, profit dividends, and payments towards pension liabilities and other liabilities). Companies have a policy commitment to a fair approach to tax and are transparent regarding their tax liabilities. Tax avoidance and evasion is avoided. Value created is re-invested ethically.
Fair rewards	**Fair distribution.** The distribution of pay is fair. Executive pay is not excessive and where possible linked to performance following best practice. Where in existence, efforts are made to include the entire workforce in shareholder or bonus schemes. Executive bonuses are capped at an agreed % of salary. Executive variable remuneration is deferred 3 years or more and claw back or malus exists for remuneration such as on poor

	performance[12]. **Fair evaluation.** Equitable procedures of job evaluation are in place to govern the definition of fair pay for the entire workforce. Variable compensation considers both issues of performance and risk. **Pay transparency.** Organisations provide transparent information on the distribution of pay and rewards across their entire workforce. This allows employees to know how they are being compensated compared to their peers and facilitates equality and diversity monitoring. **Fair deal for sub-contractors.** Sub-contractors and outsourced labour are rewarded fairly and exploitative practices avoided.
Minimum employment standards	**Real Living wage employers.** Organisations pay the Real Living Wage to all employees and contractors. **Secure and stable employment.** Avoidance of use of precarious non-standard employment practices such as zero hours contracts and excessive temporary work. **Employment standards monitoring.** The extent of non-standard employment practices and Real Living Wage coverage for workforce and contractors is monitored and publicly reported. **Fair termination policies.** Grievance mechanisms are in place. Policies are in place to facilitate transitions into

[12] E.g. see FTSE4Good.

	retirement.
Workforce investors	**Human capital developers.** Serious concern is given for training and development. Where feasible a focus is placed upon workforce development as a means to increased productivity. **Employee advancement opportunities.** Progression opportunities or 'career ladders' (e.g. training & promotion opportunities) exist from lower level positions into higher ones. Single-track internal labour markets are operational providing access to career opportunities for the entire workforce.
2. Stakeholder inclusion & governance	
Values all stakeholders	**Consults all stakeholders.** An effective stakeholder listing strategy is in place that identifies and consults different stakeholders (e.g. employees, investors, local community, NGOs, and government). Stakeholder engagement is seen as integral to risk management strategy. **Participatory management philosophy.** Managers are trained to actively listen to and engage employees. Employees are meaningfully consulted concerning operational and strategic decisions and change management issues, whether directly through employee involvement and participation policies or indirectly via trade union representation. **No blacklisting.** Avoids trade union member blacklisting.
Ethical supply chains	**Supply chain risk management.** Supply chain practices are monitored for ethical risk and corrective action taken

	where necessary. **Social value champions.** Procurement procedures contain ethical considerations to promote positive supply chain behaviour. Supply chain management used to encourage social value.
Community champions	**Community investors.** Organisations seek to invest in local communities in which they operate such as through charitable giving and supporting local voluntary sector. **Civic stakeholders.** Organisations actively engage with local government, education providers, and other agencies to support the development of skills, employment opportunities, and inclusive economic growth in the locality. **Community social accounting.** Output of community investments are quantified.
3. Inclusion through equality & diversity	
Equality and diversity champions	**Best practice employers.** Employers follow best practice in relation to equality and diversity policy and practice. Staff members are fully trained in equality and diversity issues and legislation. An action plan is in place to improve diversity. **Inclusive hiring.** Organisations take equality and diversity commitments seriously in recruitment. Recruitment also targets disadvantaged groups in the labour market (e.g. ex-offenders). **Fair promotions.** Equality and diversity issues are considered in promotion procedures. Promotion opportunities

	and career ladders are provided for both full-time and part-time employees. **Reward equality.** Procedures are in place to ensure discriminatory biases do not effect the distribution of rewards and that allow corrective behaviour. **Maternity & parental leave**. Developed maternity and other parental leave policies are in place. **Flexible working.** Flexible working practices are in place. Senior positions are offered as flexible working such as part-time posts.
Equality & diversity monitoring & transparency	**Gender equality and diversity reporting.** Companies report gender pay gaps and representation in middle and senior managerial positions. **BME equality and diversity reporting.** Companies report BME pay differences and representation in middle and senior managerial positions. **Workforce age structure.** Age structure of workforce in different levels of seniority is reported.
Community employer	Organisations seek to recruit from local community and actively engage with local long-term and youth unemployment issues.

4. Environmental sustainability	
Environmental champions	**Resources efficiency.** Organisations seek to actively cut resource usage (e.g. energy, water, and harmful materials). **Pollution.** Organisation minimise negative impact of pollution and effluents and waste. Policies are in place to reduce the carbon footprint and pollution impact of workforce commuters. **Supply chain influence.** Supply chains are monitored for risk and influence is used to encourage environmentally friendly practice.

2.2 The Inclusive Growth (IG) Responsible Business Framework in more detail

Drawing on issues raised through the consultation in the following sections we go on to explain further the conceptual links between this framework and inclusive growth. The subsequent section then considers links to existing ESG monitoring frameworks.

Economic Inclusion in Prosperity

The Economic Inclusion in Prosperity Pillar is broken down into 4 dimensions:

- Inclusive Business Model
- Fair Rewards
- Minimum Employment Standards
- Workforce Investors

Inclusive Business Model

The business model of a company concerns its approach to creating, delivering and capturing value and embeds the business strategy of an organisation. Within a given product or service market organisations may compete for advantage on a number of dimensions such as the cost, quality, or the innovation of their products or services. All companies seek to have efficiency in some sense such as to contain costs in order to maximise profit. In our interviews inclusive businesses models that have a **positive growth mindset** however were viewed by some respondents as ones that avoid excessive cost reduction strategies such as over-aggressive downsizing, asset stripping, workforce or research and development (R&D) under-investment, or increasing profit through excessively squeezing labour costs. Inclusive businesses view their workforce as a valuable asset rather than just a cost and seek to engage and develop. Where workforce reductions are unavoidable inclusive businesses were seen as ones that meaningfully consult their workforce in planning the implementation of redundancies to minimise negative impact on employees.

In terms of **ethical strategic management,** many organisations today realise that evaluating the ethical implications of their business activities such as in terms of their social and environmental impact is essential to effective risk management[13]. Ethical strategic management means that rather than such an assessment being an afterthought, issues of ethics are a living part of the strategic management planning process when organisations set out their strategic and operational plans.

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[13] Guay, T., Doh, J. P., & Sinclair, G. (2004). Non-governmental organizations, shareholder activism, and socially responsible investments: Ethical, strategic, and governance implications. *Journal of business ethics*, *52*(1), 125-139.

The financial performance of a company is undoubtedly the most critical measure of performance for businesses in that it indicates company health in terms of continued viability and profitability. Inclusive businesses nonetheless were viewed as ones that also evaluate company **performance beyond profit** in terms of their environmental and social impacts and the sustainability of their business model. Triple bottom line accounting[14] procedures for example require businesses to report on their social, environmental, and financial performance. In order for organisations to achieve performance beyond profit, such objectives however it was felt also need to be actively built into the performance management or managers. Balanced Score Cards[15] for example provide a semi-structured reporting framework where organisations can develop and monitor progress against performance targets in terms of financial stewardship, customers and stakeholders, internal processes, and organisational capacity such as for learning and growth. This was not just seen as a question of ethics but of sustainability and performance. Such approaches may help orientate businesses away from short-term profit maximising strategies towards considering longer-term business sustainability, raising productivity[16].

In terms of **financial transparency,** company reporting procedures on financial performance can provide an indication of how value created is distributed within an organisation and so the extent of economic inclusion of the workforce. Company reporting procedures remain orientated towards the information needs of company owners or investors. In order for a more inclusive model of business to be achieved such practices it was felt need to be developed towards the requirements of broader stakeholders. Financial transparency is essential for (potential) employees, consumers, investors, and local communities to make informed ethical assessments regarding the nature of the business models of organisations. For example, more accessible and transparent reporting practices could help facilitate the benchmarking of organisations within a given sector (e.g. supermarkets) in terms of how value created is divided, such as in terms of profit, staff costs, pension liabilities and so forth. This may help generate consumer consciousness regarding inclusive business practices.

Financial transparency was further considered to concerns tax affairs. Taxation provides a chief mechanism through which value created in an economy is re-distributed, through public expenditure. Rather than just by direct impact, businesses support economic inclusion through taxation. This is because broader economic inclusion in prosperity also involves redistribution through public investment in education, health, infrastructure, welfare, and so forth. Inclusive businesses are therefore ones that are transparent regarding their tax affairs and refrain from tax

[14] Elkington, J. (1998). Partnerships from cannibals with forks: The triple bottom line of 21st□century business. *Environmental Quality Management*, *8*(1), 37-51. E.g. see http://www.ibrc.indiana.edu/ibr/2011/spring/article2.html

[15] Kaplan, R. S., & Norton, D. P. (1996). *The balanced scorecard: translating strategy into action*. Harvard Business Press. E.g. See http://www.balancedscorecard.org

[16] Kaplan, R. S., & Norton, D. P, op cit.

avoidance and evasion. Tax avoidance also presents a CSR risk to some organisations in that publicity can lead to reputational damage.

Fair Rewards

Reward management concerns the policies and practices that organisations have to compensate employees for the work they undertake and their contribution to value creation within organisations. Basic pay rates are probably the main issue for most people. The term 'total rewards'[17] however concerns:

- Basic pay
- Variable rewards. The distribution of bonuses, share options and other variable rewards across workforce
- Extent & distribution of training and development funds across workforce (considered under 'training and development')
- Pension contributions and employee insurance coverage
- Other 'fringe' benefits

The **fair distribution** of rewards concerns the extent to which different stakeholders (e.g. different employees, investors) are reward fairly. The fair distribution of rewards in organisations is a central inclusive growth issue in that it denotes how value created is allocated and therefore who is included in the prosperity arising from business activity. In terms of inclusive growth objectives more inclusive reward management could help to reduced poverty and in the case of improved pension provision combat future pensioner and fuel poverty. The issues of pay differences has also received considerable attention in the UK and internationally such as in relation to excessive executive pay or gender differences.

From a social responsibility perspective, executive pay should not be excessive and where possible linked to performance. Based on the practices of existing ESG frameworks (e.g. FTSE4good) executive performance can be linked to performance in order to prevent excessive risk taking or short-termism. Executive pay however represents just one issue. It was felt in our interviews that organisations also need to evaluate the fairness of the broader distribution of pay. Furthermore, where in existence, efforts could be made to include the entire workforce in shareholder or bonus schemes.

The determinants of wages differences in companies are complex and so is the issue of what constitutes fairness. Two broad approaches to defining fair pay can nonetheless be identified, one that seeks to establish objective criteria for fair rewards, the other that highlights how broader social norms can unfairly shape pay differences[18]. In terms of objective definition, to a large extent differences in pay may

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[17] Mujtaba, B. G., & Shuaib, S. (2010). An equitable total rewards approach to pay for performance management. Journal of Management Policy and Practice, 11(4), 11-121.
[18] Steinberg, R. J. (1990). Social construction of skill: Gender, power, and comparable worth. Work and occupations, 17(4), 449-482.

reflect the different skill levels of jobs or employees, and the supply and demand for skills. Organisations may consider the 'internal equity' of rewards such as through job evaluations to ensure people are rewarded fairly compared to their peers. They also consider 'external equity' in terms of benchmarking against the going market rate for a given position, such as in order to be able to attract and retain candidates[19]. Beyond job analysis criteria other pay systems link pay to individual or group performance ('performance related pay').

There are a number of reasons why differences in pay may not be fully efficient or 'fair' (i.e. such as objectively defined by skills, job task, or performance). Firstly, gaps in corporate governance raises the risk of rent-seeking behaviour where senior executives or managers are able to extract greater value for their rewards by virtue of their position and ability to exert wage push beyond their contribution to value creation[20]. In some cases, poorly structured executive pay systems can even reward poor performance. Where pay is linked to performance, there are also information constraints in terms of measuring performance. For example, some jobs may have a high visibility and clear performance metrics whereas other may not. Evaluators may also be influenced by subjective biases[21].

Such an account consequently highlights how other factors such as social norms developed through processes of history and power shape rewards rather than just an objective definition of skill or performance. Firstly, the definition and measurement of 'skill' is not necessarily a scientifically objective exercise but instead shaped by social norms and customs. For example, the 'equal pay for equal worth' movement recognises that some jobs or types of skills may be classified as higher skilled than others by virtue of the gender of the people mostly likely undertaking the work (e.g. physical versus emotional labour, warehouse work versus shop floor). Social norms have also lead to lower pay for women undertaking identical work to men[22].

Exclusive practices surrounding 'talent management' provide one example of how the contribution of certain positions or people may be discursively constructed by management as more valuable than others, without necessarily objective empirical basis. Reward management systems controlled from the top may therefore produce artificial distinctions between the assumed productivity of different worker or occupational groups[23].

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[19] Gomez-Mejia, L. R., & Welbourne, T. M. (1988). Compensation strategy: An overview and future steps. *People and Strategy*, *11*(3), 173.
[20] Bebchuk, L., and Fried, J. (2004). Pay Without Performance: The Unfulfilled Promise of Executive Compensation, Cambridge, MA: Harvard University Press.
[21] Keeping, L. M., & Levy, P. E. (2000). Performance appraisal reactions: Measurement, modeling, and method bias. Journal of applied psychology, 85(5), 708.
[22] Steinberg, R. J. (1990), op. cit.
[23] Dundon, T., & Rafferty, A. (forthcoming) 'Provocation piece: The (potential) demise of HRM, *Human Resource Management Journal*.

The business case for fair rewards can be built around reducing inefficiencies in the pay structure and linking rewards more to actual performance whilst mitigating legal and reputational risks linked surrounding pay inequality. From an inclusive growth perspective, inclusive companies were consequently viewed in our interviews as ones that spend meaningful effort to provide a **fair evaluation** of rewards, considering whether internal equity exists in the pay offered for different jobs, occupations, and demographic groups. **Pay transparency** it follows is important to establishing whether organisations pay fairly or not such as by reporting pay differences by gender. Organisations fully committed to transparency can go further by disclosing other pay differences such as by ethnicity or even the full pay distribution of their organisations.

A **fair deal for sub-contractors** was further raised in our interviews as an important issue. It was felt that sub-contracting and outsourcing often provide a way in which organisations may externalise some of their more precarious employment practices or low paid work. This means that although an organisation's core internal workforce may look to have good conditions and pay, poorer labour practices can be hidden through contracting out.

Minimum Employment Standards

Minimum employment standards were seen by several interviewees as a way to provide minimal criteria for employee economic inclusion. This may involve standards concerning pay levels but also employment stability and security. **Minimum pay floors** such as the Real Living Wage were viewed as an important mechanism for setting minimum standards. Although income requirements vary based on household size this is intended to roughly indicate the wage level required for people to escape poverty[24]. The potential benefits of paying the real living wage include reduced employee turnover, increasing worker morale, reducing absenteeism, productivity improvements, strengthening recruitment opportunities and reputational benefits[25]. Employers through small price increases or productivity enhancement may also often absorb wage floor increases[26].

Some interviewees highlighted how minimum wage floors nonetheless highlight issues regarding the different capacity of organisations to engage fully with a responsible business agenda. Given there are differences in inputs and profitability between organisations and sectors varying levels of ESG performance can be expected. This means some policies such as the Real Living Wage will be easier to implement for some organisations than others. Business such as those with lower margins, who are struggling financially, or where there is little scope for productivity

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[24] Coulson, A. & Bonner, J. (2015). Living wage employers: Evidence of UK business cases. Living Wage Foundation.
[25] Dube, A., Naidu, S., & Reich, M. (2007). The economic effects of a citywide minimum wage. ILR Review, 60(4), 522-543.
[26] http://irle.berkeley.edu/are-minimum-wage-increases-absorbed-by-small-price-increases/

enhancement among low paid workers may have greater difficulty achieving such aims. The Real National Living Wage remains voluntary and organisations that pledge to pay it are more likely to be large organisations in more profitable sectors[27]. At the same time the promotion and aspiration for wages that lift people out of poverty is fundamentally aligned to the notion of economic inclusion and inclusive growth. Ideally financial transparency and industry benchmarking could to an extent help stakeholders know which organisations can and cannot afford to implement such policies.

Secure and stable employment was a further important issue raised through our interviews. Employment security concerns the type and duration of contracts offered whereas stability is used to refer to a regular number of hours being offered from week to week. Insecurity and a lack of stable employment may arise from a variety of employment practices including:

- The use of temporary employment contracts
- Zero hours contracts
- Increases in self-employment and contract-based arrangements[28] [29]

Such practices may also present a social responsibility risk to organisations such as evidenced by the negative publicity surrounding zero hours contracts.

The improvement of minimum employment standards requires active **employment standards monitoring** and reporting so that broader stakeholders can understand the level of employment standards in different organisations. For example, the extent to which non-standard employment practices and Real Living Wage coverage for employees and contractors is monitored and publicly reported was seen as important in our interviews.

The issue of **fair termination policies** is broad and covers all the different ways people may leave an organisation. A serious commitment to policies that assist transitions into retirement such as flexible working, pension schemes and commitments to pensions liabilities represents an important issue here. Some interviewees further highlighted the need for employee voice such as through grievance procedures that can help avoid the breakdown of relationships between workers and employees.

Workforce Investors

Organisations that are **human capital developers** can assist economic inclusion by increasing and renewing the skills of their workforce, raising productivity. It was felt

[27] D'Arcy, C., & Kelly, G. (2015) Analysing the National Living Wage, Resolution Foundation Briefing.
[28] https://www.gov.uk/government/news/taylor-review-on-modern-employment-practices-launches
[29] Eg. see https://www.thersa.org/about-us/media/2016/matthew-taylor-to-lead-independent-review-of-employment-practices-in-the-modern-economy

that inclusive employers are ones that give serious concern to training and development. Where feasible a focus is placed upon workforce development as a means to increased productivity. Increasing levels of skills and the productivity of the workforce can facilitate economic inclusion by equipping the workforce with the skills required to participate in the modern economy. Technological advancement means that worker skills in many occupations become quickly out-dated or obsolete. Raising productivity and inclusion therefore arguably requires a greater focus on retraining and lifelong learning.

It was recognised nonetheless that in some labour-intensive industries that rely on a high degree of unskilled labour there may be little room to increase productivity through skill levels or improving management practices. Workforce up-skilling in some cases will also be associated with the introduction of new technology that replaces jobs. Increased productivity in some cases may therefore lead to the destruction of lower skilled work. In this sense the development of skill or occupational pathways between lower skilled and higher skilled work, and growing and declining occupations, was seen as a way of helping mitigate against the negative long-term impact of low paid work.

There are a number of structural problems with the UK economy that inhibit incentives for organisations to pursue upskilling and intead maintain a 'low-skilled equilibrium'.[30] A commonly noted perception concerned the comparative weakness of the vocational education system in the UK, and inadequate coordination between businesses and vocational education providers. A greater coordination at the local level between businesses and educational providers could help support skill and productivity increases. The 'residual' welfare state in the UK is also likely implicated. Compared to a human capital first approach to welfare policy, the work-first approach to welfare in the UK arguably helps maintains a supply of low skilled workers to low paid sectors of the economy that helps keep labour costs lower but inhibits upskilling and productivity increases[31].

Employment advancement opportunities concern the prospects people have to progress in the labour market. Employment progression was partly viewed as a job design issue. For example, if the jobs of low skilled workers provide few opportunities to develop further skills this will likely limit progression. The issue of job design does not just concern the design of individual jobs but an overall consideration of what the labour needs are for a specific product or service system. This concerns how the different tasks (including managerial and supervisory) are divided up into discrete job roles, and how jobs are then organised and labour is sourced. Job-rotation,

[30] Hall, P. A. (2001). Varieties of capitalism: The institutional foundations of comparative advantage. D. W. Soskice (Ed.). Oxford: Oxford University Press.
[31] Bartik, T. J. (2000). Displacement and Wage Effects of Welfare Reform. In D. Card and R. M. Blank (eds) Finding Jobs: Work and Welfare Reform, New York: Russell Sage, pp. 119–58.

mentoring programmes and other job design techniques can be used to increase task variety and also raise the productivity and engagement of the workforce. Job rotation between roles can be used to improve the functional flexibility of employees whilst increasing their work experience and skill base[32]. Secondment practices where employees gain experience in other roles can also help generate experience and improve productivity.

The unification of internal labour markets into one inclusive career structure (one-track progression pathways) where in theory any employee from any division or function can be promoted or take any internal vacancy provides another mechanism against segmenting opportunities. Removing the barrier to employment progression for those with young dependent children was also viewed as a job design issue. This can involve increasing the availability of flexible working practices in senior positions and offering part-time and full-time employees the same training and progression opportunities.

Stakeholder Inclusion & Governance

The stakeholder inclusion & governance pillar consists of three dimensions:

- Values all Stakeholders
- Ethical Supply Chains
- Community Champions

Values all Stakeholders

A key message from the literature on corporate social responsibility and ESG Performances concerns the need to **consult all stakeholders** in developing ESG and risk management plans[33]. Beyond investors, stakeholders include employees, customers, supply chains, third sector organisations and local and national government bodies. Rather than second-guessing, in order for organizations to understand and respond to broader stakeholder interests appropriate mechanisms of stakeholder consultation need to be in place. Without such mechanisms it may become difficult for organizations to assess the wishes or needs of their varying stakeholders.

The dominant model of capitalism with the UK and other liberal economic market economies such as the US can be described as based around the concept of shareholder sovereignty or investor welfarism[34]. This reflects the view that the primary purpose of businesses is to seek shareholder value with the interest of other stakeholders being secondary and only genuinely of material concern where bound

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32 Philpot, J. (2014). Rewarding work for low paid workers. York: Joseph Rowntree Foundation.
33 Roberts, R. W. (1992). Determinants of corporate social responsibility disclosure: An application of stakeholder theory. Accounting, organizations and society, 17(6), 595-612.
34 Drucker, P. (2001). Will the corporation survive?. The Economist, 1.

by regulatory compliance, or presenting opportunities or risks to shareholder value for other reasons. Indeed this view is enshrined in current regulation on corporate governance in the UK under Section 172 of The Companies Act (2006),[35] This is largely interpreted as asserting that the director of a company must promote the success of the company and that, although the interests of broader stakeholders should be given regard, this consideration occurs within the context of where contributing to the success of the company. In this sense the first business responsibility of managers in law is towards their owners or investors.

This model of capitalism is often contrasted with stakeholder capitalism, where although investors still hold considerable power, more of an effort is made to pay more attention to the interests of different major stakeholders such as employees, customers and the broader community. These two hypothetical models are not necessarily absolutes but can be seen as poles on a continuum in corporate governance terms. The representation of broader stakeholder concerns and stronger corporate governance are arguably central to an inclusive economic model that more fully represents and includes the interests and prosperity of other stakeholders beyond investors. Debates regarding the relative merits and problems of a shareholder-sovereign or stakeholder models of capitalism are long-standing and so not recounted in any detail here.[36] From the stakeholder model, however, even from a company performance perspective, what is ‘pro-investor’ or ‘pro-market’ is not necessarily pro-business in that the short-term interests of investors are not always necessarily aligned to the long-term developmental interest of organisations.

Employee involvement can further be facilitated by a **participatory management philosophy.** Employee involvement and participation can be achieved by formal mechanisms of information sharing and consultation, or the manner in which jobs are designed to foster involvement. At the same time ‘informal employee involvement and participation’ refers to a high involvement management style among managers and supervisors who are trained to take a collaborative rather than command and control approach to management[37]. In some contexts there is evidence to suggest that high involvement management practices and greater employee involvement and participation can improve workforce productivity[38].

A positive approach to workforce consultation can also be sought through trade union partnership. **No blacklisting** concerns the approach of management to trade union activity. At bare minimum organisations need to recognise the legal rights of

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[35] http://www.legislation.gov.uk/ukpga/2006/46/section/172
[36] Freeman, R. E., Martin, K., & Parmar, B. (2007). Stakeholder capitalism. Journal of Business Ethics, 74(4), 303-314.
[37] Marchington, M., & Suter, J. (2013). Where Informality Really Matters: Patterns of Employee Involvement and Participation (EIP) in a Non-Union Firm. Industrial Relations, 52(s1), 284-313.
38 Wood, S. (2010). High involvement management and performance. The Oxford Handbook of Participation in Organizations, 407-26.

employees to association and avoid the blacklisting of trade union members and representatives.

Ethical Supply Chains

A key concern that emerged from the interviews was **supply chain risk management**. A responsible approach to business ensures supply chain practices are monitored for ethical risk and corrective action taken where necessary. The manner in which organisations can be **social value champions** through using their contracting processes was further highlighted. A focus on supply chains activity locally was seen as important. Following the 2012 Social Value Act a number of public sector organisations in Greater Manchester seek to use their contracting systems to promote broader social outcomes objectives such as increasing local employment or reducing poverty.[39] An important question raised from the interviews was the extent to which such a model could also be adopted by the private sector.

Community Champions

A common form of social responsibility behaviour is where organisations seek to be **community investors** in the local communities in which they operate such as through charitable giving and supporting the local voluntary sector. One problem raised within our interviews was that organisations may be more willing to support some more popular causes than others, such as in relation to their brand image.

The fulfilment of inclusive growth objectives can be supported by organisations being **civic stakeholders** actively engaging with local government, education providers, and other agencies to support the development of skills, employment opportunities, and inclusive economic growth in the locality. One example given in the interviews concerned the lack of integration and sufficient coordination of local businesses with local education providers, particularly in relation to the development and delivery of vocational education. Once again, the need for the work being undertaken by organisations to be monitored and assessed was highlighted such as through **community social accounting**.

Inclusion Through Diversity and Equality

The inclusion through diversity and equality pillar has three dimensions

- Equality & Diversity Champions
- Monitoring & Transparency
- Community Employers

[39] CLES (2016). Forging a good local society: Tackling poverty through a local economic reset. Manchester: Centre for Local Economic Strategies. https://cles.org.uk/our-work/publications/forging-a-good-local-society/

Equality and Diversity Champions

Best practice employers were viewed as ones that followed or exceeded up to date standards regarding equality and diversity policy implementation. Having **maternity and parental leave** provision beyond legal minimum standards was further seen as important to equality and diversity objectives. In terms of **flexible working** practices, advertising higher skilled or more senior or supervisorial/ managerial roles as available with flexible working arrangements (FWAs) such as part-time or job share was viewed as critical. This was seen as important to allow women and men with dependent children greater access to better quality employment whilst combining paid work with domestic work and care responsibilities[40].

Inclusive hiring requires attention to the 2010 Equalities Act to avoid discrimination in the labour market such as on the grounds of gender, ethnicity, disability, age, sexual orientation, or gender reassignment. An inclusive approach to hiring further guards against recruitment judgements being biased by discrimination and seeks to offer jobs that are accessible to all. The business case for such practices is typically built around topics such as reputational benefits, the advantages of having a diverse workforce in terms of attracting and retaining talent, and the value of fully reflecting a company's customer base[41]. Recent legislative developments and changing social norms regarding issues such as gender equality also present a social responsibility risk for organisations.

Several interviewees also noted that inclusive hiring can also give recognition to other issues of socio-economic disadvantage in the labour market. In this sense examples of inclusive recruitment practices may include:

- Hiring from the local communities or people from disadvantaged backgrounds. Examples of such schemes are facilitated by organisations such as Business in the Community.[42] Such schemes can focus on the employment of groups disadvantaged in the labour market such as ex-offenders, care leavers, recovering addicts, homeless people, and military veterans[43].
- Increasing employment opportunities for people with physical and/or mental health issues and disabled people[44].

[40] See https://timewise.co.uk/about-us/timewise-foundation/ (Timewise Foundation).
[41] http://www.bitc.org.uk (The Princes Responsible Business Network).
[42] http://www.bitc.org.uk (The Princes Responsible Business Network)
[43] HM Government (2017) Strengthening your workforce with talent from disadvantaged groups. http://www.bitc.org.uk/our-resources/report/strengthening-your-workforce-talent-disadvantaged-groups
[44] See http://www.wearepurple.org.uk/uploads/documents/Purple%20Charter%20for%20Change.pdf

At the same time, it was recognised that many companies without additional support such as through government or third sector agencies independently will lack the capacity to face the challenges of providing employment opportunities to people with more complex and multiple social needs. This means that the mapping out of potential local support provision is vital to providing the information and training required for businesses to more meaningfully undertake such activities.

Equality & Diversity Transparency and Monitoring

Once again, the monitoring of activity was felt important to understanding the practices of organisations. Recent legislation requires **gender equality and diversity reporting** for larger organisations in the UK in relation to pay gaps. It was felt by some interviewees that this could go further such as towards **BME Equality and diversity reporting** or reporting regarding **workforce age structure.** More radically, complete pay transparency was seen as a potential approach to providing transparency to internal reward practices.

Community Employer

In terms of being **community employer**s, some interviewees highlighted a spatial dimension to equality and diversity issues. Inclusive organisations were consequently seen as those that seek to recruit from the local community or actively engage with local long-term and youth unemployment issues.

Environmental sustainability

The issue of environmental sustainability was viewed as important to broader business sustainability. Inclusive businesses it was felt should seek as much as they can to become **low carbon businesses**, and to reduce the **commuter footprint** of their workforce through travel to work policies and flexible working arrangements (e.g. teleworking). The manner in which larger organisations can use **supply chain influence** to promote environmental sustainability across their supply chains was further highlighted. Inclusive growth was therefore in this sense viewed as not just about positive forms of economic inclusion but the avoidance of negative inclusion in the consequences of business activity such as related to the effects of pollution on residents living around city centre commuter routes. The potential efficiency gains of pursuing environmental sustainability objectives were further highlighted such as in terms of reduced energy use.

2.3 Conclusions

In this section based upon a brief consultation exercise we sought to provide a first attempt at outlining what responsible business practices might look like from the perspective of inclusive growth that places a broad notion of economic inclusion at its centre. Such an approach highlights how the business model of organisations and people management practices (e.g. reward management and training policies) are central to delivering a more inclusive form of economic growth. The framework presented is purposefully broad in order to seek breadth of coverage of the topics raised from the research and consultation exercise. At the same time, it is recognised that many organisations will not have the capacity to cover all of the issues raised. In terms of the prioritisation of issues, the question arises therefore whether a core set of practices should be identified and applied to all organisations combined with a more modular approach to select other options, or whether screening and engagement should be more fully tailored to specific organisational priorities and capabilities.

3. Inclusive growth and existing ESG Performance Monitoring frameworks

3.1 Introduction

In this section we go on to further consider the framework introduced in Section 2 in relation to existing ESG monitoring frameworks in more detail. This is undertaken to consider the extent to which there are gaps in current frameworks from an inclusive growth perspective and facilitate a discussion of methodological issues surrounding the screening of responsible business behaviour. In the below discussion of the different pillars identified we also provide examples of where topic coverage is available in current frameworks. These examples are not supposed to provide an exhaustive account of the discussed frameworks but instead are used for illustrative purposes. To recap, the frameworks considered were:

- FTSE4Good
- Global Reporting Initiative (GRI)
- The European Federation of Financial Analysts Societies (EFFAS)
- ISO (SR)

3.2 Economic inclusion in prosperity in current frameworks

Inclusive Business Model

Several reporting frameworks require information in their basic standards on the strategy of organisations although often this relates more to strategy in relation to tackling sustainability issues around ESG performance rather than more broadly. For example the Global Reporting Initiative (GRI) requires a statement from the most senior decision maker in an organisation on the relevance of sustainability to the organisation and its strategy for addressing sustainability[45]. In terms of ethics and integrity the GRI also has reporting requirements on the values, principles, standards and norms of behaviour of organisations and how organisations seek advice on matters of ethics. In terms of the governance of organisations it considers the positioning of risk management and environmental social impact decision-making within an organisation's governance hierarchy. For example whether this is an issue lead from the highest governance body with executive level responsibility, of further down the organisational governance structure is contemplated.

A further approach taken concerns the narrative reporting of key performance monitoring. For example EFFAS in their key performance indicators considers

[45] GRI 102.

whether ESG performance is taken into account in performance agreements. It further considers total investments in research on ESG relevant activities as an indicator of innovation. This approach understands that high-level strategy requires cascading through management systems in order to be converted into actual behaviour such as through performance management and Key Performance Indicators (KPIs).

Across existing frameworks there is less of an explicit focus on the overall strategic approach to value creation or the overall 'business model' than suggested by the IG Responsible Business Framework. Given corporate governance and sustainability remains partly construed as an agency problem in terms of the control of investors over management, the role of investor influence is also arguably not sufficiently considered, such as in terms of the impacts of profit strategy on sustainability, as discussed in the preceding chapter. Investors therefore become construed as external stakeholders that, although require consulting, a largely exogenous to the issue of responsible business. Investor behaviour nonetheless is a potential source of both positive impact (e.g. 'impact investing') and also a potential risk to ESG performance (e.g. through pressurising for short-term profit over sustainability). The difficulty rests therefore in how such behaviour can be brought into the remit of a responsible business monitoring agenda given ESG frameworks need to palatable to the owners of businesses to facilitate adoption, thereby arguably circumventing the agenda of what topics are and are not considered.

Fair Rewards

None of the considered frameworks considered the total distribution of pay within organisations as an ESG issue. Where pay distribution was mentioned this largely focussed on executive pay issues[46]. Some frameworks did consider the distribution of some rewards in relation to specific aspects. The GRI for example considers an indicator of the % of workforce that receive 90% of bonuses and share options as a proxy of the coverage of rewards but this does not extend to broader pay distribution. From an inclusive growth perspective this is a considerable omission in that executive pay disparities and variable rewards only represent restricted dimensions of broader pay inequality issues.

Pay ratios also need to be interpreted carefully. In some cases, they will produce counterintuitive results or interpretation problems. For example, due to the structure of the workforce an executive to median pay ratio could make a large investment bank look more equitable in its pay than a supermarket given the manner in which the median benchmark figure is composed.[47],[48] The relative figure does not indicate

[46] In 2015, the U.S. Securities and Exchange Commission (SEC) adopted a rule mandated by the 2010 Dodd-Frank Act, requiring medium and large public companies to disclose the ratio of the compensation of chief executive officers to the median compensation of their employees (starting in 2017).
[47] https://www.ft.com/content/96dc7712-7f55-11e6-bc52-0c7211ef3198

that both the median employee and executives in the former are paid considerably more than the latter and it may be the absolute level of pay that presents the greater business responsibility issue. At the same time such extreme examples should not detract from the overall value of pay ratios and sensible interpretation. This can be achieved for example through benchmarking against sector norms or other more meaningful comparisons between competitors[49]. From an inclusive growth perspective there is also a need for reporting that provides some comprehension of broader wage inequality across the entire wage distribution within organisations, particularly regarding the lower end of the distribution. Meeting minimum wage floor standards can also supplement such measures.

Once again a further issue concerns how the value taken by shareholders in profit sits above current corporate governance debates. None of the ESG frameworks explicitly consider profit taking practices in relation to responsible business activity. Economic inclusion in prosperity concerns how the overall revenue created by organisations is allocated and not just the labour cost bill. Pay ratios give some information regarding how the labour share slice of the revenue pie is distributed but not how big this slice is in the first place in relation to overall revenue or profit taking.

The focus on executive pay consequently sits firmly within the discourse of investor welfarism in that executive pay is primarily still constructed as an agency problem for shareholders[50] rather than a broader stakeholder issue and CSR risk. For example, there are potential social responsibility issues here regarding profit taking as a trade off against companies servicing pension fund deficits, investing in research and development budgets to increase innovation and productivity, workforce human capital investment, or servicing other liabilities. The clear reporting on employee pension deficits size in relation to profits or other financial liabilities for example would take a fuller measure of reward management issues in relation to total rewards and other benefits. Research conducted in 2016 showed that nearly half of all FTSE 100 companies could have cleared their pension deficits with payment of one year's share dividends[51].

The GRI does include some broader attention to the distribution of economic value in terms of 'economic value distributed' (operating costs, employee wages and benefits, payments to providers of capital, payments to government by country and community investments) which can be compared against 'economic value retained' (direct economic value generated less economic value distributed) (GRI 201 Economic Performance)[52]. The development of an accounting basis for some form of a proxy

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[48] https://www.ft.com/content/969170c8-8018-11e6-bc52-0c7211ef3198https://www.ft.com/content/969170c8-8018-11e6-bc52-0c7211ef3198
[49] See http://highpaycentre.org (High Pay Centre).
[50] Styhre, A. (2016). Trust versus contracts in corporate governance: Agency theory, contractual theory and the fortification of shareholder welfare governance. *Management & Organizational History*, *11*(3), 276-297.
[51] https://www.ft.com/content/a8e34726-d67e-11e6-944b-e7eb37a6aa8e
[52] https://www.globalreporting.org/Information/about-gri/Pages/default.aspx

measure of profits to labour costs and other factors linked to workforce investment is therefore likely possible. An alternative approach would therefore be to express profit in relation to average (median) wages rather than overall labour cost. This could be accompanied by industry benchmarking. Some form of measure of the distribution of economic value created that provides transparency to the ratio of profit to labour costs to supplement pay ratio measures could be used to provide a more comprehensive picture of workforce economic inclusion. Pay differentials however also reflect regulatory issues that are unlikely to be resolved by organisational level intervention. For example, the decline in collective bargaining particularly since the 1980s, abolition of wage councils, rise of passive investors, and the softening of other policy that regulated pay have likely contributed to the widening of wage inequality between the highest and lowest earners[53].

Minimum Employment Standards

Many international standards focus on minimum standards in a global context such as absolute poverty levels (e.g. subsistence less than $1 a day) [54]. The FTSE4Good does consider whether organisations have living wage policies although there is no absolute benchmark target given and the presence of a policy does not provide information on the extent of implementation such as coverage in terms of both primary employees and sub-contractors. Within other considered frameworks the ideas of an income baseline did not extend further than beyond (implicit or explicit) compliance with national minimum wage floors that do not necessarily provide non-poverty wages.

In terms of employment security, the FTSE4Good includes a measure of the percentage of employees that are contractors or temporary but there is no explicit mention of zero-hour contracts. Within some frameworks, full-time and part-time employment (voluntary) turnover rates were taken as a way of monitoring levels of job stability although it is unclear what level of turnover is to be considered 'healthy' for an organisation and what indicates undesirable levels of job insecurity. Industry benchmark comparison in such respects may still however prove meaningful. A further indicator considered concerned the percentage of employees employed less than 1 year.

Workforce Investors

Although considered important there is a lack of agreement regarding how training and development should be measured across ESG performance frameworks. For example, whereas some focussed more on the average hours of training per year

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[53] Kasparova, D., Wyatt, N., Mills, T., & Roberts, S. (2010). Pay: Who were the winners and losers of the New Labour era. *London: The Work Foundation.*
[54] In terms of the public sector, several local authorities including in Greater Manchester present being a Real Living Wage employer as an example of how contractors may demonstrate social value in their guidance in relation to the Social Value Act 2012[54].

per employee (by gender and other demographic employment categories), others focussed on the level of expenditure. A time based measure of training and development activity does not provide insight into the level or quality of training although breakdown by demographic group does hold conceptual validity from an equality and diversity perspective. Overall training expenditure similarly does not provide information on the distribution of training funds across the workforce and there may be a tendency for training budgets to be top heavy, overlooking employees in lower occupational roles[55].

The percentage of employees receiving regular performance and career development reviews (by gender, age, and other indicators of diversity) was further present in the GRI framework as a training and development measure. A further measure considered concerns the availability of opportunities for upgrading employee skills and transition assistance programmes. The latter could be linked to retirement or the termination of employment and may become an increasingly salient issue through technological replacement linked to ICT, artificial intelligence and developments in robotics.

3.3 Stakeholder Engagement & Governance in Current Frameworks

Values all Stakeholders

Evidence of stakeholder engagement activities and reporting were listed as the chief way to demonstrate stakeholder involvement. In the FTSE4Good for example this was listed as a 'human rights and community' indicator. The GRI places consulting stakeholders on economic, environmental, and social topics as a key disclosure in its core standards and seeks to establish the processes of consultation through narrative reporting. This requires organisation to list all stakeholder groups and information on mechanisms and frequency of engagement. This framework also requires reporting on collective bargaining agreements with trade unions and the percentage of the workforce covered.

Guidance in ESG frameworks on how firms consult employees and incorporate their perspectives into operational and strategic decision-making were less clearly formed. A key issue concerns the extent to which information and the outcomes of consultations are used to inform the strategic or performance objectives of organisations and so whether such information constitutes a living document or just a paper exercise. This may be evidenced however via narrative reporting of how such consultation is utilised. A further issue concerns how stakeholder engagement

[55] Philpot, J.; Chartered Institute of Personnel and Development (CIPD) (2013) Learning, Training and Development. London: CIPD, April.

activities can be scaled down to small businesses such as through alliance partnerships and whether a SME business case can be constructed for such activity.

There was less of an explicit focus on employee involvement and participation mechanisms. Further potential indicators therefore could involve:

- Evidence of developed employee involvement and participation procedures that feed both into operational and strategic decision-making, or established organisational development models[56]
- The presence of participatory management practices as evidenced by training or KPI objectives.
- The presence of board level employee representation.
- Evidence of functioning partnership models with trade unions.

Ethical Supply Chains

Supply chain risk and trying to encourage ethical behaviour in supply chains was a cross-cutting theme across the considered frameworks. Many of these had an international focus such as addressing core International Labour Organisation (ILO) conventions. Whereas part of the focus was on policies and practice in place to identify risk in supply chains, a second issue concern monitoring and upholding standards such as regarding labour and health and safety. EFFAS focuses on narrative reporting such as regarding how companies ensure suppliers meet ESG standards similar to the company, and purchasing and procurement functions. The GRI considers narrative reporting but also the proportion of spending that is on local suppliers. Negative social impacts in supply chains and action taken is a further topic.

Community Champions

The FTSE4Good includes a commitment to local employment and policies on under-privileged and youth unemployment. Other activities include evidence of stakeholder engagement and reporting, the quantification of community investment, and information regarding donations to not-for-profit organisations. The GRI considers infrastructure investment and services supported in relation to local communities and economies. This can involve provision of commercial services or pro-bono activity linked to transport, utilities, community social facilities, health and welfare centres, or sports centres. The monitoring of actual and potential negative impact on local communities is a further theme.

[56] E.g. see https://hbr.org/2012/11/accelerate

3.4 Equality and Diversity in current frameworks

Equality & Diversity Champions

Several ESG frameworks included attention to gender equality and BME equality issues in the labour market. Part of the focus was on labour standards. The FTSE4Good for example considers whether organisations have a policy to address non-discrimination, and 'black economic empowerment'. The main focus of frameworks tended to be regarding monitoring rather than policies and practices. Equality and diversity was a prominent theme in FTSE4Good and GRI but less so in EFFAS.

Monitoring & Transparency

In terms of equality and diversity monitoring, beyond pay measures an emphasis tended to be more on women in senior level positions rather than meaningfully mapping broader gender inequality and segregation in the labour market. Some frameworks did consider outcomes related to maternity and paternity provision such as job retention rates after maternity leave, whereas pay rate gaps between part-time and full-time employment were used to provide some indication of the extent to which organisations offer part-time employment of a comparable quality to full-time paid work. Other potential indicators include the part-time occupational employment gap and the percentage of jobs offering flexible working.

The percentage of women on the Board of Directors was a further indicator used. EFFAS considers reporting on the total gender composition of the workforce and the percentage of women in senior positions in relation to total Full Time Equivalent (FTE) senior positions. The age demographic of the workforce is further considered. Some frameworks considered the broad BME monitoring of the workforce but in some cases without specific detail regarding occupational status levels of workers. A high proportion of a workforce being from minority groups does not say anything regarding the quality of their jobs and working conditions.

The GRI seeks to mainstream aspects of diversity reporting by requesting organisations break down a number of indicators by 'indicators of diversity'. These include the percentage of employees receiving regular performance and career development reviews by gender, age and other indicators of diversity (minority or 'vulnerable groups'). Part of its equality and diversity monitoring also looks at the demographic profile of new hires and of turnover. A further disclosure item requests information on incidences of discrimination and corrective action taken. Differences in benefits between full-time and part time and temporary employees are further considered, as are parental leave policies, including the monitoring of return to work post-maternity employee retention rates. The ratio of basic salary between men and women was further considered as was differences in entry level wages.

Community Employer

Employer schemes that target recruitment on local communities or people from disadvantaged background are perhaps one of the most commonly recognised employment policy approaches to corporate social responsibility. Community employment impacts were therefore a commonly considered ESG performance outcome across frameworks. In terms of hiring locally some ESG frameworks considered indices such as regarding the % of employees hired from local communities although the questions tended to be more orientated towards multi-national corporation international activity.

3.5 Environmental Sustainability

Environmental sustainability was a major theme across the different frameworks considered. For example, the GRI standards consider a variety of issues such material usage, energy usage, water, biodiversity, emissions, effluents and waste, environmental compliance and supplier environmental assessment.

3.6 Further Methodological Issues

A number of further crosscutting methodological issues were identified through the desk research and interviews. Some interview respondents for example discussed the relative advantages and disadvantage of a metrics quantitative based approach to monitoring responsible business performance versus a more qualitative narrative reporting approach. A metrics based approach can provide comparable information that could be aggregated into overall indices, facilitating the benchmarking of the ESG performance of organisations to allow customers, investors, and employees to make enlightened choices. The concept of Social Return on Investment (SROI) was relevant here where organisations seek to apply frameworks to estimate the (financial) value of the social impacts. From an audit perspective SROI may be useful to demonstrate social value to funder or contractors.

Metrics however requires meaningful comparisons. This for example could involve a ‘race track’ approach where key competitors in a given market segment are compared to each other on their ESG performance. Current approaches to ESG measures it was felt however are potentially too complex for communication to a non-technical audience for reasons such as helping consumers benchmark the ethical performance of different companies.

Different organisations undertake non-financial reporting for varying reasons and have varying levels of exposure to different ESG related risks. Currently this means there is a lack of standardization in terms of both the coverage and depth of reporting under existing frameworks. A focus on output and outcomes also obscure the fact that different organization by virtue of factors such as their size and nature of business have different types and levels of resources meaning that a fair benchmarking of companies where possible should take into account differences in resources. For example, it may be easier for larger multi-national corporations (MNCs) with explicit CSR budgets to be involved in more community outreach projects, or organisations with higher profit margins to pay better wages and offer better working conditions. A racetrack approach therefore once again could help overcome such problems where careful comparisons are made.

Beyond a core set of measures not all of ESG performance activities are necessarily quantifiable meaning narrative reporting is necessary. Narrative reporting in contrast may provide a more ‘human’ focus to communicate to broader community stakeholders. Consequently, a further issue with a metrics-based approach relates to communication. Although quantitative information and charter marks could be helpful for benchmarking and informing stakeholder decision-making, in some respects it was felt that the more ‘human interest’ stories of CSR activity that likely resonate with the broader public. Narrative reporting in this sense can communicate stories of business activities to audiences that statistical and charter mark measures do not necessarily reach. There is a problem however that reporting frameworks often appear to focus on the amount of information on a given ESR target rather than the quality of information and an assessment of firm performance[57].

ESG performance charter marks for organisations that meet a given level of standards such as FTSE4Good provide a way of monitoring activity. At the same time, such approaches need to strike a balance in that they are broad enough to be attract the interest of a range of organisations but also stringent enough to discriminate between the best performing companies from the rest (e.g. bronze, silver and gold awards). Where the requirements are too low to gain a charter mark or lack discriminatory power this may undermine the purpose and validity of the system as an indicator of performance.

A criticism of the FTSE4Good is that it lacks discriminatory power. By 2005 80% of FTSE100 companies were listed on the index leading some to question the extent to which it can be considered as a genuine ethical investment index[58]. At the same time the engagement process is partly responsible for helping bring companies up to the required standards and the index is set so that 30-40% of potential companies for inclusion meet the standards[59]. A central behavioural lever is the threat of removal from the index and the FTSE4Good Policy Committee has decision-making powers in this respect after a process of dialogue and engagement with organisations being at risk from removal[60].

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[57] Luke, B. (2016). Measuring and reporting on social performance: From numbers and narratives to a useful reporting framework for social enterprises. Social and Environmental Accountability Journal, 36(2), 103-123.

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Another question that arose within our interviews concerned whether a one size fits all approach to monitoring inclusive business in necessary of feasible. The sheer diversity of employers and size of businesses will undoubtedly affect the scalability of practices. This raises the question of whether a more modular approach should be taken such as where a core set of inclusive business practices are identified but other dimensions may be selected in relation to capacity and priorities.

3.7 Conclusions

From an inclusive growth perspective, many of the considered ESG Performance frameworks contain constructs and measures linked to inclusive growth objectives. At the same time several of the commonly used reporting frameworks contain holes or omissions in terms of the ability to fully represent the varying dimensions of business behaviour that affects inclusive growth. Examples include: the reporting of some non-standard employment practices (e.g. zero hours contracts); broader measures of pay inequality beyond executive pay; and profit ratios.

If the government is serious about strengthening the representation of broader stakeholders (employees, customers) within corporate governance then increasing the transparency regarding shareholder and profit activity and not just executive pay is required. From an industrial policy perspective asset stripping and excessive profit taking where inhibiting business growth and development for short-term gain are also a material concern. Beyond executive pay, inclusive companies are ones that do not extract excessive value through profit taking, re-invest in their businesses and workforces, and ensure employees are fairly included in the prosperity that arises in part from their endeavours. Profit ratios may therefore be relevant in addition to executive pay ratios or other measures that provides an assessment of the relative balance of growth and profit objectives.

There are limitations however in the extent to which indicators and monitoring practices can help encourage more responsible business and inclusive growth. This means that in the absence of specific change strategies to promote the fulfilment of objectives such indicators alone will lack their full potential impact. An influencing strategy that support business activity to implicitly or explicitly promote inclusive growth is therefore important. It is this topic we turn to in the second report.