September 2017

Strengthening Board Accountability for Alignment of Wider Pay Policy

Demonstrating fairness, building trust

Interim submission from the Steering Group of The Purposeful Company

1. Submission objective and context

The issue of fairness in society has become a high profile issue, of growing political prominence since the financial crisis, and, in particular, since the vote to leave the EU. The referendum vote was commonly interpreted, at least in part, as a reaction against a system perceived to be rigged against ordinary people.

The result has been a series of reviews and interventions on pay at the top and the bottom of the income distribution. Over the last year we have had a Government Green Paper and a BEIS Committee Parliamentary Inquiry focusing on corporate governance and executive pay. In parallel we have seen introduction of, and progressive increases in, the National Living Wage as a development of the existing National Minimum Wage, and the Taylor Review of Modern Working Practices addressing pay and conditions at the lower end of the income spectrum. In its election manifesto, the Conservative Party committed to continuing increases in the National Living Wage, and to ensuring the interest of employees are properly protected, taking into account the findings of the Taylor Review. Perceived excesses in executive pay were to be addressed through stricter shareholder votes and requiring companies to publish pay ratios between the CEO and average of the UK workforce.

But fair pay should not just be a matter of political interest. On the one hand corporate Britain needs to engage constructively with the agenda of rebuilding trust in business, to retain the licence to operate to generate wealth and growth. But also, a greater focus on unleashing more of the potential in the workforces of British companies must form an essential part of addressing the productivity conundrum we face. Fair treatment of employees – appropriately defined and framed within a commercial context – is part of this, and leading companies have an opportunity to demonstrate the great work they already do in this area.

We believe there is an opportunity both to increase trust and to contribute positively to employee engagement and company performance, by strengthening board accountability for pay fairness. But there is also the risk of the concept of fairness being hijacked by special interests or a particular viewpoint, such that inherent in pay ratios. Thoughtful implementation is therefore essential for the benefits to be delivered and any unintended consequences minimised.

The Government has now issued its White Paper on Corporate Governance Reform. As well as requiring disclosure of pay ratios, Action 2 refers to broadening the role of Remuneration Committees:

> **'The Government will invite the FRC to consult on a revision to the UK Corporate Governance Code and its supporting guidance to give remuneration committees greater responsibility for demonstrating how pay and incentives align across the company, and to explain to the workforce each year how decisions on executive pay reflect wider pay policy. This consultation will provide an opportunity to seek best practice examples from those remuneration committees that already proactively engage with the wider workforce, while enabling current work in this area by a number of prominent think-tanks to be taken into account.'**

The purpose of this submission is to give the views of the Steering Group of The Purposeful Company on how the FRC should consider this request. In our Policy Report and more detailed Executive Remuneration Report published in February this year[1], we set out proposals for strengthening board accountability for pay fairness. The recommendation was that there should be: expanded oversight accountability for Remuneration Committees, disclosure requirements through a Fair Pay Report within

[1] The Purposeful Company Policy Report, February 2017 http://bit.ly/tpcpolicy ; The Purposeful Company Executive Remuneration Report, February 2017 http://bit.ly/tpcpay

the Remuneration Report, and meaningful engagement with employees. This is very aligned with the recommendation now being made by BEIS to the FRC. However, we have reflected the language of the BEIS recommendation by recommending a framework of accountability for overseeing **alignment of wider pay policy** across the company. The concept of **pay fairness** will remain core to this, and we would encourage companies to look at alignment of wider pay policy in these terms. However, we have chosen to reframe our recommendations so that they directly address the request that BEIS have made of the FRC.

Following publication of our report, working with PwC we convened a working group of non-executive directors and HR professionals from a dozen major UK organisations to test and develop the recommendations we had made, and to consider how they might be implemented in practice. The proposals have also been tested more widely with a group of around 30 global corporates through PwC. This paper sets out our updated recommendations following this process. Although the core of the recommendations remain, the further engagement has led to some important insights, which we have factored into the proposals presented in this submission.

Summary of recommendations

1. The UK Corporate Governance Code should strengthen Board accountability for overseeing governance in relation to alignment of wider pay policy across the company.

2. As part of this companies should be required to produce a Company Remuneration Report, setting out their philosophy on company-wide pay alignment and how this is implemented.

3. The report should include information on how employee input into the wider pay policy has been sought and what the result of that input has been.

2. Key principles of implementation

Our focus with the working group was to identify how our recommendations could be implemented in a way that would encourage positive change while minimising any unintended consequences. Overall we were greatly encouraged by the enthusiasm with which our proposals were greeted, although naturally the group was somewhat self-selecting. Moreover, it comprised large, predominantly multi-national, organisations which generally already have a significant responsible business agenda, and which have the resources to consider the issues raised by the fairness question. A number of large organisations we have spoken to are now exploring voluntary adoption of fair pay principles regardless of any regulation or code developments that may emerge.

It will be important to test the proposals also with smaller, domestically-focused organisations within the FTSE-350. However, we believe there is no reason why a common approach could not be applied. Indeed, implementation through the UK Corporate Governance Code, as opposed to Remuneration Reporting Regulations, means that large private companies, who often follow aspects of the Code on a voluntary basis, would also be encouraged to adopt. Indeed, inclusions of provisions on accountability for wider pay policy could be included in a version of the Code that could be extended to large private companies. This would not require detailed executive pay disclosures from private companies, but would ensure that, along with wider s172 obligations, the important issue of pay fairness was also prominent in the considerations of private company boards.

Reflecting on the feedback received, there are four principles of implementation that we would like to draw to the attention of policy makers before presenting the detail of our proposals:

- the approach can and should reflect sound economics;
- the focus should be on wider employee pay as much as executive pay;
- the approach should be principles-based rather than prescriptive to allow fairness and pay alignment to be considered in a broader context; and
- the approach should not assume a single definition of ‘fairness’ or ‘alignment’.

The approach can and should reflect sound economics

Markets matter, and pay differences exist for a reason. Market prices, including wages, send important signals about where resources should be applied. A focus on market principles has doubtless played a role in the UK’s success in job creation over the last two decades. Markets also need to be able to reallocate resources. Decisions made for the benefit of the economy as a whole may not benefit individual groups of employees at a point in time. Business acting ethically within the legal framework of employment law and the National Living Wage provide important employment opportunities, even if financial constraints prevent them paying above minimum legal requirements. Paying above market rates without purpose may simply lead to inefficiency and reduced productivity growth, with broader adverse economic consequences. Unsustainable increases in employee pay would ultimately damage employment prospects and the competitiveness of British business.

Markets also apply to senior executives. The UK is a uniquely open economy, and provides capital for listed business with operations all around the world. It is important that the UK remains open in a post-Brexit world. UK executive teams are international, and we need the UK to remain an attractive place for talented managers to come and work, and investors to invest. Senior executives often face market forces that differ from those applying to local workforces. A simple connection between executive pay and employee pay cannot be made.

In this context, the working group was strongly against a focus on pay ratios, which were felt to pander to uninformed prejudice as opposed to providing meaningful information. Pay ratios are also based on a presumption that lower ratios are always good, and higher ratios always bad, which is not borne out by the evidence. The case for alternatives to pay ratios have been made elsewhere[2] and we will not repeat the arguments here. But it is notable how publication of ratios had no support from companies who are strongly committed to a responsible business agenda, fair treatment of employees, and being employers of choice. At the very least, pay ratios should be reported on a multi-year basis (e.g. five or more years), to focus on trends within the company over time, rather than on a 'spot' basis, which increases the tendency of misleading comparison across companies. Now that pay ratios will be introduced, it is important that companies are encouraged to consider and explain pay policy within a broader context of fairness and alignment rather than narrowly in relation to the pay ratio itself, which as a snapshot is a largely meaningless statistic.

At the same time, employees are clearly not just another 'resource', but stakeholders who must be treated with respect and consideration. Employees are also citizens. Capitalism requires the consent of society to operate, and we are at a point where business needs to do more to demonstrate the benefits it brings society as a whole and a commitment to fairness. If all sense of proportionality is lost between the pay of executives and that of the wider workforce, and if differences are not seen to be based on merit or performance, then public support for a business-friendly environment will gradually decline, with costs for all of society. Moreover, the evidence of the long-term benefits of good treatment of employees, in terms of the long-term shareholder value created, is extremely compelling[3].

Therefore, challenging boards to take a fuller role in considering fair treatment of employees through pay (and broader mechanisms) encourages good business practice that is supportive of long-term value creation. Equally, ensuring that executive incentives are appropriately aligned to performance and that pay is not higher than necessary is an important part of board responsibilities. These two issues should be considered together within an overall framework of pay alignment, but the two may be subject to quite different considerations and so should not be mechanically connected.

The focus should be on wider employee pay as much as executive pay

In some ways it could be considered surprising that inequality has risen so decisively up the political agenda at this time. Data from the Office for National Statistics[4] shows that inequality in the UK has actually fallen since the financial crisis with the Gini coefficient now at a level not seen since the 1980s. Furthermore, data shows employment rates at their highest level since records began[5] and unemployment down at levels last seen in the mid-1970s. The fact that employment levels remained so high following the worst financial crisis in living memory is a tribute to the extraordinary resilience and high level of flexibility of the UK labour market.

But international research by PwC tracking strength of public concern about inequality against actual levels of inequality has shown there to be no correlation[6]. Instead, concerns about inequality are strongly correlated with concerns about employment opportunities. Yet why should there be a particular concern about employment opportunities in the UK given the impressive record of job creation in the UK economy? This is a complex issue, with many likely components to the explanation. One is that our

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[2] The Purposeful Company Executive Remuneration Report, 2017, pp26-34 http://bit.ly/tpcpay ; Tom Gosling, Written Evidence to the BEIS Committee Corporate Governance Inquiry, 2017 http://tinyurl.com/jmrc9ux ; and Alex Edmans, 'Wy we Need to Stop Obsessing over CEO Pay Ratios', 2017, Harvard Business Review, http://tinyurl.com/y7sk9ynn
[3] See for example Edmans, A. (2011), 'Does the Stock Market Fully Value Intangibles? Employee Satisfaction and Equity Prices', *Journal of Financial Economics* 101, 621-640 ; and Edmans, A. (2012), 'The Link between Job Satisfaction and Firm Value, with Implications for Corporate Social Responsibility', *Academy of Management Perspectives* 26, 1-19
[4] Office for National Statistics, 2017, 'Household disposable income and inequality in the UK: financial year ending 2016'
[5] Office for National Statistics, 2017, 'Labour force survey'
[6] PwC, 2016, 'Time to listen', http://tinyurl.com/h4dfg5y

job-rich economy has failed to deliver real wage growth for the past decade[4]. The reduction in inequality has been driven by increases in income for the retired. Real disposable income for working people has fallen since the financial crisis, at the same time as rising housing costs have made home ownership a less attainable goal, blunting the sense of aspiration for young workers, and their parents. At the same time, as the Taylor Review notes[7], work has become less secure and under-employment, rather than unemployment, remains an issue. Trends towards part time and contract work, and the potential impact of technology, are potentially casting a shadow over workers' sense of future security. And regional variations in the labour market remain profound.

This context goes well beyond the scope of policy considered in this paper, but is important for this reason. Executive pay has long been a signature issue in the debate about inequality. But concerns about unfairness in society will only to a very limited degree be addressed just by bearing down on pay at the top. There needs to be a sustained focus on improving the lot of ordinary workers. This is a difficult and long-term enterprise largely located in the areas of education and skills policy and industrial strategy. But corporate governance can play a role, and we believe it would be a missed opportunity for it not to do so.

This insight also has important implications for the thrust of any policy. Many proposals on linking executive pay to the wider employee context have been from the point of view of seeking to control executive pay: pay ratios; seeking employee views on executive pay (including potentially even employee votes); requiring the remuneration committee chair to speak to employees about, or explain, executive pay.

While ensuring that executive pay is understood and felt to be justified by employees is doubtless helpful to the wider social fabric of the organisation, it is likely to be much less relevant to employees' concerns than ensuring that their own pay and conditions are fair. Unjustified executive pay is clearly corrosive to public and employee confidence in business. But simply controlling executive pay is likely to have little impact on employee welfare unless they feel their own concerns are being addressed in good faith.

This is why the current governance reforms should take the opportunity to direct board attention more to the wider workforce pay and conditions, to create a balance to the significant amount of time devoted to considering senior executive pay.

The approach should be principles-based rather than prescriptive to allow fairness to be considered in the broader context

Rules-based regulation encourages a compliance mind-set. The goal should be to encourage boards to think more broadly about their company's approach to pay alignment and the issues raised. Any corporate governance intervention in this area should pose questions for boards to debate and consider, rather than detailed disclosure requirements which may be published and ignored. The success of UK Corporate Governance has been the way in which a Code-based approach has encouraged boards thoughtfully to consider the approach to governance that is suitable for their circumstances, rather than merely satisfying themselves that they legally comply with a set of rules. This leads to a deeper and more mature consideration of governance issues, which in turn helps build confidence in UK markets.

Moreover, many businesses will see pay alignment and fairness only in the context of wider dimensions of the employee value proposition. There is a case to be made that limiting discussion of fairness to pay could itself create a one-dimensional view that underemphasises other important dimensions such

[7] Good Work: The Taylor Review of Modern Working Practices, 2017

as social mobility, training and reskilling, flexible working and so on. On the other hand, fairness is *at least* about pay; yet defining the full scope of fairness across the employee value proposition creates a potentially unmanageable scope. Therefore, regulation or codes should not seek to define what alignment or fairness is, but instead challenge boards to consider and articulate these concepts in their own context. This extends to where the board seeks to place oversight of the issue (e.g. Sustainability Committee versus Remuneration Committee) and where it seeks to report on it (e.g. Sustainability Report versus Remuneration Report). This leaves companies free to position the question in as broad a context as makes sense for them and their strategy, while ensuring consideration of at least pay. Market competition in reporting in response to investor demands should then create a natural evolution of best practice which can extend beyond the confines of pay into broader considerations of how companies treat their employees.

This makes a Code-based implementation ideal, as opposed to regulatory intervention with potential unintended consequences. Avoiding too prescriptive an approach should also help gain acceptance from business and encourage best practice to develop over time, as has been the case, for example with Corporate Social Responsibility reporting.

A principles-based approach also helps to avoid over-reach from non-executive to executive responsibility. The board and its committees should be providing governance oversight and challenge, and not be tasked with operational responsibility for matters within management's remit. Experience with banking regulation has shown that increasing the role of Remuneration Committees in overseeing pay across the firm can have some very productive consequences, but that these can be undermined if the Committee gets mired in detailed operational decision making. It is also important that chairing a Remuneration Committee does not become an impossibly demanding job, open only to those with specialist HR backgrounds and the capacity to manage a greatly increased time commitment.

The approach should not assume a single definition of 'alignment' or 'fairness'

A principles-based approach also enables companies to implement any requirements in the manner that best fits their circumstances. Fairness is multidimensional and regulation should not drive companies towards a single interpretation (for example increasing pay equality across the organisation, as implied by pay ratios). Research by PwC in conjunction with the London School of Economics and Political Science[8] suggests that multiple dimensions of fairness will be relevant for a given organisation and that fairness does not equal equality. These could include: equal pay for equal work, minimum levels of income to lead a dignified life, pay for performance, market competitiveness, and so on. Different businesses will have a different emphasis. Concepts of pay fairness extend far beyond a one-dimensional view of comparisons between executive pay and employee pay[9].

Focussing the requirement on boards simply to justify or explain pay ratios would create entirely the wrong mind-set, and would likely lead to little change and little by way of meaningful insight. It will be much more beneficial for employees, and the companies they work for, if board attention is instead shifted to paying more attention to the principles by which management reward employees across the organisation. Consideration of the principles by which pay and conditions are set across the group, undertaken with authentic intent and supported by insight from appropriate engagement, creates the opportunity for positive change in a way that narrow consideration of pay ratios never will.

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[8] Research ongoing, due for publication Autumn 2017

[9] Starmans, C., Sheskin, M. and Bloom, P. (2017), 'Why people prefer unequal societies', *Nature Human Behaviour*, 1, 0082

3. Recommended approach

3.1 Proposed Board Remit

Below we set out an example UK Corporate Governance Code Requirement in relation pay fairness.

Example UK Corporate Governance Code Requirement:

The Board, either directly or via delegation to a sub-committee such as the Remuneration Committee, should:

- review and endorse a clear philosophy and principles, produced by management, in relation to alignment of wider pay policy and pay fairness across the company, including broader dimensions of the employee value proposition if considered appropriate by the board;
- satisfy itself that appropriate governance exists to ensure those principles are enacted through the organisation;
- receive appropriate periodic information from executive management on achievement of, or progress towards, the company's objectives;
- produce a Company Remuneration Report outlining the principles, governance, and outcomes with appropriate narrative and quantitative reporting in addition to statutory disclosures; and
- regularly seek employee views in an appropriate way to inform the wider pay principles and explain how it has done this in the Company Remuneration Report.

Note that the remit is designed to avoid executive over-reach by the Board into areas of legitimate management responsibility (a potential criticism of some financial services regulation on pay).

Boards should have flexibility about how this remit is discharged. In many cases the Remuneration Committee would be the natural point of delegation, but some companies may choose to implement any requirement via, for example, a Sustainability Committee. Therefore, the Committee where this work is undertaken should not be prescribed.

While the experience of how employees are treated clearly goes beyond pay, the immediate societal pressures relate to pay, and organisations would, of course, be free to place pay policy and pay fairness within a broader context of HR strategy and the employee value proposition. However, framing the requirement around pay in the first instance prevents an impossibly broad requirement.

3.2 Company Remuneration Report Contents

The Company Remuneration Report would develop according to best practice developments, but subsection headings could be:

- Principles of pay policy alignment and fairness across the group
- Governance
- Mechanism for seeking employee views
- Narrative and quantitative description of implementation of the principles
- Pay ratio disclosure and other mandated disclosures

An illustrative Company Remuneration Report, prepared with the assistance of PwC, is included as an appendix to this submission. We have focussed this example on pay, being the minimum requirement for consideration under principles of fairness and alignment. However, many organisations might wish to include wider dimensions of the employee relationship within their fairness approach including, for example, social mobility, parental leave, and training. As such the Company Remuneration Report would become a People Report.

Given the requirement for flexibility as to how the Board delegates responsibility for the fair pay process, there should be flexibility about where the Company Remuneration Report is published. Some companies may include it as a section in the remuneration report, whereas others my feel it sits more naturally within the scope of sustainability reporting.

Prescriptive reporting requirements can lead to boiler plate disclosure. A more flexible approach would be preferable with organisations asked to set out their approach, for example under the headings above. Quantitative reporting would be encouraged and could incorporate any limited mandated disclosures legislated for by Government. Making reporting requirements less prescriptive, focusing instead on what companies are being encouraged to explain, could help limit the extent to which the Company Remuneration Report is viewed negatively as just another bureaucratic requirement.

Undoubtedly explaining pay fairness is more challenging for economically marginal businesses that cannot afford to pay more than legally mandated amounts. However, this simply means that in such businesses market competitiveness is the dominant principle of pay alignment. The board remit around alignment of wider pay policy will still encourage the board to think about sources of perceived unfairness within their own organizational context, which could be focused on, for example, timely and accurate calculation and execution of payments, equal pay, or broader aspects such as quality of opportunity to opportunity to progress, or allocation of shifts and working hours.

3.3 Engaging with employees on the Company Remuneration Report

The Government has asked the FRC to consult on the development of a new UK Corporate Governance Code principle establishing the importance of strengthening the voice of employees and other non-shareholder interests at a board level as an important component of running a sustainable business. Specifically the Government will invite the FRC to consider and consult on a specific Code provision requiring premium listed companies to adopt, on a comply-or-explain basis one of:

- designated non-executive director;
- formal employee advisory council; or
- director from the workforce.

In addition, the role of engagement feedback surveys and focus-groups should not be overlooked. Many companies now run these on a sophisticated and frequent basis, to provide a robust statistical measure of employee attitudes and concerns at any point in time.

Practically, any approach to seeking employee feedback on the Company Remuneration Report should be aligned with the chosen mechanism for employee voice, and should be based around the overall Fair Pay Report as opposed to just executive remuneration. There would be some limited benefits to engaging with employees on executive remuneration, in terms of helping build two-way understanding of relevant issues, but this would do little to help respond to employee feedback about their own situation. The bigger prize is to nudge boards towards more holistic consideration of fair treatment of employees and to create accountability for that through appropriate reporting.

Therefore, again, flexibility would be required, recognising the diverse circumstances of different businesses. This could, for example, be built into extended Information and Consultation mechanisms as suggested in the Taylor Review. It is also important to note that the Board (or delegated Committee) responsibility is to ensure governance oversight of the process of engagement, rather than to get involved in operational implementation, which is the role of executive management.

4. Next steps

This paper outlines the views of the Steering Committee of The Purposeful Company in relation to how the UK Corporate Governance Code could be amended to strengthen board accountability for alignment of wider pay policy in a proportionate way.

We provide a 'best practice' example of what a Company Remuneration Report could look like, together with ideas for how the process could be integrated into board governance and employee engagement.

Together with PwC we continue to develop the concept of the Company Remuneration Report, or Fair Pay Report, with companies and expect best practice to develop over time. We are ready to help facilitate further dialogue with companies on these proposals and on developing practice as required.

Purposeful Company Steering Group
September, 2017

Appendix

Illustrative Company Remuneration Report for Mythical FMCG plc

What follows is a purely illustrative Company Remuneration Report for a mythical consumer goods company, FMCG plc, prepared with the assistance of PwC. This illustrates how the requirements of the Board's remit above could be reflected in reporting. Note that this level of reporting would not be mandated. Rather we have illustrated how a company might respond to the requirements, taking a best practice approach. Note that the reporting requirements would be largely non-statutory, although any statutory requirement to disclose pay ratios could be included here. Indeed it may make sense to disclose pay ratios in the context of wider company remuneration policy and so companies could be given some flexibility as to where the statutory pay ratio disclosure was placed.

The purpose of the illustration is to provide a tangible example of what is meant by a Company Remuneration Report. Best practice guidance could be developed separately in due course.

We also note that we have, for simplicity, restricted this report to pay. As highlighted above, for many organisations sitting pay policy and fairness in a broader context that goes beyond pay may be more meaningful and can encourage good practice across a range of dimensions. In this case a wider range of qualitative and quantitative metrics could be considered.

The dimensions of pay policy selected here are also purely illustrative, as are the supporting metrics. These would each differ by company. It is acknowledged that high-value industries providing good-quality high wage jobs would find it easier to articulate a positive and engaging philosophy on fairness than economically much more marginal industries where minimising labour costs can be a matter of corporate survival. This should not lead to demonisation of businesses providing valuable employment opportunities, but could lead to encouragement for them to think of how fair treatment of employees is ensured in a respectful environment, even where wages are at minimum levels.

Introduction

FMCG plc operates in global consumer goods markets with supply chain, manufacturing, sales and distribution covering over 30 countries globally. We seek to improve health and wellbeing of our customers and communities.

Pay principles

The company is committed to fair pay in line with the following key principles.

Market competitiveness

FMCG operates in 34 territories across the world. We need to ensure we pay competitively to attract and retain colleagues at every level. Our approach is to pay median fixed pay, to provide excellent benefits, and for Colleagues participating in our short and long-term incentive plans to provide the opportunity for upper quartile reward for excellent performance. This same benchmarking approach applies for all Colleagues, including senior executives. In setting our market positioning we also take account of the world class training and development opportunities offered to colleagues at FMCG (see our People Report at page XX for further information on our broader Employee Value Proposition).

Pay for contribution

Our philosophy is that all Colleagues should have the opportunity to improve their pay through the contribution that they make to FMCG. This is achieved through three main devices. Around half of our colleagues participate in bonus plans that provide them with the opportunity to earn incentive pay based on their individual performance as well as that of their business and the company as a whole. Most colleagues not participating in bonus plans receive base pay awards based on merit and skills acquisition. We also provide all Colleagues with the opportunity to share in the success of FMCG through our Global Share Plan. Colleagues can invest up to a fixed monthly limit into the plan to buy FMCG shares, and receive one share for free for each share that they buy, provided they hole the shares for at least three years.

Equal opportunity

FMCG is committed to providing equal opportunities to all employees. FMCG has monitored pay gaps by gender for the last 3 years in accordance with local regulations and our standardised global methodology. We have an active programme of seeking to correct pay gaps as we identify them as well as addressing root cause through improving balanced gender representation at senior levels of the organisation. In 2016 we started to monitor the pay gap by ethnicity and will be developing methodologies for reviewing other pay gaps through 2017 and 2018, in particular by disability and social background. Our activities on pay are closely integrated with our wider Diversity and Inclusion activities (see our Diversity and Inclusion Report on page XX).

Dignity and wellbeing

We believe that all Colleagues at FMCG should be paid in a way that provides them with a living wage and a minimum level of security. We have developed a process globally for establishing living wage levels and are progressively ensuring that Colleagues are paid at or above these levels. Living wages are established and audited with the help of the Pay Foundation, a global body devoted to measuring and monitoring living wages. More information can be found in our separate policy framework Living Wage Accreditation at FMCG. We are now seeking to ensure that suppliers operate to comparable standards so that we can ensure that our suppliers enable their employees to live with dignity.

We have also launched our FMCG Core Benefit programme. This programme seeks to provide all of our Colleagues with a minimum level of basic protection benefits, covering life assurance, medical assurance and critical illness / income replacement. The level of benefits is established taking into account local state provision. In this way all Colleagues should earn sufficient and be secure enough to lead a dignified life fully participating in their society.

Our approach to dignity and wellbeing is integrated with our wider employment policy (see our People Report on page X). While flexible contracts can provide freedom, consultation with Colleagues indicates they appreciate a minimum level of security. Therefore, we do not offer zero hours contracts, but instead offer minimum average hours over any rolling one month period. Colleagues tell us that this provides the right balance of freedom and security.

Effective administration

An important part of our approach to reward is that Colleagues clearly understand how their reward works, and it is delivered to them in an effective way. This includes ensuring we have robust systems to minimise pay-roll errors so that our Colleagues are paid in an accurate and timely manner, and investing in our *My Reward* technology that enables Colleagues to exercise choices about their pay and benefits in a simple manner at a time of their choosing.

Governance

The Fair Pay Principles / [Wider Pay Principles] were agreed by the Remuneration Committee under delegated authority from the board, following recommendations made by executive management. They are reviewed annually. Responsibility for ensuring the principles are met lies with the Management Remuneration Committee, comprising the CEO, CFO, Group HR Director, and Group Head of Reward. This Committee is responsible for setting policies that have group application and ensure the Fair Pay Principles are met. The Group Head of Reward operates a rolling programme of review and assurance to ensure that our businesses are in compliance with the policies. Each year the Group HR Director presents to the Remuneration Committee a detailed report on the application of the Principles, and the then Committee reviews and signs off this Company Remuneration Report.

Engagement with Colleagues

When these Principles were first set, the company ran a series of focus groups with Colleagues to identify those aspects of pay fairness that were most important to them. Each year, employee representatives on our Stakeholder Panel (see page XX) receive a presentation on the Remuneration Report and the Company Remuneration Report from the Group HR Director, which the Remuneration Committee Chair attends in order to respond to questions. Management shares with the Stakeholder Panel its plans for progressive development and roll-out of the actions to meet the principles, and on occasion has adapted plans in response to Colleague feedback, as described above in our approach to zero hours contracts.

Quantitative disclosures

The narrative disclosure above has set out the key ways in which we apply the principles within FMCG plc. The Management Remuneration Committee tracks a number of KPIs to monitor implementation of our policies on pay fairness. Key metrics are summarised in the table below.

Principle	Relevant KPIs	2014	2015	2016	Key developments during the year
Market Competitiveness	Attrition	8%	6%	6%	• Established improved approach to market data and benchmarking
Pay for Contribution	Participation in Global Share Plan	25%	37%	48%	• 'Share our success' marketing campaign leads to 11%-point increase in global Share Plan participation • Skills based pay rolled out through European manufacturing
	Proportion of employees in bonus, merit, or skills based pay	65%%	71%	80%	
Equal Opportunity	Gender Pay Gap	17%	16%	16%	• 2,000 managers received unconscious bias training • 'Closing the Gap' plan for gender pay removes grade-adjusted gap • BAME pay gap measured for first time
	Gender Pay Gap - grade-adj	2%	1%	0%	
	BAME Pay Gap	n/a	n/a	25%	
	BAME Pay Gap - grade-adj	n/a	n/a	5%	
Dignity and Well-being	No. of countries covered by Living Wage	24	28	32	• Living wage accreditation extended to Philippines, Malaysia, China, and Vietnam
	% of employees covered by Living Wage	70%	79%	93%	
	% of employees covered by Core Benefit	n/a	34%	65%	• Core Benefit roll-out completed in Europe, North America, plus Peru and Chile

Pay relativities and alignment

Statutory disclosures[10]

(i) pay ratio

FMCG is required under UK regulations to disclose the pay ratio calculated as the single figure of CEO pay, compared to the average pay of UK Colleagues calculated on the basis used for the gender pay gap. In 2016 this ratio was 98x.

(ii) base pay increases

FMCG is also required to disclose the pay increase for the chief executive compared to the average increase for UK Colleagues. As set out in our remuneration policy, increases for the CEO do not normally exceed the average increase for UK Colleagues.

Base pay increase for CEO	Base pay increase for UK Colleagues
2.4%	2.5%

(iii) material changes to the CEO's package

There have been no material changes to the CEO's package during the year. In light of the successful turnaround of the group over the last three years, the Committee will be reviewing the CEO's package during the year, and will consider this in the context of wider employee conditions. Any changes will be described here in that context next year.

Non-statutory disclosures

The following information is not required by UK regulation, but is provided to help readers of the report understand our approach to pay relativities and alignment across FMCG.

Our UK population has a high weighting of senior management colleagues. Compared with average total remuneration of our global population, the pay ratio was 135x. We do not have a policy for what our pay ratio should be. We determine pay levels through our principles of market competitiveness and pay for contribution. Because 75% of the CEO's pay is performance related and 50% is linked to share price, the pay ratio can realistically vary, dependent on performance, between 25x and 125x for our UK population and 40x and 200x for our global population.

To help explain the development of our pay relativities, the chart below shows, over the last five years, the ratio of CEO pay to average UK workforce pay based on total pay, and based on base salary only. This is compared with our TSR performance over rolling three year periods.

[10] The statutory disclosures and non-statutory disclosures explaining pay ratios could either sit in the Company Remuneration Report or could form part of the Directors' Remuneration Report

Ratio of CEO to UK workforce pay versus performance over last five years

The key trends in the ratios can be explained by the following developments:

- The base salary ratio reduced in 2014, which was when Joan Smith was appointed as a CEO on a salary 10% below her predecessor.
- The subsequent increase in the ratio back to its prior level as her salary was increased to market median following her appointment, but overall over the period CEO base salary has increased broadly in line with the average of the UK workforce.
- The pay ratio based on total pay has reflected our performance. Because senior executive pay is much more at risk than wider Colleague pay, the ratio is volatile. The reduction in the ratio in 2013 reflects the fact that Simon Jones, who was CEO at the time, received no bonus on long-term incentive award in light of the Health Supplement product recall. The ratio has subsequently increased following the strong performance of the company, which resulted in payment of bonuses to Joan Smith.
- The large increase in the ratio in 2016 arises because this was the year in which Joan Smith's first long-term incentive plan (LTIP) award vested, as set out on page X of the Directors' Remuneration Report.

Further information on pay alignment and relativities

The table below shows how the components of our pay plans vary through the organisation.

Comparison of executive and wider employee pay structures

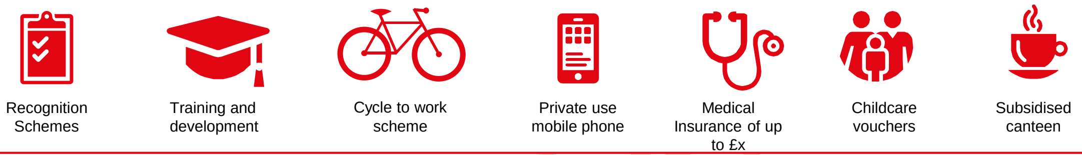
Fairness and equal opportunity tor all is a key part of our employee value proposition and culture. The table below sets out the pay structure of all grades within the company. The Committee is comfortable that the cascade is appropriate and reflects the responsibility that sits with each level.

Number of people	Element of pay	*Employee level – % salary* CEO	Board	ExCo	Senior Management	Grade 5s	Grade 1-4s
12	LTIP – based on TSR and EPS	150%		90%			
35	LTIP – based on EPS only				70%		
154	Restricted shares					40%	
210	Annual bonus – Deferred shares	87.5%	75%	40%	30%	10%	
30,000+	Annual bonus – Cash	87.5%	75%	60%	45%	30%	Up to 20%
35,000+	Pension	30%		25%	10%	Up to 10% - based on tenure	
35,000+	Benefits	All employees are offered some form of benefits – 3-15%					
35,000+	Salary	All employees					

This section represents our policy table for remuneration across the population and the approach taken to internal and external comparisons, covering the structure and level of pay.

The company pays above the National Living Wage for all UK employees, and aims to pay competitive salaries at all levels. We are pleased to be one of a few companies that fully disclose and explain our gender pay gap. Our gender pay disclosures are set out on page XX of the Remuneration Report.

In addition to the above, we offer the following benefits and non-monetary rewards to our employees:



Participation in incentive plans is appropriate to the level of responsibility and accountability. While it is right that the pay of senior executives should be reduced if performance is not strong, less well paid employees need greater certainty in their overall pay package.

The annual bonus for grade 5 and above is based on a common framework as set out for Directors on page X, although a component of the business performance is based on each individual's local business area. At grades 1 to 4, the cash bonus is a profit share arrangement based on company-wide performance. Most employees at this level have pay linked to contribution through merit or skills-based salary awards.

The LTIP is cascaded in a manner appropriate to the accountabilities of managers at different levels. The Executive Committee participates in exactly the same plan as the Executive Directors, as set out on page XX. For the next level of Senior Management, the LTIP still has forward looking performance conditions but these are based purely on EPS, as this measure has greater line of sight for the responsibilities of those individuals. Managers at Grade 5 receive awards of restricted stock, where the award level is modified based on individual performance and talent rating.

The FMCG Final Salary Pension plan was closed to future accrual in 2014, and all Colleagues now participate in defined contribution pension arrangements. These take advantage of local tax-efficient pension savings vehicles in each territory where possible. Where tax-efficient vehicles are not available or are limited in the contributions that can be made, Colleagues are offered a cash supplement of equivalent value to put towards pension savings as they see fit.

Statement

The Remuneration Committee is satisfied that the company has put appropriate governance in place to ensure that the Remuneration Principles set out in this report are either fulfilled or that tangible actions are put in place to progress towards their fulfilment in future.

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Launched in September 2011, Big Innovation Centre is a hub of innovative companies and organisations, thought leaders, universities and 'what works' open innovators. Together we test and realise our commercial and public-purpose ideas to promote company and national innovative capabilities in a non-competitive and neutral environment. We act as catalysts in co-shaping innovation and business model strategies that are both practical and intellectually grounded. Our vision is to help make the UK a Global Open Innovation and Investment Hub by 2025, and to build similar initiatives internationally. For further details, please visit www.biginnovationcentre.com