Shining a Light on Pay Transparency

It’s a dark day for everyone when the annual pay discussion goes awry and the person on the receiving end is blindsided by bad news on pay. Normally, it is when an employee thinks the company has been doing well and they have been doing all the right things—a low single-digit merit increase and lower-than-target bonus leaves them frustrated. Worse, the top executives appear to be doing very well, thank you very much.

An alarming number of people—50% according to a recent industry study¹—say they do not believe they are paid fairly within their company.

Why this is important? It’s about to get even more challenging.

They Earn What?

In the United States the Dodd–Frank Wall Street Reform Act of 2010 will (eventually) require all publicly-traded companies to disclose the ratio of the CEO’s salary compared to the median salary of all employees at the company. The proposed rule, commonly referred to as the “CEO pay ratio,” is expected to be finalized by the end of this year.

There are plenty of reasons why it still may not happen. The CEO pay ratio has been talked about as a burdensome and expensive administrative headache, forcing companies to gather payroll and benefits information to both determine their median-paid employee and to calculate the median total pay of that employee. The calculation must include part-time and seasonal workers, as well as employees in all corners of the world. The mandate all but ensures an inaccurate reflection of total pay according to position, location and myriad other factors, leading many to brand it as a useless number that bears little to no value for investors.

Also, the simple fact is that CEO pay is already disclosed. Anyone can open their company’s Annual Report and do some simple maths to calculate the ratio between his or her pay and the Executive Directors. For example, if an employee’s total pay (including benefits) is £25,000 and the CEO’s total pay is £5,000,000, it’s not difficult to calculate that the CEO’s pay is 200 times that of the employee. That figure—a long way from the figure of 5x lowest to highest recommended by Plato²—is frighteningly close to reality. A recent UK study focusing on this³ points out that a sample of ten FTSE100 companies supplying lowest paid employee data leads to the conclusion that seven of 10 companies they sampled had a ratio well in excess of 200x.

The debate is out there. Thomas Piketty’s widely read and widely reported book⁴ supplies the evidence that disparities of this kind are unsustainable. They are bad for us in the long-run, and the politicians and media are quick to point this out.

Inside companies, there are already many who grumble about top executive pay being in the stratosphere and who lament their own pay in comparison, but most can rationalize the difference between what they earn and what the most senior people at their company earn,

¹ Towers Watson 2014 Global Workforce Study
² “The Republic”, Plato (n.b. George Orwell recommended 10x in 1940)
³ “The gulf between employees’ pay and chief executives’ pay and the adverse impacts on UK plc”, One Society 2015
⁴ “Capital in the 21st Century”, Thomas Piketty

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even if they don’t fully understand why the figures are so different. What we haven’t seen before is the possibility of public access to the median pay of all employees. This number may change the ‘rules’ on pay communication forever.

A Basis for Unhealthy Comparisons

While intended to highlight CEO pay, the ratio will give many the ability to focus on the difference between what they earn and what the median employee earns at his or her company. People will begin to compare themselves to Joe Employee: What does Joe Employee do? Where does Joe Employee work? How is Joe Employee’s job different than mine? Why does Joe Employee make more (or less) money than me? Is that fair?

The danger is that without a baseline of education across the workforce about how salaries, merit increases and incentive payouts are determined—and how they rightfully differ among job roles, responsibilities and geographies—these comparisons will be unrealistic. There is real risk of employee disengagement or even an erosion of trust.

Furthermore, people will look for assurances that their own pay is set and delivered according to ‘fair rules’: governance policies that are well-thought out and aligned with business strategy.

The Best Defense Is a Good Offense

Even without the CEO pay ratio looming, we know there is room for improvement in how companies are communicating about pay with their workforces. According to a recent Pearl Meyer & Partners’ OnPoint survey, less than 70% of employers felt employees had a good understanding of their pay programmes and only about half of those 70% think their employees would rate the value of their pay programmes as high. And while most companies—about 90%—focus key messages on pay for performance, information about how pay is set and the decision-making process is lower on the priority list.

Given looming changes in disclosure abroad and media about pay inequality, companies need to refocus the conversation about pay by communicating information in three important areas:

1. **Base salaries** — Providing a clear explanation of how base salaries are derived for the industry (e.g., benchmarking, market pay position) is an important starting point. It gives people a baseline for apples-to-apples comparisons. It also helps to share internal pay ranges and how they work (e.g., job families, geographic differences, career tracks). Giving people an understanding of where they fit within the company (by Grade, by function and scope of responsibility) and how their role is valued (e.g., a generalist vs specialist) helps explain some of the mystery.

2. **Incentive plans** — Regardless of the form of the award (cash or equity), communication should include clear summaries for the performance measures and targets of the plans and ways that employees, based on their respective roles within the organization, can impact results (often called “line of sight” to business objectives.) It’s also important to be clear about how bonus pools are funded.

3. **Governance** — People need to know who is making decisions about their pay and when, as well as all of the factors that contribute to the decision. This applies to merit increases and incentive payouts, especially if discretion is a part of the equation.

Sharing this type of information, with the right level of detail and delivered by the right sources, makes it less likely people will make uneducated comparisons about how they are paid relative to their peers. Of course, this requires developing and implementing a

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5 “Creating Engagement Through Executive Compensation Communication,” PM&P OnPoint Survey
comprehensive pay communication strategy and education plan that outlines your audience, key messages, timing and methods of communication delivery.

To Do List

Make use of this valuable time between now and the end of the year to map out a plan, develop the communication materials and train the right people. You can get ahead of your next round of pay discussions, your company’s Remuneration Report disclosure and (potentially) a CEO pay ratio disclosure.

There’s nothing worse than having annual pay discussions where everyone is disappointed. A solid communication plan is an excellent place to remedy that and the timing is just right. Start now.

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Originally published in Workspan Magazine by Sharon Podstupka, Principal, Pearl Meyer & Partners

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