

HCM Viewpoint

Equal Pay Governance

Enabling success by leveraging pay equality and diversity



Equal Pay as a chance for companies to execute on their talent strategy

Equal pay is moving to the forefront of regulators' and decision makers' focus globally. While some countries have already imposed equal pay legislations, others are just now putting new legislations into effect. Starting this year, Swiss companies with more than 100 employees are obliged to conduct an equal pay analysis and report on the results. In Switzerland, the pay difference between female and male employees in similar positions is still significant amounting up to about 19% in 2019.¹

The issue of pay equality is also a predominant topic on Board of Directors' agendas. Firstly, equal pay relates to the principles of fairness and no discrimination and is therefore part of most companies' codes of conduct and compensation strategy. Boards are to be informed on the roots of inequalities and remediation activities pursued. Secondly, there is raising investors' interest on ESG topics related to equal pay, including employees' satisfaction and diversity. A company needs to work on its positioning and develop an ESG strategy. Thirdly, emphasizing equal pay acts as a signal for current and potential future employees regarding a company's talent strategy and may positively affect its reputation.

Many companies have recognized that pay gaps are

often also related to low female representation on senior management levels. At the same time, there is consensus in academics and the economy that not only more women in senior positions but diversity in general correlates with higher performance. Specifically, diversity can foster profitability and innovation, enable stronger governance and better problem-solving abilities. Studies have shown that revenues are 19% higher in firms with more diverse leadership teams. In terms of long-term value creation, companies which actively support gender diversity on senior management levels have a 27% higher chance to outperform their peers.²

“Diversity fosters profitability and innovation, enables stronger governance and problem-solving abilities.”

Notwithstanding the above, current statistics for the Board of Directors level show that there is still room for improvement regarding female representation on senior management levels worldwide. In Europe 27% of Board of Directors of the largest publicly listed companies are female on average with France topping the list with 44%.

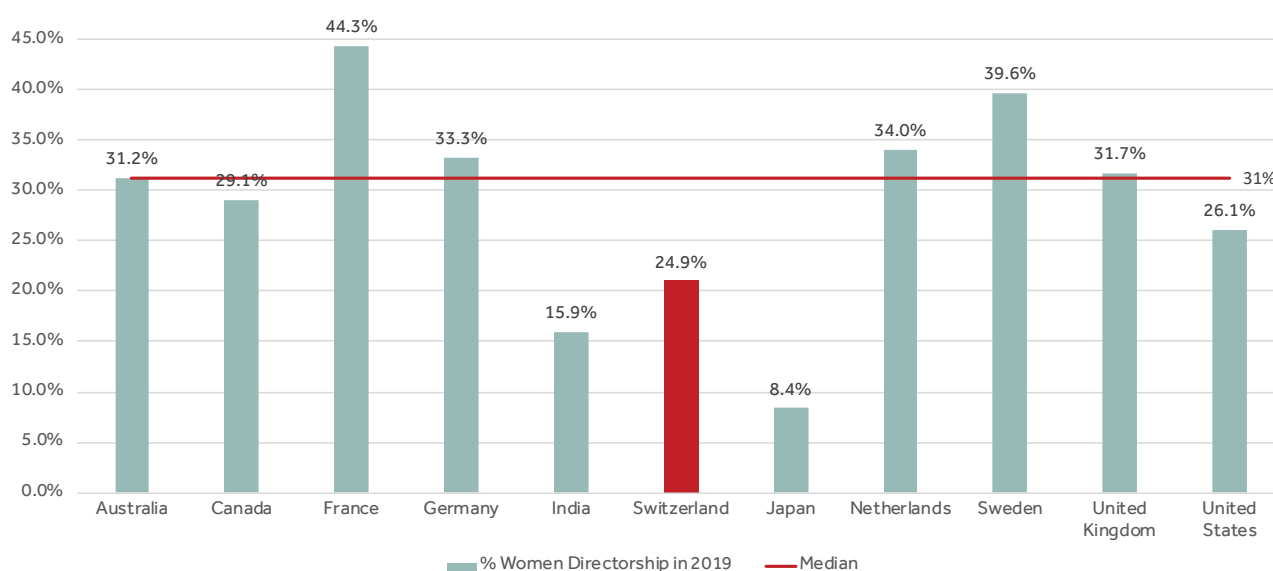


Figure 1: Women's board representation in selected European countries in 2019 (Catalyst Research, 2020).

¹ Swissinfo.ch, June 25, 2019: https://www.swissinfo.ch/eng/unequal-wages_big-pay-gaps-remain-in-switzerland/45055212.

² WEF, April 29, 2019: <https://www.weforum.org/agenda/2019/04/business-case-for-diversity-in-the-workplace>.

In Switzerland, the share of female Board members has increased over the past years but is still below global median levels of 31%. Looking at SMI and SMIM companies, women represented 11% of Board of Directors members in 2014, 18% in 2018 and 24% in 2019.³ Within the pending revision of the Swiss stock corporation law, listed companies will be required to have at least 30% female Board members and 20% female members on the Executive Committee. In case of non-compliance a company will have to report on the background ("comply or explain").⁴ From the point of entry into force of the new law, firms will be given five years to implement the changes. Bearing this in

mind, the need for action is clear, as currently a mere one of two of the 20 SMI firms comply with the targeted ratios.⁵

There is a considerable welfare impact. Based on estimations, closing the gender gap could add USD 28 trillion value to the global economy by 2025, which represents a 26% increase in global GDP.⁶ This viewpoint puts an emphasis on how companies can leverage initiatives around equal pay within their talent management strategy to embed a culture of diversity and inclusion and thereby increase the company's performance and long-term value.

How equal pay is developing around the world

Globally, legislations are increasingly requiring equal pay for equal work. The approaches and development of such regulations differ a lot between countries. For example, since 2018 the German "Entgelttransparenzgesetz" requires companies with more than 500 employees to compile an assessment and subsequently file a report on their pay gap. Further, in smaller companies with a minimum staff of 200, employees can request information on how much their colleagues in similar positions earn.⁷

In the US, the "Equal Pay Act" (EPA) already came into force in 1963. Although pay differences are not persecuted, employees with a claim can contact the Civil Rights Center to investigate the cause. However, companies are not required to assess and report on equal pay. As a result, in 2019 only 65 of the largest 890 companies reviewed and disclosed information regarding the gender pay gap.⁸ This lack of transparency makes it difficult to detect pay inequalities and holds back the convergence of female and male pay in the US labor market.

In UK law, equal pay is incorporated and set out in the "Equality Act" since 2010. Based on this regulation, the gender equality clause is automatically included in all employment contracts. For companies with more than 250 employees, a legislation introduced in 2017 requires the annual online publishing of the gender pay gap data for total pay and variable pay separately with a voluntary explanation.⁹ Nonetheless, in 2019 the pay gap among all employees was still 17.3% in 2019 although it decreased from 17.8% in 2018.¹⁰

According to the WEF Global Gender Gap Report 2020, Iceland has the world's smallest gender pay gap with a woman earning 0.877 dollar for every dollar a man makes.¹¹ Moreover, in 2018, Iceland was the first country to make gender pay discrimination illegal. The established law stipulates that all companies and government agencies employing at least 25 people must obtain government certification of their equal pay policies with violations triggering high fines.

³ HCM Analysis.

⁴ NZZ, June 19, 2019: <https://www.nzz.ch/wirtschaft/schweizer-parlament-will-geschlechter-richtwert-fuer-geschaeftsleitungen-und-verwaltungsrat-ld.1490146>.

⁵ HCM Analysis.

⁶ McKinsey, September 1, 2015: <https://www.mckinsey.com/featured-insights/employment-and-growth/how-advancing-womens-equality-can-add-12-trillion-to-global-growth>.

⁷ Bundesministerium für Familie, Senioren, Frauen und Jugend, July 6, 2017: <https://www.bmfsfj.de/bmfsfj/service/publikationen/das-entgelttransparenzgesetz--informationen-zum-gesetz-zur-foerderung-der-entgelttransparenz/117324>.

⁸ Business Insider, April 2, 2019: <https://www.businessinsider.com/us-public-companies-fail-to-release-pay-equity-reports-2019-4?r=US&IR=T>.

⁹ GOV.UK: <https://www.gov.uk/government/news/gender-pay-gap-reporting>.

¹⁰ Office for National Statistics, <https://www.ons.gov.uk/employmentandlabourmarket/peopleinwork/earningsandworkinghours/bulletins/genderpaygapintheuk/2019#:~:text=The%20gender%20pay%20gap%20among,2019%2C%20and%20continues%20to%20decline>.

¹¹ WEF, December 16, 2019: <https://www.weforum.org/reports/gender-gap-2020-report-100-years-pay-equality>.

How equal pay is developing in Switzerland

In 2018, the Swiss Parliament adopted an amendment to the Equality Act including a new section on equal pay requirements. The new provisions enter into force on July 1, 2020 and require companies with more than

100 employees to conduct an equal pay analysis which will require demonstrating compliance with the law and prove that no gender discrimination exists.

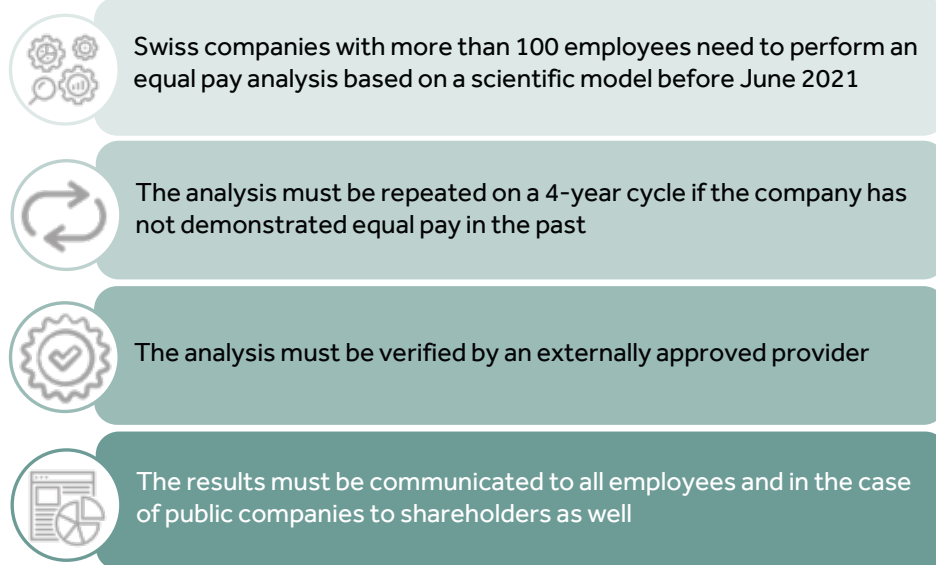


Figure 2: Summary of implications of the Swiss Equality Act amendment re equal pay.

How can pay inequality be explained?

When analyzing the pay gap, a differentiation between “explained pay gap” and “unexplained pay gap” needs to be made. Real discrimination is derived after adjusting for contributors to the explained pay gap. For example, the pay gap in Switzerland has decreased over the years and was 18.3% in 2016 on average with 44.1% of this gap not being explained by objective factors.¹²

The explained pay gap represents differences that stem from legitimate business factors such as professional position, job experience or tenure.

Additionally, performance differences and part-time work are legitimate explanations for differences in pay. Further, differences may be caused by industry with more men working in higher paid industries. Roots that became less significant over the last years but still contribute to causes of inequalities are the level of education and the choice of study. For example, within the last 10 years the share of population aged between 25 and 34 with a university degree increased from 9.8% to 42.3% for women and from 14.4% to 34.7% for men.

¹² Federal Statistical Office, May 6, 2019: <https://www.bfs.admin.ch/bfs/en/home/statistics/catalogues-databases/graphs.asset.detail.8167559.html>.

Today, women are also more likely choose subjects which were or are to this day dominated by men, such as natural science, mathematics, and engineering. The gender-specific choice of education and field of study has thus softened over the past two decades.¹³

Another reason contributing to the explained pay gap can be attributed to preferences and psychological factors that rationalize the choice of work. In general,

women may seek different career paths than men and focus more on intrinsic aspects of employment such as flexibility and work environment. According to a recent study, women also tend to be more risk averse than men and have lower preferences for competitive situations, which by enlarge also include less aggressive compensation negotiations.¹⁴ Both aspects could likely lead to career choices with lower earning potential.

What should companies consider when assessing their pay gap?

When analyzing the width of a company's pay gap, base and variable pay should be assessed separately. Thereby, a gap can already be detected if the base pay of male and female employees in similar positions executing similar work shows a difference. When assessing variable pay, differences in pay levels should be performance-driven in nature.

The Swiss Federal Office for Gender Equality has introduced a standard software called "Logib" suitable for companies with at least 50 employees to facilitate the analysis. The calculation is performed using a regression analysis measuring the impact of different factors on pay. The model further determines which part of the pay difference between female and male employees can be explained by personal characteristics (e.g. education and training), by factors of employment (e.g. the position in the company and job requirement levels), as well as which part of the difference can be attributed to gender.

The gender of employees is included in the regression as an additional independent variable, meaning that in the absence of discrimination, this variable has no significant influence on pay.

However, the tool only considers pay components such as base salary, allowances, 13th monthly wage and special payments, and hence does not consider variable compensation separately. Variable pay in some industries represents a significant part of the overall package which typically increases with seniority. Performance relation is an important reason for pay differences mirrored in variable pay, which requires thorough consideration, especially when analyzing pay packages of employees in higher positions. For companies with rating approaches in their performance management, including the assessment outcomes as independent variable in the model could provide more insights into performance-driven differences within a single company.

¹³ Federal Statistical Office, May 6, 2019: <https://www.bfs.admin.ch/bfs/en/home/statistics/catalogues-databases/graphs.asset.detail.8167559.html>.

¹⁴ Faccio, M., Marchica, M. T., & Mura, R. (2016). CEO gender, corporate risk-taking, and the efficiency of capital allocation. *Journal of Corporate Finance*, 39, 193-209.

What can companies do about unequal gender pay?

Transparency regarding gender pay practices and communicating on pay gap analysis outcomes as now required by Swiss law for listed companies are an effective measure and will lead to more equality. For example, a Danish study assessed the development from 2003 to 2008 when it became mandatory to publish equal pay results and showed that the pay gap decreased by 7%.¹⁵

“Transparency regarding gender pay practices and actively communicating on pay gap analyses are an effective measure and lead to more equality.”

Furthermore, companies themselves can initiate further measures not only to close potential pay gaps but to create a great place to work by leveraging diversity and benefit from its positive effects on performance.

A possible way to address the so-called “representation gap” (which is prevalent among many organizations because of unequal numbers of men and women at each level with often a higher proportion of men in more senior roles)¹⁶ is a balanced talent strategy. Specifically, companies should (1) hire, (2) retain, and (3) develop more women at all levels and actively communicate their talent strategy.

1 Hire

To hire more women, companies can focus on actively creating opportunities with specific recruitment programs. Role profiles should be designed so to attract talents of all gender and provide some flexibility as regards the employment conditions.

2 Retain

To retain more women, especially in more senior positions, companies can establish comeback programs after a career break or a longer leave of absence. In that respect, training managers on how to make fair performance and compensation decisions for employees who have taken a leave is essential. Additionally, organizations can promote a better work-life balance for their employees, for example by providing fair conditions for maternity and paternity leave. Other initiatives to retain more women include on-site day care services or subsidies, as well as flexible schedules, remote work and/or job sharing. To increase workplace satisfaction for women, employees should also be educated to behave in non-discriminating ways with diversity trainings aligned with best practices.

3 Develop

To give women equal opportunities for development, organizations must identify and remove barriers to promotion. This can be accomplished by investing more resources in trainings to fast-track lower managers and in conducting focus groups with these. To provide equal growth opportunities, organizations can give women opportunities to connect with influential people in the organization. For example, a powerful measure is to offer platforms to exchange with female colleagues and to give female senior employees a tool to share their experience on career development.

¹⁵ Bennedsen, M., Simintzi, E., Tsoutsoura, M., & Wolfenzon, D. (2019). Do firms respond to gender pay gap transparency? (No. w25435). National Bureau of Economic Research.

¹⁶ WEF, January 19, 2020: <https://www.weforum.org/agenda/2020/01/gender-gap-equality-income-wages-solution>.

“A balanced talent strategy is built on hiring, retaining, and develop more women at all levels.”

Moreover, while (not presently) required by law, companies may choose to proactively position themselves by integrating diversity as a topic in the annual compensation report. For example, the report could contain information related to the company's equal pay practices, compensation principles and compensation strategy which potentially has positive effects not only for the attractiveness as employer for new (female) talent but the company's reputation as such. By 2025, 75% of the global workforce will be represented by millennials. Millennials understand diversity and inclusion as being essential and a matter of course.¹⁷ To attract the leaders of tomorrow, a company must therefore position itself as providing a supportive environment for individuals of all gender, backgrounds, and views.

Conclusion

Equal pay has become a largely discussed topic in the regulatory environment of many countries. At the same time, an increasing number of companies have acknowledged the importance of equal pay and diversity as an integral part of their culture. However, most countries still show a relatively high gender pay gap with a substantial unexplained part. As Swiss companies with more than 100 employees are required to conduct an equal pay analysis starting this year, they are well advised to leverage equal pay and related initiatives as an opportunity for change to execute their talent strategy and to eventually gain from the positive effects of diversity on performance.

To further encourage a culture of diversity and inclusion, companies may consider to also include gender diversity and equal pay in their performance management processes. For example, some companies incorporate threshold levels of female representation on senior levels or the outcomes of pay gap analysis in their performance assessments. As a leadership tool, such assessments are relevant for feedback and development, including promotion. In some cases, the assessment results are also considered for compensation purposes. Either way, those processes signal a tone from the top and create an incentive to effectively implement measures throughout the organization that help narrowing the pay gap and fostering diversity.

“In essence, a company needs to embed a culture of diversity and inclusion to become an attractive employer in the future.”

Next to transparency and pro-active communications regarding pay practices, all companies can benefit from the introduction of initiatives to hire, retain, and actively develop more women on all organizational levels. Going a step further, gender representation and pay gap outcomes can be considered in performance management processes. Such initiatives facilitate a culture of diversity and inclusion and are not only expected to have a positive impact on the employer's attractiveness for talent in the future but also contribute to its positioning towards investors and will increase the company's value in the long run.

¹⁷ WEF, April 29, 2019: <https://www.weforum.org/agenda/2019/04/business-case-for-diversity-in-the-workplace>.

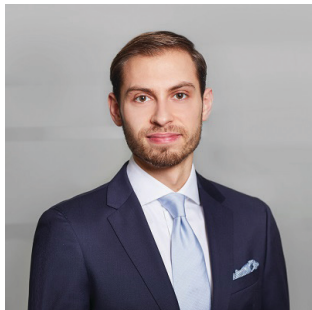
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