Accounting for a Living Wage

Key Takeaways from Piloting, April 2023

The Accounting for a Living Wage Project, a collaboration between Shift and the Capitals Coalition, aims to develop a simple and standardized model for companies to account for and disclose their progress towards paying living wages in their operations and tier 1 supply chain.

Since its inception in February 2021, the project has conducted multi-stakeholder consultations, roundtables and bilateral conversations with existing living wage initiatives and benchmarks, companies and accounting experts. The result of this extensive process was the Living Wage Beta Model:

ACCOUNTING FOR A LIVING WAGE KEY METRICS	
Living Wage Threshold ($)	= Total no. of workers x Living Wage for their location
Living Wage Deficit	**As a proportion of workforce**
	= Total no. of workers below a LW ÷ Total no. of workers
	In $
	= Total no. of workers below a LW x distance to LW for those workers
Living Wage Progress	Year-on-Year Change in Living Wage Deficit ($) as a proportion of Living Wage Threshold ($)
Human Capital Erosion	**In physical units**
	= Living Wage Deficit ($) x Utility of Income Factor (e.g. Health)
	In $
	= Human Capital Erosion (in physical units) x Value of physical welfare component

LW= living wage

This beta model was subsequently piloted by eight companies from various sectors, including apparel, fast moving consumer goods, food & beverage, luxury goods, and retail. Between June and December 2022, the participating companies used the model to collect any additional wage-related data they did not already hold, and to calculate the living wage threshold, living wage deficit and human capital erosion for the categories of workers covered. The majority of companies tested the approach in their tier 1 supply chain; one company trialed the model in relation to their employees; and one company trialed the model for their tier 1 supply chain and core contractors. The approach was tested across 12 countries in Africa, Asia, Europe and North America.

The objective of the piloting was to assess the feasibility and robustness of the model, to identify barriers to applying the model, and to propose improvements to the model. The companies were not asked to disclose any wage information to the project team or the public.

The key takeaways presented in this summary were gathered through conversations with the piloting companies, feedback forms, and the Piloting Companies Exchange webinar held on 9 February 2023.

Key takeaways

Six main themes emerged:

1. DATA COLLECTION IN TIER 1 SUPPLY CHAINS

Securing the necessary wage-related data for the model is inevitably easiest with regard to a company's own employees, can be more difficult with regard to contractors, and is distinctly more challenging with regard to workers in the first tier of the supply chain.

One company shared that even when collecting wage data within its own operations, it needed to account for differences in various pay data systems, which could hinder aggregation at the company level. They recognized a need to address this as a matter of priority. Furthermore, the company reflected the need to socialize the project's definition of wages (basic wage without overtime + payments that are guaranteed to all workers) within the company to ensure the data was reported in a consistent manner.

The majority of companies were piloting the model in their first-tier supply chain, where data collection was recognized to be more challenging. In recognition of the data challenges, the model provides three options for application in the supply chain, with differing levels of complexity.

Most participating companies needed to secure additional wage-related data from their suppliers through social audit processes. This was particularly the case with respect to the percentage of workers paid below the living wage and/or the average or lowest wage paid to the workers covered in the pilot. This proved challenging for three reasons:

1. **Access to credible data.** Some companies were met with an unwillingness from suppliers to share wage-related data. Additionally, in certain cases where this data was forthcoming, participants expressed doubts about its reliability given discrepancies with information secured through prior audit processes.

2. **Definition of wages**. Companies found that the wage definition, i.e. what is included or excluded in wage calculation, can vary among suppliers, agents and factories. Suppliers in some countries (such as China) tended to include overtime in their calculations, which is excluded by the model. While the model allows for the inclusion of fairly-assessed in-kind benefits, provided the proportion of 'wages' made up by such benefits and the methodology to attribute a value to such benefits are disclosed, the treatment of such benefits also varied quite widely, creating challenges in consistency. Most piloting companies did not include in-kind benefits in the calculations, in line with the model's preferred approach.

3. **Capacity**. Some smaller companies found that collecting data from suppliers required extensive time and commitment, which created additional pressure on their in-house capacity.

2. OPPORTUNITIES TO LEVERAGE THIRD-PARTY DATA COLLECTION

Recognizing the above challenges, participants identified an opportunity to leverage existing third-party wage data collection processes. Three of the eight piloting companies were members of amfori, a leading global business association for sustainable trade, which works with amfori BSCI to assess social performance in the members' supply chains. Amfori BSCIaudit, which already includes wage data from suppliers, could be adapted to complement the data collection required by the model. The project has been exploring this opportunity in discussion with amfori. Given that one of the model's methods for supply chain calculations is based on the approach to living wages developed by the Fair Labor Association (FLA), participants also noted the potential to incorporate the model's additional wage data inputs into the FLA's data collection methods. The project team and the FLA are further exploring this opportunity.

3. REFINING WAGE DATA INPUTS

Participants suggested refining some of the wage data inputs needed for the calculation of the percentage of workers below the living wage data point. The proposed changes included framing this data point more positively (e.g. the percentage of workers paid *above* the living wage) and requesting 'proxy' information from which the model can infer or approximate this data point. The participants reflected that such approaches might increase the suppliers' willingness to share information.

4. INSIGHTS INTO HUMAN CAPITAL EROSION

The model was also used to calculate the negative impact of companies not paying living wages on workers' health. The term used by the model to describe the value of this impact is 'human capital erosion.' In general, the participating companies appreciated having this information as it made the impact more tangible. One company shared that since presenting findings related to this negative impact on workers' health to the country team, the team has now begun considering possible mitigation actions to close the wage gap.

In order to facilitate these sorts of internal conversations in companies the project team will be looking at the most user-friendly ways to present human capital erosion.

5. TEMPLATES AND SUPPORTING MATERIALS

The participating companies noted they would welcome additional guiding materials and templates for data collection to simplify the process of gathering the wage-related data in a consistent and time-efficient manner and to support the use of the model. Currently, the model is in an Excel format. The project team is exploring opportunities to make it more user-friendly and adaptable to companies' unique needs. The team will also produce 'how-to' guidance to accompany the model.

6. DISCUSSION: GETTING TO SCALE

A large part of the discussion during the Piloting Companies Exchange webinar centered on increasing uptake of the model. The discussion was timely since one of the key Living Wage Deficit metrics proposed by the model (the percentage of workforce paid below the living wage) has already been incorporated into the Sustainability Disclosure Guidance published by the Johannesburg Stock Exchange and into a draft of the European Sustainability Reporting Standards (ESRS S1 Own Workforce).

The participants highlighted a number of factors that will be important to embedding the model successfully:

i) **Buy-in** from company leadership and ability to demonstrate how the model connects with company objectives

ii) **Engaging with suppliers**, who must see value in applying the model and sharing wage-related data. This depends on companies developing trusted relationships with suppliers, creating incentives for suppliers, and coordinating actions with other buyers, especially for smaller companies.

iii) **Transparency and access to living wage benchmarks**. Participants expressed concern about the lack of transparency in some of the living wage benchmarks. The lack of information about their methodologies to calculate living wages increases uncertainty about the credibility of the data used to calculate the benchmarks. In addition, the fact that many living wage benchmarks are behind a paywall also limits companies' access to the information. Participants voiced support for efforts to enable benchmarks to become open source.

iv) **Reporting standards** were seen as a critical means to catalyze better data collection and assessment of living wages. Companies reflected that currently they do not face pressure from standards-setters, investors, rating or ranking agencies to calculate and disclose how many workers are paid below the living wage and by how much. That said, participants from a number of companies operating in jurisdictions where mandatory human rights due diligence legislation and sustainability reporting standards are in force, or in development, shared that expectations are rapidly shifting. In these jurisdictions, companies are becoming more open to demonstrating their efforts to address human rights risks and impacts, including those related to wages.

Next steps

The project team is very grateful to the piloting companies for testing the beta model and for sharing their valuable experience and insights. The project team would like to express their appreciation to the companies' representatives and their colleagues who dedicated time and resources to applying the model. The feedback will be incorporated into the final model and its accompanying resources.

The project team's next step is to undertake those updates and develop supporting materials, with a view to launching them in summer 2023. It will work with partners and key stakeholders to disseminate the final outputs and share them with more companies, investors, standards-setters, responsible business initiatives, benchmarks and ratings. A number of further companies have also indicated an interest in applying the model, after the pilot phase, which should generate further insights. The project team will also liaise with a number of organizations whose work will be critical to addressing some of the barriers regarding the accessibility of wage-related data in supply chains.