THE one BRIEF
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PEOPLE & ORGANIZATIONS

Do Higher Wages Lead To Higher Productivity?

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OVERVIEW

Demand for skilled workers is rising – and there are signs that wages and compensation packages are beginning to rise again too. But attracting talent alone is not enough – once you've secured skilled employees, keeping them productive is vital to your long-term success.

Understanding what incentives will inspire people to take certain actions lies at the heart of economics – the idea that we respond to potential rewards being one of the fundamentals of the discipline. But the sub-discipline of behavioral economics has, since its emergence in the 1970s, modified the old assumption that people are rational – what motivates us is not as simple as the value of the reward, but can be affected by psychological factors, such as concepts of fairness, morals, or the context in which a reward is presented.

With the world facing a growing productivity challenge, a focus on how to attract the best employees and keep them engaged and productive is becoming an increasing concern, ranking as the fifth biggest business risk worldwide in Aon's Global Risk Management Survey 2015 (third in Asia and North America). Is money the answer – or are other factors more important when building a productive workforce?

IN DEPTH

With the global economy still struggling to fully recover from the financial crisis, attention has increasingly fallen on wages, one of the key indicators of healthy, sustainable economic growth. For the last few years, wages have either stagnated or fallen in real terms in most parts of the world, though there have been recent signs of improvement.

The ongoing stagnation of wages has prompted numerous governmental efforts to give wages a boost to help kick-start consumer spending. With the U.S. Federal minimum wage unchanged since 2010, 29 states have opted to increase state minimum wages and 15 have announced future rises. On the other side of the Atlantic, every European Union country except Greece has raised national minimum wages since 2008 in an attempt to stimulate the recovery. In the vast Asia-Pacific region, more than 20 countries raised or introduced minimum wages in the wake of the global financial crisis.

The global productivity challenge

Yet despite minimum wage hikes to encourage growth, the global economy has been slow to recover – and, most importantly, global productivity growth is continuing a long decline. According to a recent report by The Conference Board, while growth in labor productivity has been declining worldwide for a decade, growth in Total Factor Productivity – which takes into account efficiency improvements via technology and innovation – shrank to just 0.3 percent globally from 2007 to 2014.

This is not just a challenge for business, but for the planet, warns the Financial Times: "Without stronger productivity growth, the world may have to get used to much lower rates of economic expansion."

It's long been known that higher employee engagement leads to higher productivity, with a recent multi-country Gallup poll finding that teams in the top quartile for employee engagement outperform those in the bottom quartile by 21 percent in productivity.

But there are other benefits to your bottom line beyond simple productivity by focusing on increasing employee engagement. The difference between the top and bottom quartiles was also evident in profitability (+22 percent), absenteeism (-37 percent), customer ratings (+10 percent) and quality defects (-41 percent). Meanwhile, research by Aon has found that a 5 percent increase in employee engagement is linked to a 3 percent increase in revenue the following year.

Which means that the true challenge is boosting employee engagement.

Do higher wages lead to higher engagement?

One key to employee engagement is happiness, according to another recent study by the University of Warwick, which found that happy employees were 12 percent more productive. Which leads us to the age-old question – does money buy happiness, and therefore productivity?

According to Aon's latest Trends in Global Employee Engagement Survey, pulling together data from 270 global organizations over three years, these are the top five drivers of engagement worldwide:

- Career Opportunities
- Brand Reputation
- Pay
- Employee Value Proposition
- Innovation

Pay didn't feature higher than the third position in any region – and failed to even make it into the top five in North America.

This is, of course, a top-level view – it's worth checking out the full report for variations by industry, job type, region and generation. And there can be some overlap – compensation forms a part of most employee value propositions, and the desire for career opportunities can in part be motivated by a desire to increase one's salary or benefits.

But the findings were remarkably consistent worldwide. While pay is important, career development opportunities and brand reputation are the top factors for engagement, and therefore for productivity, in almost every region.

A question of fairness and transparency?

It is important to remember that the concept of pay isn't just about the amount of compensation – much of it is to do with perceived fairness. Only 46 percent of global employees in Aon's survey felt that they were paid fairly for their work, while a majority didn't feel that there were any career opportunities for them in their current job. Employees who feel that they are treated unfairly or are undervalued are far less likely to have pride in their company.

Much of this perception can be down to lack of transparency. Without enough information about their colleagues' relative pay and future career development opportunities, resentments can begin to fester.

Some governments are beginning to tackle the pay transparency issue with legislation. The U.K. is introducing rules to force all companies employing more than 250 people to reveal information on the average pay of their male and female workers in an effort to break down the gender pay gap. In the U.S., the Securities and Exchange Commission has recently ruled that public companies must publish details of how much their chief executives are paid compared to a typical worker to encourage greater fairness and transparency, while the European Commission is urging E.U. member states to increase pay transparency by the end of 2015.

This will mean upheaval for many companies – but studies have shown that being more transparent over pay can play an important role in building trust and pride in one's company. With company pride one of the key factors in driving employee engagement worldwide, increasing transparency on pay could be one route towards reducing feelings of unfairness while increasing company pride, your staff's engagement, and your organization's productivity.

And while you're at it, investigating ways to give your staff routes to developing their skills and careers within your own organization – the most in-demand factor to increase employee engagement – certainly can't hurt. As Virgin Group founder Sir Richard Branson famously says, "Train people well enough so they can leave, treat them well enough so they don't want to."

TALKING POINTS

"The key to resolving the productivity puzzle is to increase real wages. A pay rise for hard-pressed... workers would mark a big step forward in raising productivity. It would also help to sustain a recovery by underpinning higher levels of demand. In short, a high wage economy is a precondition for a return to sustainable prosperity." – David Spencer, Professor of Economics and Political Economy, Leeds University Business School

"Today, by and large, there is no link between wages and productivity. Tell me where in which company they link wages to productivity." – RC Bhargava, Chair, Maruti Suzuki

"If you price labor too high – pay workers more than they produce – businesses will slow or stop hiring. They won't sponsor their own bankruptcy." – Robert J. Samuelson, The Washington Post

"Many companies are experiencing a disconnect between the company's productivity and profit growth and the relatively flat increase in wages for the majority of workers... less than half of global employees think they are paid fairly for what they contribute." – Aon's 2015 Trends in Global Employee Engagement Survey

FURTHER READING

- Taking the High Road: New Data Show Higher Wages May Increase Productivity, Among Other Benefits – U.S. Department of Commerce Economics & Statistics Administration, August 4, 2015
- The Growing Gap Between Real Wages and Labor Productivity – Peterson Institute for International Economics, July 21, 2015
- Why the Gap Between Worker Pay and Productivity Might be a Myth – The American Enterprise Institute, July 23, 2015
- Inside the Fight Over Productivity and Wages – The Wall Street Journal, September 8, 2015
- Sometimes Paying People More Makes them More Productive – The Independent, July 13, 2015
- Global Wage Report 2014/15 – International Labour Organization
- 2015 Trends in Global Employee Engagement Survey – Aon Report

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