CAPTURING THE ALIGNMENT ADVANTAGE
BENEFITS FOR EMPLOYEES, COMPANIES AND INVESTORS

THE CHALLENGE
US poverty levels have risen substantially in the past decade, with a lack of quality job creation to both reduce unemployment rates and improve outcomes amongst the working poor.

Simultaneously, US companies are falling behind globally—as their workers are often poorly trained and unmotivated, turnover rates and “shrinkage” is high, and productivity suffers—which, in turn, depresses investor returns.

THE OPPORTUNITY
Impact investors are rising to the challenge, making funds available for funds and enterprises that are actively working to create quality jobs and reduce poverty.

Best practices around employment standards have also proven to help make stronger companies, and in return provide stronger investment returns.

How can companies and investors capture these advantages? This fact sheet explores how great employer practices can drive value to both employees and to investors, and provides initial resources for their implementation.

THE PROCESS
Generally impact investment funds seeking to capture the alignment advantage will take the following steps:

- Set an initial screen of corporate practices to ensure alignment with the social objectives of impact investment
- Develop a scale of quality job practices that companies can move along as they grow
- Design improvement plans alongside management at the time of investment
- Work with companies to improve practices over time as part of overall portfolio management

Example: Company Progress Plan for Employee Ownership

<table>
<thead>
<tr>
<th>TIMELINE</th>
<th>OWNERSHIP PLAN PROGRESS</th>
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<tbody>
<tr>
<td>Year 0 (time of investment)</td>
<td>Only executives have stock; ensure sufficient set-aside of option pool for the future in the term sheet</td>
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<tr>
<td>Year 1</td>
<td>Feasibility study of broad-based stock options</td>
</tr>
<tr>
<td>Year 2</td>
<td>Choose plan and seek management approval</td>
</tr>
<tr>
<td>Year 3</td>
<td>Pilot program with top 25% of employees</td>
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Pi Investments
THE PRACTICES

The following employer practices are considered to be best-of class in both addressing poverty and enhancing value to companies:

1. ENSURE FAIR PAY

HOW THIS ACHIEVES IMPACT

We don’t just have a national unemployment problem; we have an employment problem where over two-thirds of children in poverty live in households where one or both parents work.¹

This is because the minimum wage does not provide a living wage for most American families. A typical family of four (two working adults, two children) needs to work more than 3 full-time minimum-wage jobs (a 68-hour work week per working adult) to earn a living wage.²³

This problem is especially acute with historically underserved communities of color, it is worth noting that Hispanics and African Americans are twice as likely to be working poor. This has increased by 41% between 2007 and 2014.⁴⁵

This means that if impact investors are to truly alleviate poverty in the United States, they can’t just focus on providing families with a job: families need a job with fair pay.

HOW THIS ACHIEVES FINANCIAL RETURN

There is growing evidence that higher wages, rather than negatively impacting the bottom line, actually improve a company’s financial results. Evidence is so compelling that over 1,000 CEOs from major companies like COSTCO and Eileen Fisher formed “Businesses for a Fair Minimum Wage” to encourage an increase in the federal minimum wage. Among the specific effects that this coalition identified are:

- Reduction in turnover, widely recognized as costing as much as 1.5x to 2.5x an employee’s annual salary.⁶
- Reduction in shrinkage and employee theft: employees are not only less likely to steal, but less likely to collude with others to steal if paid higher wages.⁷
- Improved job performance, productivity and service delivery.⁸
- A reduction in the need for a second job means a higher commitment to their main employment, leading to reduced absenteeism.

HOW TO IMPLEMENT FAIR PAY STANDARDS

- Determine a living wage or prevailing wage for the particular region in which the company operates.
- Develop a strategy, as part of overall financial planning, to grow into a living wage salary over time.
2. PROVIDE OWNERSHIP OPPORTUNITIES FOR ALL EMPLOYEES

HOW THIS ACHIEVES IMPACT

In the United States, black men earn 75 cents to the dollar of white men. Even worse in terms of financial disparity is the fact that white families have six times the wealth of black and hispanic families - in 2010, the median wealth of white families was $124,000, versus $15,000 for black families and $16,000 for hispanic families.vi This means that even wage parity, without attention to asset creation and distribution (through, for example, business ownership) does little to address root causes of poverty.

Broad-based equity or quasi-equity programs provide a unique opportunity for non-management employees to share in any exit upside along with management and investors. This is particularly important when considering exits that might entail job loss.

HOW THIS ACHIEVES FINANCIAL RETURN

Worker ownership has long been associated with increases in productivity, decreases in turnover, and overall commitment to the well-being of the enterprise. According to research from Rutgers University, implementing employee ownership leads to a 4% permanent increase in productivity and 2% increase in shareholder value.vii

By making workers more resilient to financial shock, ownership of assets also helps businesses by ensuring the employees’ continued availability to work. For a company itself, employee ownership means a deeper commitment through down cycles.

HOW TO IMPLEMENT FAIR PAY STANDARDS

Employee ownership has gained significant traction in the tech industry, with stock compensation constituting a significant portion of the wealth created through tech employment. However, there is no reason why employee ownership and asset-building structures should be limited to the technology sector.

There is no one size fits all approach to employee ownership, and several tools and vehicles are available that may fit different businesses, both structurally and in terms of their priorities:

• Broad-based stock options plans, which allow employees at all levels the opportunity to buy company stock.
• Phantom stock and stock appreciation rights, which provide monetary benefits equivalent to ownership.
• ESOPs, is a type of tax-qualified employee benefit plan in which most or all of the assets are invested in stock of the employer. The National Center for Employee Ownership states that more than 8 million employees in more than 11,000 companies, mostly closely held, participate in ESOPs, taking advantage of significant tax benefits connected to ESOP creation.
• Matched savings and Home Ownership Assistance
• Retirement plans such as 401(k)s and simple IRAs, especially if matched
• Profit sharing plans which incentivize employees
3. PAID LEAVE

**HOW THIS ACHIEVES IMPACT**

Over 40% of low-income working parents have no access to any paid time off - no sick or medical leave, no parental leave, no vacation - with a disproportionate negative effect on their children.\(^\text{xix}\) In surveys of low wage women workers, paid sick days were highlighted as the most desired benefit, even exceeding wage increases.\(^\text{x}\)

**HOW THIS ACHIEVES FINANCIAL RETURN**

Paid leave (whether sick leave or family leave) is associated with higher retention rates and lower turnover.\(^\text{xii}\) It is also associated with increased productivity and lower levels of workplace contamination.\(^\text{xiii}\)

A 2014 study on Connecticut’s paid sick days law - the first state-wide policy in the nation - found that after the law was implemented in 2012, one-third of businesses reported improved worker morale, while 15 percent saw increased productivity and a reduction in the spread of illness. Moreover, only 1 in 10 businesses reported an increased payroll cost of 3 percent or more, likely to be offset by the gains in productivity and morale.\(^\text{xiii}\)

As became evident during the H1N1 flu pandemic,\(^\text{xiv}\) “presenteeism” - when sick workers report to work when they are unwell - bears a cost to business that actually exceeds that of absenteeism. In fact, according to one study, its cost to business is $160 billion higher than that of absenteeism.\(^\text{xv}\)

**HOW TO IMPLEMENT FAIR PAY STANDARDS**

There are a variety of potential employer policies around paid leave, ranging from paid sick days to paid family leave. The consensus, as outlined above, is that paid sick leave benefits makes the most difference, especially in the lives of lower income workers.

Private employers with plans providing a fixed number of days of sick leave offer an average of eight paid sick days to employees after one year of service. State and local government employees receive 11 paid sick days after one year of service.\(^\text{xvi}\)
INVESTOR BEST PRACTICES

SJF Ventures: A top quartile $80M VC fund that works with each portfolio company on implementing best employment practices. Those practices are detailed in the report *Beyond Paycheck to Paycheck*, published through its partner NGO SJF Institute. SJF Ventures also creates an annual impact assessment and growth plan for each investee.

Pacific Community Venture Fund: A $60 million fund specifically assists portfolio companies (high growth California businesses) in implementing innovative employee ownership programs that increase employee productivity, retention, and morale. PCV Investment Partners III LLC was a pioneer in using the phantom stock model as a means of distributing equity set-asides to low income employees—and some employee ownership clause was standard in every term sheet.

Fund Good Jobs: A philanthropic investment vehicle aimed at creating good jobs – jobs that pay more than the local living wage, provide benefits, and create opportunities for advancement and wealth building for those with the greatest need.

Atalanta Capital: A 100% women owned private investment company investing in entities that support gender balanced practices internally, provide services and goods to women and families, or are owned or led by women, with a clear scaling system for how it helps employers create more women-friendly employee policies.

ABOUT THE AUTHORS

The Transform Finance Investor Network brings together investors, family offices and foundations exploring a social justice, community-centered approach to investing. Through this community of practice, the TFIN develops tools and structures to foster investments that engage communities in design, governance, and ownership; add more value to communities than they extract; and fairly allocate risks and rewards between investors, entrepreneurs, and communities. To learn more please contact Andrea Armeni, Executive Director of Transform Finance, at andrea@transformfinance.org

Pi Investments is a single-family office supporting the transition from an extractive economy to one that is sustainable, generative and just. Pi Investments intends to align 100% of its assets towards its values, and to inspire the investment community to deepen its potential for transformative impact through the strategic placement of catalytic capital.
End notes

4. See “A Profile of the Working Poor”, above.
7. See UC Berkeley study, supra. In a report conducted in conjunction with the London Living Wage Program, more than 80% of employers involved in the LLW believe the LLW has enhanced job performance; almost 75% of the employees also reported increases in job performance as a result of the LLW. See City of London Press Release, Nov. 16, 2010, available at [http://www.london.gov.uk/media/press_releases_mayoral/global-giants-sign-pay-staff-london-living-wage](http://www.london.gov.uk/media/press_releases_mayoral/global-giants-sign-pay-staff-london-living-wage)