4.5 INCLUSIVE GROWTH & SHARED PROSPERITY

Themes

1. Executive Pay & Inequality
2. Workforce Enhancement
3. Cost of Living Recession
4. Capital Allocation and the Mission Economy

Definitions

We define inclusive growth as sustainable economic activity that is pre-distributive; allowing more people to share the rewards of growth because they are fairly recognised for their role in its creation. Inclusive growth is of critical importance in both developed and emerging markets, with just transition being a form of it.

Shared prosperity relates to the explicit need to reduce inequalities across companies, supply chains, countries, and regions. Our definition focuses on the need for rapid improvement in workforce treatment and poverty reduction.

The Rationale for Inclusive Growth and Shared Prosperity

We are concerned by high levels of economic inequality experienced in some regions of the world. Over time, we believe excessive inequality may create systemic risks, such as breakdowns in social cohesion, disruptions to political stability, and undue financial system turbulence.

We believe growth is likely to be more enduring when a greater part of the population earns a decent income, and can afford to spare time and resources to be entrepreneurial. Therefore, transitioning to a more inclusive economy, where more people have the financial security and ability to innovate, helps create the next generation of investable opportunities.

To achieve inclusive growth, systems that determine how the fruits of growth are created and distributed, need to be fairer. Unfortunately, there are cases where we do not believe economic structures achieve enough fairness. For example, in some developed economies, since the 1980s, CEO pay has risen many multiples faster than worker salaries, which over time have lost buying power. This has led to failing population financial resilience, with almost a quarter of UK citizens unable to withstand a £50 drop in monthly income to illustrate[14].

14. FCA finds the Covid-19 pandemic leaves over a quarter of UK adults with low financial resilience | FCA - *Low financial resilience is where an individual could not withstand a £50 drop in monthly income, or losing their main source of income for a week*

What we do

High Executive Pay

In addition to creating inequality, high pay at the top level of corporations can be a burden for investors. For example, in the US, we calculated that high executive pay means shareholders subcontract three per cent of the free cash flow generated by the business to executive teams. This is a steep hurdle to successfully compounding investment returns, and there is also research to suggest that on aggregate, higher CEO paying companies perform more poorly than lower payers in terms of stock price[15, 16].

For 2023, we have built on the US and UK CEO pay frameworks from 2022 to apply similar frameworks for continental Europe, North America, and Japan. The frameworks allow for higher pay levels for larger and more complex businesses, and are based on the multiple of CEO total compensation relative to the median income in the country in which the company is based.

Workforce Enhancement

We believe that workforces are a critical asset to businesses and are at the heart of achieving inclusive growth and shared prosperity. For this reason, HSBC AM is a long-standing member of the Workforce Disclosure Initiative, which is a $10.5 trillion investor coalition working to improve corporate transparency on workforce issues. Over time, participants in the WDI have significantly increased their workforce knowledge and reporting. Each year we engage to encourage over 20 target holdings to participate in the WDI.

HSBC is also a supporter of living wages, wages workers actually need to ensure a decent standard of living, and will continue to encourage companies to become living wage accredited, as part of working with the Good Work Coalition[17].

15. MSCI 2016: *Income Inequality and the intracorporate pay gap*
16. MSCI 2016: *Are US CEO's paid for performance?*
17. More information can be found on the website of Good Work Coalition

Tax Responsibility

Scrutiny of corporate tax arrangements is growing. This is due to the increased need for sustainable public finances, following significant government spending to secure populations during Covid-19. We believe that the rate corporates pay in tax is a useful indicator showing how a company considers its wider responsibilities. In 2021, 136 countries reached an agreement for a minimum tax rate of 15 per cent for large companies. Where appropriate, we engage with issuers that are paying less than the 15 per cent minimum rate on our priority list.

Cost of Living Recession

We are mindful of the risks to prosperity stemming from combined factors such as higher input costs, higher interest rates, and physical climate change impacts which are present in many economies. These issues could lead to recession and the desire of corporates to cut workforces through redundancies. In the aftermath of the 2020 pandemic, we have seen robust financial performances from companies who invested in their workforces during the crisis. They were then in a strong position to gain shares as markets recovered. As a long term and supportive shareholder we will look to encourage such behaviours where appropriate.

Capital Allocation and the Mission Economy

In the longer term, we believe growth will only be inclusive if it is mission driven - generated by resolving major challenges. For this reason, we see a strong intersection between our work on inclusive growth and shared prosperity, and the governance topic of capital allocation. We believe companies that have consistent, well communicated, and purpose driven capital allocation are more likely to be good investments for clients. An appropriate framework for companies to refer to when making investment allocation decisions to create positive impact could be the UN Sustainable Development Goals.

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