PENSIONS AND LIFETIME SAVINGS ASSOCIATION

July 2016

UNDERSTANDING THE WORTH OF THE WORKFORCE: A STEWARDSHIP TOOLKIT FOR PENSION FUNDS

We're the Pensions and Lifetime Savings Association; the national association with a ninety year history of helping pension professionals run better pension schemes. With the support of over 1,300 pension schemes and over 400 supporting businesses, we are the voice for pensions and lifetime savings in Westminster, Whitehall and Brussels.

Our purpose is simple: to help everyone to achieve a better income in retirement. We work to get more money into retirement savings, to get more value out of those savings and to build the confidence and understanding of savers.

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EXECUTIVE SUMMARY

The 2015 PLSA discussion paper '*Where is the workforce in corporate reporting?*' outlined the importance of a company's workers, and how they are recruited, retained, developed and inspired, to its ongoing success. Therefore, information about the workforces they are invested in is critical to PLSA members as investors. However, most annual reports currently fail to fully relate the role played by a company's workers in achieving past or future performance. In order to address this, we have produced a toolkit for our members, outlining the type of workforce-related information they should look for from investee companies, and how to access it.

THE TOOLKIT

Our toolkit outlines different ways in which investors can engage directly with investee companies over workforce-related issues – for example, influencing the content of annual reports, face-to-face dialogue and voting at company AGMs.

It is intended for the use of pension fund investors, but within that group different funds may find different ways to use it. We hope the content will also be relevant to wider stakeholders:

- **For pension funds that manage their investments in house** the practices outlined in the toolkit can be incorporated directly into their own investment stewardship practices
- **For pension funds that commission external consultants and asset managers** the toolkit can be used as benchmark against which to measure service providers quality of stewardship when awarding mandates and assessing performance
- **For wider stakeholders** the practices outlined in the toolkit were compiled as a result of detailed research and discussions with some of the pension funds most engaged with stewardship issues. As such, we would encourage companies or asset managers, for example, to adopt reporting and stewardship practices that cohere with the toolkit's recommendations.

NARRATIVE REPORTING

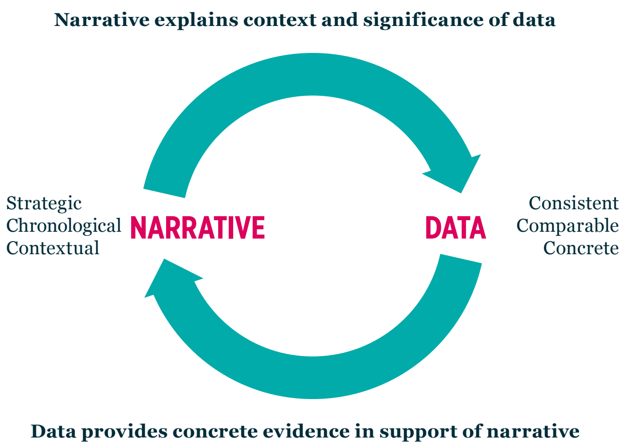

Figure 1: Data and narrative – mutual reinforcement

The annual report, specifically the strategic report intended to explain the company's business model and key risks facing the organisation, was generally recognised as being the most appropriate format for communicating issue about the workforce. Throughout our discussions with stakeholders, a preference was expressed for narrative reporting that links the company's approach to its workers to its underlying purpose and strategy, over 'boilerplate' box ticking against a long list of prescribed metrics.

At the same time, however, it was generally agreed that it would be impossible to communicate this narrative in a meaningful way without the use of certain consistently reported, concrete, comparable data. These metrics should provide evidence in support of the narrative, while the narrative should contextualise the data.

CORE METRICS

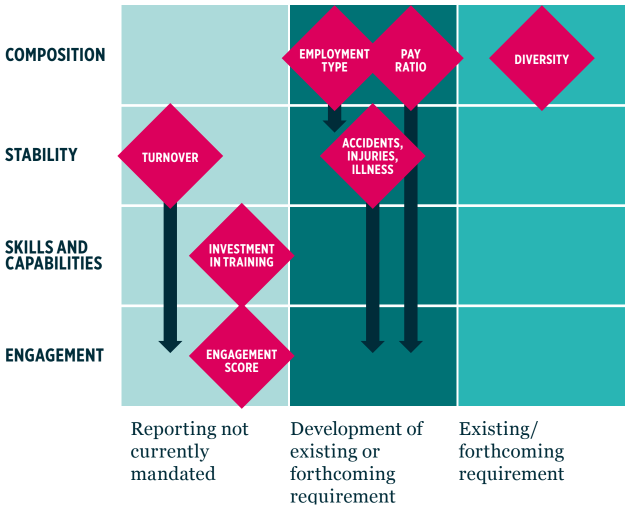

Figure 2: Core workforce-related performance measures to be disclosed in annual reports

In particular, we recommend that our members encourage investee companies to report against the following metrics as standard, at group level and across relevant markets, businesses and levels of the company hierarchy

- Gender diversity
- Employment type – for example, full-time, part-time or agency workers
- Staff turnover
- Accidents, injuries and workplace illnesses
- Investment in training and development
- Pay ratios between the highest paid and median and lowest quartile workers across the company
- Employee engagement score

Together these measures serve as useful proxies for investors wanting to measure the corporate cultures in effect within an investee company, and the four key themes of composition; stability; skills and capabilities; and employee engagement identified in our previous discussion paper – who is working for the company they invest in; how secure this employment model is; how different people in the company are treated; and thus how motivated and committed to corporate goals they might be.

Reporting or recording these metrics is in some cases mandated, at least in part, by various regulations. As such, this is less a case of an onerous new requirement of companies than an attempt to bring together existing obligations in a way that – when supplemented by contextualising narrative and perhaps other supplementary metrics – can form the core of a useful explanation for investors about company strategy and risk.

BEYOND THE ANNUAL REPORT

While the annual report remains the central vehicle for communicating information about a company's workforce to investors, the process of influencing, corroborating and interpreting the content of annual reports necessitates a wider range of activities. In particular, we recommend the following practices to investors

- **External verification of annual reports** via the multiple emerging online sources of information about particular workplace cultures and practices, based on employee testimonies and other sources
- **Face-to-face meetings with investors,** enabling more dynamic, qualitative discussions of workforce-related issues, as opposed to the static information conveyed in company reports. Questions asked could relate to how companies enable and measure collaboration and innovation; what degree of agency their workers have over their own working lives; and how the company's leadership understand what is happening at 'the coalface' of their organisation
- **Adopting voting policies for AGMs** as a means of exercising leverage over companies to ensure better disclosure and performance in relation to workforce issues, and sanction those companies who refuse to improve disclosures or recognise the importance of a stable, secure, skilled and motivated workforce to their long-term success

Together, we hope that adoption of these measures will lead to better disclosure of workforce-related issues on the part of companies, resulting in improved scrutiny of these issues from investors and ultimately to heightened productivity, improved investment performance and better working lives.

INTRODUCTION

BACKGROUND

In Summer 2016, the PLSA published *'Where is the workforce in corporate reporting?'*, a discussion paper examining the extent to which corporations discuss their working practices and workplace cultures in their reporting to investors and other stakeholders, before identifying potential improvements that could be made in this area.

The paper was predicated on the assumption that **a company's strategy for recruiting, training, developing, retaining and inspiring its workers is fundamental to its ongoing success.** In a 'knowledge economy' where intangible assets, such as brand recognition or 'human capital', are becoming more important than physical assets, such as plant or property, performance in this area is likely to become increasingly vital.

As a representative body for over 1,300 UK pension schemes with hundreds of billions of pounds worth of savers money invested in listed companies across the world, this has major implications for our members' investments. **The workers of PLSA members' investee companies are a critical determinant of our members' capacity to provide secure, sustainable incomes for their beneficiaries in later life.**

WORKFORCE REPORTING IN THE WILD

Our initial interest was informed by a wide range of case studies. Failures of working culture and the ways in which workers are managed and incentivised has led to major corporate crises across a number of sectors

- Major banks have accumulated billions of pounds worth of fines as a result of LIBOR manipulation and PPI mis-selling, sparked in part by the structure of incentive payments and a failure to imbue workers with an appropriate ethos.
- Any major company hosts a range of different working cultures across its many different divisions and businesses. Poor culture and a failure of boards and management to properly understand or manage what was going on at the 'shop floor' of their companies has also been cited as a contributing factor to major corporate scandals at Volkswagen (emissions cheating); News International (phone hacking); and BP (Deepwater Horizon oilspill).
- Sports Direct recently fell out of the FTSE 100 amidst revelations about the treatment of workers at its warehouse in Shirebook. The company's founder Mike Ashley famously blamed negative publicity resulting from criticism of Sports Direct's employment practices for its travails.

This anecdotal evidence is supported by a substantial volume of concrete research (see box 1).

BOX 1: THE CASE FOR INVESTING IN WORKERS: A TOP 5

- Warwick Business School and the Wharton Business School at the University of Pennsylvania found that Companies that appeared in the 'Great Place to Work' institute's 'Great companies to work for' all exceeded the performance of the wider stock market in their country of listing.
- The Aon Hewitt 2014 employee engagement survey found that when ranked by engagement score, organisations in the top quartile outperformed average returns to shareholders across those surveyed by 4 per cent, while those in the bottom quartile underperformed by 8 per cent.
- Research in 2014 for Oxford Economics found that staff turnover costs UK firms across five sectors (retail, accounting, legal, IT/tech, media/advertising) a total of £4 billion a year.
- An older (2005) but authoritative review of the impact of skills on business performance by the Institute of Employment Studies cites multiple analyses showing that higher levels of training and/or education translates into improved performance. For example, the top performing UK manufacturing firms hire workers with an extra qualification level compared to the lower performers.
- Analysis by MSCI ESG Research found that in the five years to 2014, companies with a high pay gap between their CEO and their average worker under-performed those where the gap was lower in 9 out of 10 sectors.

Despite this body of evidence however, and the ostensible acceptance of the importance of a company's workers to its long-term performance, **reporting in this area is generally not of sufficient quality to enable investors to identify risks or opportunities relating to a company's workforce** and target their engagements accordingly.

While anyone familiar with annual reports will know that Chairs and Chief Executives often note that 'our people are our greatest asset', they rarely explain how or why or what they are doing to ensure that this remains the case.

Our discussion paper summarised a 2014 analysis by Bloomberg finding there were still some FTSE 100 companies (6 per cent) that did not report their 'headcount' of total employees. Fewer than half (47 per cent) reported the level of turnover or attrition. Only 24 per cent reported their investment in staff training and just 11 per cent the composition of their workforce in terms of full-time, part-time and agency workers. The paper also cited a global study from the same year, finding that just 12 per cent of the companies covered reported staff turnover and only 11 per cent reported the number injuries occurring in the workplace.[1]

Without this kind of information, it is difficult for investors to understand who they are investing in or how this 'greatest asset' is being strengthened and retained for the future.

PLSA ON HUMAN CAPITAL… THE STORY SO FAR

Our discussion paper identified four major workforce-related themes that corporate reporting ought to cover, in order to give investors a better sense of the companies they are invested in, and the associated risks and opportunities. Beneath each theme, we identified a series of concrete metrics that could collectively act as proxies for performance with regard to that particular theme

- **The composition of the workforce:** what kind of workforce is a company's business model based on – full-time, part-time or temporary workers; gender/ethnic diversity; different pay levels, for example?
- **The stability of the workforce:** how stable is this employment model – levels of turnover, retention rates and absenteeism.
- **Skills and capabilities:** how does the company add to the value of its workforce and ensure it has the workers capable of executing strategy, meeting future challenges and taking advantage of emerging opportunities – measures could include investments in training and development, qualification levels and succession planning.
- **Employee engagement:** how are workers motivated and engaged to ensure commitment towards corporate goals and maximise the contribution of each worker – using measures such as employee engagement score and accidents, injuries or deaths in the workplace

1 For all figures, see Pensions and Lifetime Savings Association, *Where's the workforce in corporate reporting?*, 2015 p10

Using these themes as a basis for the type of information we wanted to see covered by corporate reporting, we undertook a series discussions with stakeholders across our membership, as well as their advisers and asset managers plus corporations themselves and external experts from professional associations, civil society, academia and the trade union movement.

These discussions were designed to identify more specifically how companies could communicate performance in respect of these themes and how our members and wider stakeholder community could facilitate that process. This information was then used to inform the recommendations outlined in the next section.

THE TOOLKIT

FRAMEWORK

For many pension funds, **the initial priority will be to ensure that their wider approach to investment enables due regard for the corporate cultures and workforce-related factors affecting their investee companies.** Some critics have suggested that some pension funds investment governance frameworks encourage a focus on short-term time horizons, meaning that the more gradual effect of workforce management on company performance is over-looked.

For example, the Investment Association's 2016 'Productivity Action Plan' highlights potentially damaging practices included quarterly reviewing of investment performance and excessively short contracts for asset managers charged with managing the fund's investments (with the net result that returns are targeted over the length of contract, rather than the much longer timeframe relevant to the saver/corporate sponsor of a pension scheme).[2]

Judicious motivation and management of an organisation's workforce is one aspect of a business that might be expected to generate value over the long-term – and can in fact be costly over the short-term. Practices such as investment in training or increasing wages to attract and reward workers might generate immediate costs and therefore impair short-term profitability. It is over a longer period that an under-qualified and demoralised workforce will result in a much lower quality of work that is ultimately detrimental to a company's financial results.

Give that pension funds are generally investing on behalf of members who are interested in generating returns over the course of their entire lifetime, the performance of investee companies over the long-term are more relevant than cycles of a few months or years.

As such, pension funds' **investment governance should be focused on the performance of investee companies over the longer timeframe (and thus, the factors that affect performance over that timeframe).** The selection, direction and assessment of investment consultants and managers should also be set within an appropriately long-term framework.

2 Investment Association, *Supporting UK Productivity with Long-Term Investment*, 2016, p31

NARRATIVE REPORTING

Beneath the four over-arching themes, our discussion paper listed 24 specific metrics that could potentially be used when assessing a company's human capital performance. A meta-analysis of the work by all the different organisations working on this area has identified over 60 human capital performance metrics suggested in various reports and recommendations.

Table 1: Possible Human Capital performance metrics[3]

HUMAN CAPITAL DISCLOSURE REQUIREMENTS MATRIX

Category, element, metric or dimension	International Integrated Reporting Council	OMERS Ontario Municipal Employees Retirement System	Sustainable Accounting Standards Board, SASB	IRRC Institute-HBS, Materiality of Human Capital to Fin Perf.	GRI – Global Reporting Initiative	Accounting for People Task Force 2003	Smarter Annual Report 2015, Creelman, Bassi	Dow Jones Sustainability Index 2014-2015	ANSI-SHRM Investor Guidelines for Reporting HC 2012	CIPD Valuing Your Talent 2014-2015	PLSA – Pensions and Lifetime Savings Association	ISO:NWIP N-141, HC Reporting for Int. & Ext. Stakeholders	TOTAL
Workforce composition													
Workforce headcount		✔		✔	✔	✔	✔	✔	✔	✔	✔	✔	10
Workforce cost		✔		✔		✔	✔	✔	✔	✔	✔	✔	9
Workforce productivity		✔	✔	✔		✔	✔	✔		✔	✔	✔	9
Return on workforce or people		✔	✔	✔		✔	✔	✔		✔	✔	✔	9
Workforce composition breakdown		✔			✔	✔	✔	✔	✔	✔	✔	✔	9
– Contingent labour cost					✔	✔			✔	✔	✔	✔	6
– Contingent labour force size					✔	✔			✔	✔	✔	✔	6
– Benefits (i.e. full-time v part-time)					✔	✔	✔		✔	✔	✔		6
– Geographic-global workfirce distribution						✔	✔	✔			✔	✔	5
– Revenue per employee or FTE						✔		✔			✔	✔	4
– Demographics, diversity (i.e. age, gender)		✔									✔	✔	3
– EBITDA per employee or FTE						✔					✔	✔	3
– Full-time v part-time									✔		✔	✔	3
– Job level									✔		✔	✔	3
– Talent efficiency/effectiveness										✔	✔		2
– Proportion professional qualified employees											✔	✔	2
– Work hours												✔	1
Workforce skills and capabilities													
– Total training investment		✔		✔	✔	✔		✔	✔	✔	✔	✔	9
– Leadership depth/career development/succession		✔				✔	✔	✔	✔	✔	✔	✔	8
– Talent Management		✔					✔	✔	✔	✔		✔	6
– Competencies and skills				✔		✔			✔	✔	✔	✔	6
– Internal hire rate							✔	✔	✔	✔	✔	✔	6
– Average training hours per employee				✔	✔						✔		3
– Leadership quality/effectiveness							✔		✔			✔	3
– Training types (formal/informal, technical, apprentice)				✔								✔	2
– Training by job group				✔								✔	2
– Number of courses taken											✔		1
– Number of PHDs (or total number of patents)												✔	1
Overarching HC disclosure objectives													
Human capital performance, productivity	✔	✔	✔	✔		✔	✔	✔	✔	✔	✔	✔	11
Comparable across entities/industries	✔	✔	✔	✔	✔		✔	✔	✔	✔	✔	✔	11
Transparency (clear, complete, reliable, simple)	✔		✔	✔	✔		✔	✔	✔	✔	✔	✔	10
Validity (useful, link to financial results)	✔		✔	✔	✔		✔	✔	✔	✔	✔	✔	10
Consistence over time (measure over time)	✔		✔		✔	✔	✔		✔	✔	✔	✔	9
Material, auditable information	✔		✔	✔	✔			✔	✔	✔	✔	✔	9
Sustainability of human capital	✔		✔		✔		✔	✔		✔	✔	✔	8
Business and management governance	✔		✔				✔	✔	✔	✔	✔	✔	8
Comprehensive (complete/talent lifecycle)	✔		✔		✔		✔	✔	✔	✔	✔		8
Human capital risks	✔		✔				✔	✔		✔	✔	✔	7
Strategic, future directional focus	✔		✔				✔		✔	✔	✔	✔	7
Connectivity of information	✔		✔		✔				✔	✔		✔	6
Superior human capital talent decisions				✔			✔		✔		✔	✔	5
Workforce stability													
Workforce turnover (i.e. terminations)		✔			✔	✔		✔	✔	✔	✔	✔	8
– Regrettable or voluntary turnover					✔	✔		✔	✔	✔	✔	✔	7
– Pay policies and ratios (mgmt, gender equity)					✔	✔		✔	✔	✔	✔	✔	7
– Turnover by category or level (EEO)									✔		✔		2
– Recruitment costs										✔	✔		2
– Applicants per position/brand awareness											✔	✔	2
– Offer/acceptance statistics											✔	✔	2
– Retention rates (demographic)											✔	✔	2
– Levels of skill shortages											✔	✔	2
– Pension/retirement programme (cost, % eligible)											✔		1
– Industrial relations issues											✔		1
– New hire retention rate (12 month retention)												✔	1
Workforce culture													
– Employee engagement score						✔	✔		✔	✔	✔	✔	6
– Absentee rates (i.e. percentage or cost)					✔		✔	✔			✔	✔	5
– Lost days, accident rates, fatalities					✔		✔	✔			✔	✔	5
Other													
– Human capital discussion and analysis									✔			✔	2
– HR cost or investment												✔	1
– HR return on investment												✔	1
TOTAL RECOMMENDATIONS	12	12	14	15	20	20	25	25	31	31	48	50	59

3 Human Capital Management Institute, *Presentation to Rockefeller Asset Management webinar on Human Capital reporting,* 11 February 2016

Our conversations with stakeholders focused closely on these different metrics, examining what information about the company they convey; how they could be used by investors; their potential limitations; and challenges associated with their calculation and disclosure.

While stakeholders generally agreed that our four themes broadly covered the approach that companies should take to communicating their human capital, there was also **a consensus that a long list of numbers showing how the company had performed against 60 (or even 20) metrics was neither necessary nor desirable** (and this was never the approach envisaged by our initial report). Many of these metrics would not be relevant to a lot of companies, and it would also be possible to accurately and usefully convey a company's performance in relation to its workforce without undertaking a time-consuming process of reporting against each one.

Instead, **our members should promote narrative-style reporting, explaining how the way in which their investee companies workers were employed, engaged and managed contributed to the company's performance** – for example, what impact did workforce-related factors have on value, in relation to costs, revenue, quality and productivity.

Equally, **reporting should include a forward-looking element, outlining how a company's approach to its workforce relates to its underlying purpose and business model – and what workforce-related risks and opportunities did the company anticipate in future.**

Rather than, prescription – either on the part of investors or regulators – companies should have 'a blank sheet of paper' on which to outline progress against their long-term strategy, including how the workforce has been mobilised to deliver strategic objectives. **The four themes outlined in our original discussion paper should inform the type of information that our members encourage to be prioritised for disclosure.**

Regulations introduced in 2013 require companies to produce a 'Strategic Report' in narrative form, providing an insight into the company's business model, principal risks facing the company and an analysis of past performance. This could provide a natural home for enhanced reporting on the workforce. Indeed, FRC guidance states that information about employees should be disclosed in the strategic report 'when material.' It is difficult to think of an organisation where the composition, stability, skills and capabilities and engagement levels of the workforce are not material.

Each of these factors is deeply relevant to business models, risks and performance and so ought to be covered here.

REPORTING AGAINST PERFORMANCE METRICS

However, as our discussion paper notes, the introduction of the strategic report has not led to a significant improvement in human capital reporting. Research published in May 2016 by the Chartered Institute for Personnel Development (CIPD) has also identified 'a clear need for a common approach to human capital reporting.' While the CIPD note (and we agree) that identical 'boilerplate' reports would be unhelpful, our stakeholder discussions repeatedly iterated the need for some concrete, comparable data to underpin narrative reporting.[4]

This data should take the form of certain consistently-reported performance metrics relating to the key themes identified in our initial discussion paper, supporting the qualitative information contained in the narrative reporting and vice versa.

For example, the narrative could explain what figures for a particular performance metric represent in terms of progress towards broader strategic objectives within the wider operational context. It could outline the implications of particular figures in terms of the company's costs, revenue, productivity and quality of product/service.

The metrics, in turn, should provide evidence to support the description of the company's approach towards its workforce outlined in the narrative.

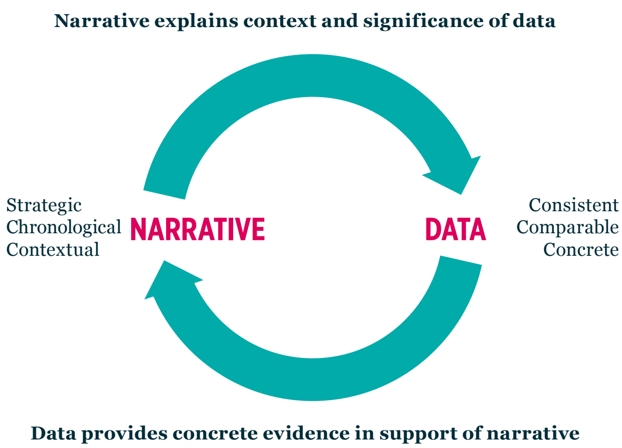

Figure 1: Data and narrative – mutual reinforcement

4 CIPD, *Reporting Human Capital: Illustrating your company's true value*, 2016 p8

Some of the most relevant workforce-related performance metrics will vary between different companies and sectors, based on their individual strategic challenges and objectives. However, the need for some degree of comparability across companies, enabling investors to make a valid assessment of the working cultures that exist within different organisations and inform investment decisions accordingly, necessitates a degree of standardisation.

MAKING THE MOST OF GOVERNMENT REPORTING REQUIREMENTS

In the first instance, certain UK government regulations require the recording and/or publication of additional workforce-related data, which could be used to enhance investor understanding of corporate cultures and workforce models.

For example, the UK Government's draft proposals on mandatory gender pay reporting will require companies to compare the pay gap between the mean and median male and female employee, as well as the number of men and women in each pay quartile. This is a step that the Association has welcomed, on the basis that it helps investors to understand how successfully a particular company is making the most of potential talent from historically under-represented demographics. Existing rules – The Companies Act 2006 (Strategic Report and Directors' Report) Regulations 2013 – already require publication of the gender balance of listed companies across the board, senior management and the wider workforce.

Similarly, the 2013 Enterprise and Regulatory Reform Act mandating UK-listed companies to calculate a 'single figure' for total CEO pay, while the 2006 Companies Act mandates companies to disclose their average number of employees employed over the financial year. The Reporting of Dangerous Injuries, Diseases and Dangerous Occurrences Regulations (RIDDOR) to report and keep record of the number of work-related deaths and serious accidents, as well as of certain dangerous occurrences.

Given that companies essentially have to calculate these figures anyway, **it makes sense for investors to maximise the value of this exercise by requesting the publication of this data as part of a wider strategic narrative about a company's cultures and working practices.**

As such, we would encourage our members to ask for universal reporting from investee companies against the following metrics:

- **Gender diversity** – the number of women at board level, in senior management and across the workforce as whole. This is a useful indicator of the cultures throughout the company and the degree to which they are making the most of potential talent available to them (a poorer record of diversity than competitors suggests a more limited talent pool).
- **Workers by employment type** – The number of full-time, part-time and agency workers working for the company. These figures are a potential indicator of the problematic issues that have arisen around poor treatment of 'zero hours' or agency staff at certain businesses.
- **Pay ratios** – The ratio between the CEO and the pay threshold at each quartile of the organisation, as well as the gap between the CEO and the next-best paid executive. Ratios are a useful proxy for measuring the culture of the company and whether certain constituencies within the workforce are benefiting disproportionately to colleagues and other stakeholders. The gap between the CEO and their next-best paid colleague provides a telling insight into a company's succession-planning and whether a single personality is perceived to dominate the company's fortunes. Again, this is particularly relevant to pension fund investors whose time horizons often extend beyond the tenure of a single CEO.
- **Accidents and injuries** – The number of work-related deaths, serious accidents, work-related deaths and dangerous occurrences. With understanding of mental health increasing, it would also be appropriate to report levels of work-related mental illnesses. These figures are useful to investors in that they offer an insight into potential levels of reputational and/or legal risks resulting from poor health and safety practices. The number of accidents and how it reflects on duty of care to workers and general diligence is also illustrative of organisational culture more generally.

While these are not wholly required by regulation, they do not represent a great extension of existing or forthcoming rules and practices. For example, the fact that companies will soon have to calculate pay quartiles for the gender pay gap regulations, as well as the single figure for CEO pay, means that disclosing the pay ratio between the CEO and workers at different quartile thresholds should not be too challenging. Similarly, the RIDDOR rules require companies to record accidents and injuries – it is not a huge leap to publish these records.

As such we do not think that by asking for reporting against the above metrics, our members would be placing a particularly onerous demand on investee companies.

OTHER CORE METRICS

However, in order to provide a body of evidence to fully support a narrative around the workforce-related issues affecting a company, it will also be necessary to report against other metrics beyond those where disclosure is supported by existing regulation.

The additional metrics that stakeholders contributing to this projects felt should be reported as standard were as follows:

- **Turnover** – The proportion of a company's workforce leaving the company in a reporting year. This gives an insight into the company's future capacity to execute its strategy, as well as levels of employee morale and commitment to the company, which can be indicators of wider problems.
- **Investment in training and development** – The total amount invested by the company in formal training processes leading to the development of additional skills by the workforce. This helps to understand how seriously the company is dedicated to improving their product/service, increasing efficiency/productivity and ensuring they have the workers in place to 'future proof' themselves in a fast changing business environment. Given that the kind or activities that count as 'training and development' can be nebulous, companies should express clearly how they have calculated their figure.
- **Engagement** – Levels of satisfaction expressed by the company's workers. This measures motivation and commitment towards corporate goals, which are again very relevant to how successfully a company is able to execute its strategy. It is important to recognise that the quality of staff surveys can vary, so investors should prepare follow-up questions to interrogate the results (see section on investor dialogue).

We would not wish to be overly-prescriptive about how any of the seven core metrics be calculated and communicated, but it would make sense for the headline company-wide figure to be broken down by, for example, particular markets, businesses or levels in the company hierarchy, in order to enable a more detailed view of where particular challenges or opportunities might lie. This is the way in which many financial performance indicators – such as revenues or profit margins, for example – are already communicated in annual reports so would represent greater consistency.

Between them, the metrics we identify (shown in full in Figure 2) serve as useful proxies for investors wanting to understand the corporate cultures in effect within an investee company – who is working for the company they invest in; how secure this employment model is; how different people in the company are treated; and thus how motivated and committed to corporate goals they might be.

It is difficult to argue that there are any organisations where this is not relevant to long-term performance. While one would expect a financial institution to have a lower pay ratio between the highest-paid and median worker than a catering firm, or a mining company to have more accidents in the workplace than a retailer, nobody would make these kind of cross-sector comparisons – rather, comparisons would be made within the sector (as is the case when many of the companies themselves calculate their executive pay awards).

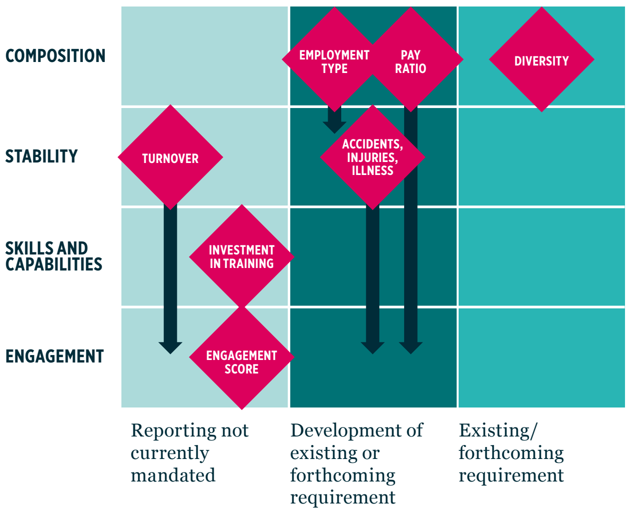

Figure 2: Core workforce-related performance measures to be disclosed in annual reports

BOX 2: CASE STUDY

In 2012, Halfords was voted the worst retailer in the UK by the consumer group 'Which?'

In order to cope with a challenging retail environment, the company's priorities for its workforce had focused on cost and flexibility, with the result that a large number of staff were younger (and therefore lower-paid) workers working fewer hours per week. Many would also have second jobs with other organisations.

Following the arrival of a new Chief Executive in 2013, the company chose to focus on expert customer service as a means of differentiating themselves from online and generalist retailers. And as the company's annual report outlines 'Our colleagues are fundamental to the achievement of our customer experience ambitions.'

Since 2013, the company's annual report has emphasised the need to improve the quality of in-store service, noting anecdotally the increased number of staff capable of carrying out various technical services. The narrative is underpinned by concrete figures showing Halfords' record in terms of:

- Staff turnover
- Number of staff passing through the company's '3 gears' training programme
- Total staff numbers and average working hours
- Employee engagement
- Rating in the list of 'best companies to work for'

These employee-related metrics are intended to demonstrate Halfords evolution into a company with fewer, more skilled workers, working closer to full-time hours in jobs to which they are more committed, ultimately resulting in better customer service and higher returns for investors.

SUPPLEMENTARY METRICS

In many cases, **it may be appropriate to report against additional metrics,** depending on the particular circumstances and strategy of the company. These should be chosen on the basis of how usefully they help to communicate the value added/subtracted by workforce related issues and how they explain past performance and future risks or opportunities.

The scenario outlined in Box 3 gives examples of companies and circumstances where certain measures would and would not be helpful to investors.

BOX 3: CASE STUDY

For Poshington's Wealth Management, the number of employees entitled to some form of state benefits is probably irrelevant.

In the main the proportion of their small, highly-educated and well-paid workforce wouldn't be eligible for benefits so policy changes in this area are unlikely to have any impact on company performance.

At Cheapmart supermarket, the stability of workers in receipt of benefits such as working tax credits – and therefore the company's ability to meet customer demand – could be disrupted by policy changes beyond the company's control. Therefore, the levels of benefits receipt might be of considerable interest to investors in Cheapmart.

Conversely, reporting the social background of tens of thousands of Cheapmart employees – by, for example, calculating the proportion that were privately educated – would be a costly and bureaucratic endeavor. It is difficult to see anything useful being gleaned from any deviation from the national average (though this maybe more useful/feasible if analysis was limited to senior managers).

For Poshington's the same figure would be much easier to calculate owing to the far smaller number of employees – and could be revealing about the culture of the organisation and whether or not factors beyond ability to do the job were (subconsciously or otherwise) affecting recruitment policy. This could result in a more limited pool of potential employees and a less diverse range of thinking within the organisation, so would be a potential issue for investors.

Other metrics that investors might consider applicable to companies in certain circumstances are outlined in Table 2

Table 2: Additional workforce-related metrics

STABILITY OF THE WORKFORCE	COMPOSITION OF THE WORKFORCE	SKILLS AND CAPABILITIES	EMPLOYEE ENGAGEMENT
Diversity of age, ethnicity or social background	Applicants per post	Hours spent on training per employee	Absentee rates
Divergence in benefits	Offer/acceptance levels	Number of courses taken	Occupational disease rate
	Skills shortage levels	Leadership or career development plans	Proportion of pay comprised of performance-related incentives
	Industrial relations and trade union coverage	Internal hire rate	Level of employee share – ownership
	Retention rates post parental leave	Proportion of professionally qualified employees	
	Benefit entitlements of employees	Level of employee autonomy and innovation	

Chosen metrics should also be reported consistently in order to enable investors to make historic comparisons and to give confidence that companies are not simply choosing the measures that paint them in a favourable light.

BOX 3: CASE STUDY

Spanish bank Bankinter report consistently on their 'human capital' – the value delivered to the organisation by their workforce. – in a dedicated section of their annual report. Their chosen metrics broadly cover the themes of the composition, stability, skills and engagement levels of the workforce. Critically, the measures are detailed for the past 5 years, so that stakeholders can assess emerging trends, risks and opportunities facing the company.

Table 3: Interbank's 'Human Capital' performance measures

HUMAN CAPITAL	2015	2014	2013	2012	2011
Descriptive indicators					
No. of employees	4,405	4,185	4,088	4,068	4,210
Average age (years)	41.19	40.93	40.30	39.58	39.00
Personnel costs (thousands of €) (*)	296.44	271.76	263.31	243.35	254.51
Experience					
Average years of service	13	13	13	12	12
Average years of service / 40 years (career) (%)	32.50	33.15	32.50	30.00	30.00
Diversity					
Breakdown by gender					
Men (%)	49.35	49.41	49.17	48.80	49.31
Women (%)	50.65	50.59	50.83	51.20	50.69
University graduates (%)	80.09	77.90	77.05	76.72	76.96
Capacity and development					
People who have received training (%)	97.64	94.00	95.35	96.06	78.08
Average no. of hours of training per person trained	58.86	47.31	35.81	38.85	40.08
Training investments over total wages (%)	1.2	0.8	0.5	0.6	0.8
Training investment per person trained (euros)	553	381	207	246	383
Commitment and motivation					
External rotation index (calculated with average staff headcount)	4.40	3.52	4.09	5.59	10.29
People with flexible remuneration (%)	47.79	45.07	39.92	35.15	30.74
New hires in last year/total staff (%)	9.28	5.81	4.33	2.19	2.76
Productivity (thousands of euros)					
EBIT/No. employees	118.12	93.87	63.87	37.90	57.04
GDP contribution per employee	185.85	150.60	132.16	115.83	119.70
Customer funds per employee	7,856	7,243	6,915	6,159	5,382
Credit investment per employee	10,030	10,143	10,077	10,339	10,120

FINDING ROOM FOR THE WORKFORCE

Over the course of our discussions on this subject, many of the companies we met with pointed out that they were already under pressure from investors to reduce the length and complexity of annual reports. While both companies and investors accepted the importance of communicating workforce-related factors, this was a fair challenge.

We would not recommend our members to agitate for longer annual reports. Instead, **companies should be encouraged to prioritise relevant information on their working cultures and practices ahead of material that may be of less interest to investors and other stakeholders.**

For example, annual reports typically include over 20 pages of information on executive pay (partly because of the complex nature of executive pay awards). If this could be substantially reduced (a process that would be greatly aided by simpler executive pay practices) then it would create ample space for the improvements to reporting of workforce-related issues that we recommend. In fact, one of the objectives of this project is to promote an understanding of our pension fund members' interest in their investee companies pay practices and corporate governance as relating to the pay and governance of the workforce in its entirety, rather than just the board and executive team.

CORROBORATING REPORTING

As the main resource for investors requiring information about current and prospective investee companies, we would expect this information to be presented each year in annual reports (included in the 'strategic report' section, as previously stated).

Indeed it was strongly iterated during our discussion with stakeholders that **workforce-related reporting should be included in the annual report, rather than in CSR or Sustainability reports**, as these create the false impression that organisational culture and workforce issues are of secondary importance, compared to the financial information outlined in the annual report.

However, annual reports do have certain limitations. They necessitate an acceptance of the company's own version of events. By and large, this can be taken at face value. The annual report is required by the UK Corporate Governance Code to present a 'fair, balanced and understandable' view of the company and it would be a serious matter if it were in anyway mis-leading.

Nonetheless, the CIPD's 'Reporting Human Capital' notes the propensity of surveyed companies to accentuate the positive while making little mention of prominent negative workforce-related issues that would have be of considerable interest to investors.

At the same time, **the internet has proliferated a wide range of alternative sources of information about companies, particularly with regard to their relations with their workforce. It would be remiss of investors not to take advantage of these new insights.** Where particular concern or interest in a company's management of their workforce exist, it may be prudent to seek internal corroboration of the narrative provided in the annual report. Potentially useful sources are listed below:

- There are now multiple 'Trip Advisor' style websites where employers can leave reviews of the companies they work for. Some sites, such as Glassdoor, have hundreds of reviews for single companies, giving a valuable insight into the corporate culture of an organisation.
- Similarly, websites and social media feeds run by workers dedicated to highlighting poor employment practice at their employers are both an interesting potential resource for investors and an example of how poor human capital management is an increasingly important risk in an age when social media and 24-hour news have massively amplified the voice of disgruntled workers. The 'Former and Current Employees of Amazon' campaign is one such example.
- Rankings of the best employers are also a useful insight into which companies are most likely to successfully attract and retain key workers. The Times and Sunday Times newspapers provide lists on the best graduate employers and best companies to work for, while Glassdoor and the 'Great Place to Work' institute do likewise.
- For companies with major industrial relations issues or long-running and high-profile problems with their working practices, it may be useful for investors to consult with the relevant trade union. Unions can articulate the experience of frontline workers and maybe able to pinpoint key operational issues for the company and how to resolve them.

It was also proposed by an investor at one of our seminars that, given the wide-range of stakeholders interested in the content of an annual report, companies should make a genuine effort to ensure to get worker input into relevant sections of the report. In addition to the above resources, **investors could also ask what steps the company has taken to engage workers in the production of the annual report.**

DIALOGUE

In addition to annual reports, the main way in which companies convey information to investors is through direct engagement (ie conference calls and face-to-face meetings).

These engagements are critically important to the workforce reporting agenda, because they are two-way. Rather than presenting information for a passive audience, as with the annual report, companies can be asked follow-up questions and lobbied by their interlocutors.

As part of our research for this toolkit, stakeholders repeatedly emphasised the need for guidelines to help our members undertake a constructive engagement process with investee companies, as well as setting out requirements for company reporting.

This is a challenging task because it is difficult to identify general guidelines for conversations that will inevitably be very specific to the individual company. However, the same objectives of identifying how the company's approach to its workforce relates to its wider purpose and strategy; what workforce-related risks and opportunities are facing the company and how can the risks be minimised and the opportunities taken. **The four themes of composition, stability, skills and capabilities and engagement of the workforce provide a useful framework for the type of insights that the investor should be looking to develop.**

Some qualitative questions that maybe pertinent to ask of investee companies, in order to supplement information included in the annual report, could include:

- How would you explain your employment model, in terms of the people that work for you, their commitment to the organisation and the value that they deliver?
- What is the overall culture and management style of the business?
- In terms of culture, how is the tone set by the board reflected by middle management and across the wider workforce?
- How do the board/senior management understand what is going on at the 'frontline' of the company?
- How would you describe the networks, communications and decision making in your organisation (i.e. top-down, informally networked, etc.)?
- What capacity do your workers have to collaborate and innovate and how do you measure this?
- How much individual agency do your workers feel they have in terms of shaping their working lives?
- How do you ensure that people in your organisation feel able to speak out about wrongdoing?
- What are the potential 'risk behaviours' from your workforce that could be problematic to the company, and what action are you taking to mitigate them?
- How well do employees understand their role in relation to risk, and how do they learn from mistakes to avoid repeat incidents?

In addition, **engagements should also seek to further understand details on workforce-related performance outlined in the annual report**, particularly where there are concerns about the levels of performance achieved.

ENFORCING REPORTING

Investors' potential recourse to opposing votes at company AGMs is a powerful leverage mechanism during these engagements with investee companies. While dialogue and engagement with companies is always preferable to conflict at company AGMs, votes on AGM resolutions do afford investors a mechanism of last resort when engagement fails to yield desirable outcomes.

The value of potential sanction in terms of forcing better disclosure or engagement with companies also depends on this sanction being deployed from time-to-time, otherwise it is seen as an empty threat. Examples of **ways in which poor reporting or performance in respect of organisational culture and workforce-related issues can be addressed via AGM votes are given in the table opposite.**

Table 4: Possible voting options for investors

AGM RESOLUTION	VOTE AGAINST IF...
Approval of the annual report	The report fails to include a details explanation of how the company's approach to its work force relates to its wider strategy, underpinned by the metrics outlined in this report
Approval of the remuneration report	The report fails to include details on pay ratios outlined in this report, or the pay ratios are perceived to be excessively wide
Election of the Chair of the Remuneration Committee	Persistent incidences of widening or excessively wide pay ratios, as outlined above
Election of Chair to the Nominations Committee	Persistent failure to develop plausible internal candidates for the senior management team, as a result of long-term underinvestment in training/ development
Election of Chair of the Board	Serious cultural failures and/ or workplace related problems resulting in serious detriment to the company and/or persistent failure to report on workforce-related issues in the manner outlined in this report

As a caveat, it should be noted that for many companies, more detailed reporting of workforce-related issues would represent a new aspect of their communications with investors. Some of the data we are hoping to see reported may require companies to establish new collection and compilation processes, which would inevitably take time. As such it would be fairer for the use of AGM votes to leverage better reporting to be adopted as a tactic over the long-term rather than the immediate future.

NEXT STEPS

This toolkit is intended to support PLSA members – and other stakeholders – throughout the investment process. It is **a guide that we hope will be useful as a benchmark or standard-setter that can inform pension funds – and different stakeholders – approaches to workforce-related stewardship,** which will inevitably vary based on their particular needs and circumstances. It is not meant to be a set of inflexible recommendations that we expect to be adopted universally and to the letter.

At the asset manager selection stage, the outlined approach – from measurement to engagement to voting – can be used for benchmarking and comparing against the approach to stewardship taken by potential asset managers (the toolkit can also be.

used to outline expectations to investment consultants, where they play a role in asset manager selection). Similarly, it can also be used for reviewing and assessing the performance of managers once they have been contracted.

For pension funds that manage their own investments directly, the toolkit provides a template for understanding the culture and workforce-related challenges or opportunities of prospective and existing investee companies.

The toolkit also supports ongoing stewardship efforts designed to improve company performance and therefore returns to the ultimate beneficiary, the scheme members. Indirectly, better management and employment practices can also potentially yield benefits before retirement, by raising standards across the UK economy and therefore working conditions for millions of working people.

In this respect our aims are ambitious and will require significant use of the toolkit by our members and others. We will be disseminating the toolkit to members and promoting at our events and training sessions, attended by representatives from across our membership.

In the short-term we also hope to engage with individual companies in whom our members are invested and where we perceive the potential value of the approach outlined in this toolkit to be particularly significant. We will also be incorporating our recommendations into our corporate governance policy and voting guidelines.

Over the long-term we hope to see a sharp increase in corporate reporting along the lines we recommend and for engagement on human capital to become a standard part of pension funds investment and stewardship activities.

We welcome the support of our members, the investment industry, companies and all other stakeholders in the implementation of this agenda.

Pensions and Lifetime Savings Association
Cheapside House,
138 Cheapside,
London EC2V 6AE

T: 020 7601 1700
E: plsa@plsa.co.uk

www.plsa.co.uk

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