



Unlocking Human Capital: Engagement on Employment Best Practice

*Presentation to the 6th Annual Conference
Capital Matters: Managing Labour's Capital
Harvard Law School
16-18 April 2008*

Alan MacDougall, PIRC Limited





The LAPF Forum

- **LAPFF is a voluntary association of 48 local authority pension funds in the UK with AUM of £95 billion, founded 1991;**
- **“LAPFF exists to promote the investment interests of local authority pension funds, and to maximise their influence as shareholders whilst promoting corporate social responsibility and high standards of corporate governance amongst the companies in which they invest”;**
- **PIRC is the research and engagement partner of the Forum.**



Background to the Forum's work:

- PIRC internal policy paper in 2000, 'Employment: A strategy for shareholders':
 - i. Identified need for greater disclosure by companies of specific types of employment data;
 - ii. Identified lack of data as a major impediment to ability of shareholders to monitor company management of 'human capital'.
- PIRC research for Focus Central on how institutional investors valued human capital in companies and what HR measures they take account of when making portfolio investment decisions:
 - i. Investors' formal valuation models were heavily dependent on financial metrics due to resource constraints and the absence of reliable and well-defined standards for quantifying HR returns;
 - ii. Company disclosure resistance and 'insider' knowledge.

Background to the Forum's work:

- PIRC conducted various literature searches and reviewed academic material.
- 2002 West Midlands Pension Fund commissions PIRC to 'identify FTSE 100 companies that are leaders in promoting good employment practices and also those companies that are doing less well, with the long term aim of seeking improvements to protect shareholder value'.
- During 2002 UK Government establishes 'Accounting for People Taskforce' whose aim is to: 'look at ways in which organisations can measure the quality and effectiveness of their human capital management, consider best practice in HC reporting and the performance measures most helpful to stakeholders and champion the business case for such reporting'.



WMPF study methodology:

- PIRC created a set of criteria with which to analyse FTSE 100 companies, and provide a rating based on a simple scoring matrix;
- These were: a. Principles & Policies, b. Accountability & Management, c. Stakeholder Engagement, d. Performance & Key Data, and e. Standards, Audit & Reporting.
- For each criterion PIRC developed a set of specific data points and gave each one a score.
- Each criterion's total was added together and individual scores per criterion calculated for each company. Totals were then added to provide a final weighting and an index created.
- All data used was publicly available and each company was provided with an opportunity to clarify and correct data reviewed.

WMPF study conclusions:

- West Midlands Study Conclusions:
 - i. The scores of the FTSE 100 are spread widely across the index: BT Group had the highest score (97) and Daily Mail and General Trust the lowest (0); the distribution of scores between thematic areas of analysis becomes progressively more skewed towards the bottom of performance;
 - ii. Several sectors contain both high and low scores eg mining & food retailers;
 - iii. Widely different levels of reporting cannot be explained by firm complexity and there seems to be no reason why high standards of reporting cannot be achieved by all companies; and
 - iv. There is a potential for developing a common framework for reporting and evaluating HC, confirmed by parallel studies and the AFP taskforce.

From research to implementation:

- The West Midlands study was presented to the Forum in September 2003 and the following recommendation was adopted: 'That the Forum approves the methodology set out in the WMPF study and agrees the sectors and companies proposed for engagement on the theme of Company Workforce Practices.'

The Forum's engagement work began on the following basis:

- All 40 companies scoring less than 40 on the WMPF rating would be targeted for engagement (18 industry groups comprising 44 companies);
- A prioritisation process was implemented based on significant CSR risk resulting in 4 sectors and 13 companies.

The initial under-performers:

- Banks: RBS, Lloyds TSB Group, Alliance & Leicester, Standard Chartered & Northern Rock.
Rationale: only 1/5 identifies employment risk; little data published on H&S performance; 4 conduct employee surveys.
- Food: Unilever, Associated British Foods.
Rationale: no employment risks identified; no employee satisfaction surveys; 1 publishes some H&S data.
- Leisure: 6 Continents, Hilton Group, Whitbread, P&O Cruises
Rationale: non employment risks; no H&S or diversity; 2 surveys conducted.
- Chemicals: BOC Group, Johnson Matthey.
Rationale: no employment risks; no surveys.

The engagement process:

- The AFP reported & the Forum decided to take a different approach for their engagement than that recommended in the AFP final report. This concluded that it should be left up to company boards to decide on which core indicators if any to report;
- An independent review of UK Company Law had reported earlier in 04 recommending a new reporting framework entitled the 'Operating & Financial Review'. This was to enable stakeholders to assess the strategies adopted by companies and the potential for companies and their boards to successfully achieve them;
- Following initial consultation the Forum revised its core indicators: a. to require a minimum standard of reporting on employment practices; to identify material industry-specific employment risks and opportunities; and to question director's views on the materiality of employment issues, and to confirm that they are reasonable and balanced on employment issues in the preparation and publishing of OFR's.

The engagement process: disclosure

- Initiated in the spring of 2004, letters were sent to the target companies, asking for a dialogue on the initial rating outcome of WMPF study on their company profile and enclosing the study for their review;
- Evaluating company responses took place over the following months and re-assessments were then made by the Forum on the target list drawn from the WMPF study.
- Improvements in reporting had taken place amongst banks; one of the food producers had made sufficient progress to be taken off the target list for further engagement; amongst the chemical companies all exhibited some improvement and were therefore removed from the target list; however, the four companies in the leisure sector – a very labour-intensive set of businesses - had made comparatively little progress and were selected for more in-depth engagement.

The engagement process: risk

- The Forum's attempt to apply a risk assessment of industry-specific factors proved more problematic;
- Most of the target companies even where their disclosure was otherwise deemed good, disclosed little on employment risks and opportunities faced in their industry sectors;
- In the light of this evidence the Forum decided to use the ASB's reporting exposure draft to benchmark the OFRs reporting standard for companies on employment risk. This requires directors to provide investors with information to assess strategies adopted by the entity and their potential to succeed;
- The eventual implementation of the OFR was delayed by a year to 2006 and to a certain extent limited by the renaming process that took place, in the face of hostile corporate lobbying. The OFR became the 'business review' and fell into line with EU Directive.

The engagement process: a Trustee Guide

- In 2005 the Forum revised its framework again following member consultation and engagement feedback. It was decided during 2006 to publish a Trustee Guide and this appeared in June 2007.
- The Forum's engagement strategy on company workplace practices continues and engagement with individual companies has become more intensive, albeit not in a particularly aggressive manner;
- The Forum has met considerable resistance from some companies to meet and discuss. Many of the target companies were surprised at an investor body's interest in their employment practices and disclosed more data when pressed, raising the issue of their own lack of understanding about how valuable their policies and practices could be in informing investors and possible leading to competitive advantage.
- The Forum has also extended its dialogue with workplace representatives and unions.