NAPF

Where is the workforce in corporate reporting?

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Pension funds have a clear interest in promoting the long-term success of the companies in which they are invested.

At a time when policy makers and central banks seek to find solutions to the productivity puzzle there is also increased scrutiny on the way organisations are managed and a desire for more focus on the sustainability of company operations.

There is evidence to demonstrate the materiality to financial performance of human capital, however, presently there is very limited quantitative or qualitative reporting by companies on their approach to managing their workforce. In turn this means it is impossible to see a full picture of a company's operations and therefore to make comparisons and form a view as to how companies are maximising the productivity of their workforce.

Of the companies in the FTSE 100 during 2014:

- less than half disclosed the levels of staff turnover;
- less than a quarter reported on their investment in training and development; and
- approximately only one in ten provided information about the composition of the workforce.

There are, however, both tangible and intangible costs and benefits associated with people management. We believe there is compelling evidence to demonstrate that a well engaged, stable and trained workforce which operates within a supportive environment is one which is likely to be more committed and productive and, in turn, be more likely to drive long-term business success.

In this context, we believe that issues related to the management of the workforce are deserving of more transparency by companies and attention by investors. The present 'chicken and egg' scenario is unsatisfactory; more disclosure should assist investors to make more informed investment decisions and to act as better stewards of their investee companies.

Boards should actively consider how strategy, governance arrangements, performance and prospects, in the context of the firm's external environment, leads to the creation of value in the short, medium and ultimately long term. The composition of the workforce and the sustainability of the employment model should be core to these discussions. Boards should seek to understand and communicate whether the company is maximising the long-term value of the human capital it has at its disposal.

This discussion paper suggests four areas where better reporting is required and suggests that data points in relation to each of these can and should be provided.

- the composition of the workforce;
- the stability of the workforce;
- the skills and capabilities of the workforce; and
- the motivation and engagement of the workforce.

Communication of a company's long-term sustainability should include an explanation of the appropriateness and sustainability of the employment model. What is desired is a holistic approach which provides consistent data points alongside entity specific policies and context – this will require further consideration of about both what and where disclosures are currently made and may necessitate a mixture of voluntarism and mandatory requirements.

The NAPF intends to explore this agenda further with investors, companies, analysts, exchanges, regulators and other standard setters over the coming months. Whilst we encourage companies to seize the initiative we intend to host a series of roundtables during the second half of 2015 to discuss with relevant parties how more progress can be made. Ultimately conclusions will be incorporated into the NAPF's Corporate Governance Policy & Voting Guidelines.

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Joanne Segars

Chief Executive, National Association of Pension Funds

Having been the Chief Executive of the NAPF for the past eight years I have become acutely aware that the organisation can only be strong and successful if the wider team is motivated and working together.

Workforces are an essential and core component of any organisation. Yet too often it is the experience of our members that they are the missing piece in the corporate reporting jigsaw.

The NAPF has been intimately involved in corporate governance for more than two decades. And in more recent years we have also been at the forefront of debates around stewardship. Our members as long-term investors fully recognise the risks to their investment portfolios posed by E, S and G issues, however, it seems presently for both companies and investors there is a blind spot associated with the “S” of “ESG”.

Investors are now provided with page after page of reporting about pay and other governance matters. It is possible to know exactly what metrics an executive is rewarded against. It is however, not uncommon to have little idea about the how many employees an organisation employees.

Now companies will commonly retort that they would provide more information if their investors were asking for it. And they are right, presently too few investors do ask questions about these issues.

On the other hand, investors suggest that they would take these matters into account were there useful information to digest and comparisons to make. This chicken and egg situation has resulted in an unsatisfactory impasse.

The NAPF is now keen to try and kick-start this agenda.

In the spirit of what gets measured gets managed and what gets reported gets done, we are asking, what metrics can companies report which can and will be used by investors. In this discussion paper we identify four particular areas where there should be better disclosures. What is sought is communication which conveys succinctly how a workforce is composed; how stable that workforce is; how the composite skills and capabilities are being maximised; and, in turn how motivated, engaged and ultimately productive the workforce is. Ultimately, all companies should be able to explain this within the context of their stated corporate strategy.

We suggest that better reporting of the issues identified in this paper will be good for long-term investors, companies and the wider UK economy.

Paul Druckman

Chief Executive Officer, International Integrated Reporting Council

‘People are our greatest assets’ is rhetoric that has been used by businesses for over twenty years. Traditionally, it was just that – rhetoric – with little evidence supporting this claim in business performance indicators and reporting.

However, the arrival of stewardship and corporate governance codes has signalled a new era for business, investor and stakeholder interaction. Much more than just understanding the finances of a business, it is now about understanding their strategy and business model. A reassessment of our understanding of value – its parameters and its effects - is taking place, making sure that business models sing to the tune of a value creation model fit for the 21st century.

So if people are the greatest assets of these organisations, then information about human capital must be treated with the same rigour and accountability as is afforded to the financial statements. For example, having an understanding of employee capacity and potential, the results of investment in research and development, and the quality of leadership needs to be understood and communicated. Businesses are not hiding this away in silos, because they understand that it is essential to the strategic performance of a business. Bringing human capital into the mainstream of business-decision making has knock on effects, meaning more efficient allocation of human resources which in turn contributes towards higher skills levels and increased productivity.

The Governor of the Bank of England Mark Carney, has warned, that the UK’s level of productivity per worker fell during the global financial crisis, citing it as “one of the great costs of the financial crisis”. He said, “What you have in economies after a financial crisis is a sharp drop in productivity... There is a huge opportunity cost.” This warning signals that understanding the productivity of a workforce is essential for the long term success of an organisation. As the saying goes, ‘what gets measured gets managed’ and if a business truly understands its workforce, it can deploy it properly.

But all of this is not enough by itself, forward thinking companies are going one step further. They are ensuring investors are informed about how their human capital is connected to the other capitals – to intellectual, manufactured, social and relationship, natural and financial capital. They are using Integrated Reporting to provide investors with information about how all the resources that the organisation uses and effects work together to create value over time.

Publications such as this one will encourage better understanding about why this change in thinking is crucial to the financial stability of markets. I am delighted to see such a spike in interest in this area, and the evidence and insight presented in this publication really does demonstrate that financial performance fundamentally relies on a better understanding of all the capitals an organisation uses and effects.

Alan McGill

Partner, PWC

The time has come for a new, market-driven blueprint for human capital reporting to reflect the significance of people to business. While financial reporting has a long-standing tradition, it has become clear that non-financial information provides at least as much insight into the future performance of business. Human capital is paramount to this and I hope that this paper acts as a catalyst for collaboration, new thinking and a fresh approach to develop consistent reporting and frameworks to assess how business manages this most critical resource.

There are various trends that drive the importance of human capital to business. As our economy is becoming increasingly more knowledge-intensive, research shows that a more significant share of economic growth is attributable to intangible capital rather than fixed assets. For this reason, the UK Government and organisations like the OECD and World Economic Forum have already developed methodologies to assess the "stock" and quality of human capital countries have access to.

Meanwhile, it has also become clear that an organisation's people and culture are fundamental to driving business performance and resilience. Irrespective of the strength of a company's financial and physical asset base, it's only when employees live their organisation's values that business can deliver growth in the long-term. The relevance of human capital is increasing and corporate reporting on people should reflect this if it is to provide the insight business leaders and investors require to make better informed decisions.

To some extent business is already responding to this: reporting on human capital management is expanding and evolving. Whilst previously the only people-related information in an annual report would typically be the wage and remuneration information in the notes to the annual accounts, more information is now being reported on employee-related indicators including retention, training and diversity. Other areas, such as employee satisfaction and wellbeing are also featuring in corporate reports – a further acknowledgement of their importance and relevance.

However, more effort is required on reporting on the relation of these indicators to the financial performance of businesses. That is, how do human capital management practices drive or erode business value? This requires quantitative evidence in addition to the narrative information now requested from business. Recently, we have seen a number of initiatives from individual companies addressing this question. While these are just a starting point for developing a widely accepted, consistent framework, they are an important sign that this matters to business.

Efforts such as this discussion paper and recent research by the Valuing your Talent programme also contribute to the debate. It is encouraging that, since the UK's Accounting for People Taskforce, there is renewed effort to drive this debate. This should be treated as a starting point for stakeholders to come together and debate the issues and opportunities outlined in this paper and ensure that market mechanisms are harnessed to build value and improve every company's most prized asset, its human capital.

The workforce – the ultimate unvalued intangible asset

The people who constitute a company's workforce are in many cases a firm's most valuable asset - indeed this view is ascribed to regularly by many companies. However, all too commonly they are viewed and reported as a cost.

Despite steady technological advances, the way the workforce, often termed the human capital is managed, developed and promoted is likely to be one of the key determinants to a company's long-term business success. Recent events have clearly demonstrated how getting culture and behaviours wrong can be highly damaging and value destroying.

We are conscious, however, that within the Environmental, Social and Governance acronym the understanding and awareness of Social issues is perhaps least developed. Indeed, the "S" is often the forgotten cousin of the ESG family. Workforces, however, clearly matter and are directly linked to the creation of value. Furthermore, whilst in the financial accounts people may be accounted for as an expensive cost they also remain the only company asset capable of self-improvement.

How companies make use of financial and natural capital is well described, documented and accounted for in a company's report and accounts. In contrast, the use of human capital is minimally reported on and can only be partially found in financial statements. At a time where there is increased scrutiny on the way organisations are managed and a desire for more focus given to the sustainability of company operations we believe that these issues are deserving of more transparency by companies and attention by investors.

Companies commonly argue that they would provide more information if they were asked for it by their shareholders. On the other hand, shareholders suggest that they do not take into account nor engage on these issues at present as there is little useful information to digest, no articulated link to business strategy and no ability to make comparisons between companies. Investors are increasingly mindful of the wide range of issues which can positively or negatively impact a company's long-term performance and with the drive towards integrated reporting both parties are being encouraged to think more about this agenda. With the increasing recognition, the NAPF is keen to break the current impasse with respect to reporting on human capital matters.

The NAPF is now keen to initiate a discussion on how companies can better articulate how their human assets drive their strategy, contribute to growth and are aligned with the creation of long-term shareholder value. Of course, if companies begin to provide the data points and information, it will also be incumbent upon investors to make use of the information in the interests of acting as good stewards of their client's assets.

To answer these challenges and to build momentum for progress we will be inviting thoughts and input from companies and investors as well from other interested parties including policy makers and standard setters. We intend to host a series of roundtables with relevant parties later this year and concluding principles are expected to be incorporated into the NAPF's Corporate Governance Policy & Voting Guidelines.

What is human capital?

Essentially a company's human capital is its people – the skills and capabilities of whom are used in its value creation process. Whilst accounting standards do not account for people on the balance sheet there are estimates that the value of human capital is substantially larger than that of physical capital[1].

The International Integrated Reporting Framework defines human capital as people's competencies, capabilities and experience, and their motivations to innovate, including their:

- alignment with and support for an organisation's governance framework, risk management approach, and ethical values;
- ability to understand, develop and implement an organisation's strategy; and
- loyalties and motivations for improving processes, goods and services, including their ability to lead, manage and collaborate.

The Organisation for Economic Co-operation and Development (OECD) defines human capital as: "the knowledge, skills, competencies and other attributes embodied in individuals or groups of individuals acquired during their life and used to produce goods, services or ideas in market circumstances."

Why measure human capital?

Companies often claim that people are their greatest asset, however, very few presently seek to demonstrate how well they recruit, retain, manage and motivate their staff in order to foster a positive corporate culture and manage risk to support sustainable long term performance. This is despite a growing body of evidence which highlights the positive relationship between high quality leadership and people management, more engaged and resilient staff, and improved business performance.

A recent survey of the literature on human capital by the Investor Responsibility Research Centre[2] concluded that "there is sufficient evidence of human capital materiality to financial performance to warrant inclusion in standard investment analysis."

We suggest that good management of, and investment in, a company's workforce should enable a company to be more stable, lower risk and have higher expected future cash flows. Conversely, a negative organisational culture, poor people management and inadequate training are widely recognised as having played significant roles in numerous corporate failures over past decades. Good people management should result in the company being a safer investment and a better long-term proposition.

There is growing interest in this area

Economists and policy makers note and endeavour to understand what the Bank of England has called the "UK productivity puzzle"[3]. Whilst the UK has historically high levels of employment, the Bank of England has suggested many people may be underemployed and the ONS has reported that productivity, output per hour worked, remains at 2007 levels.

Businesses themselves recognise that human capital is an important driver of value creation. As such, creating a better understanding of the significance of employees to a business can provide insights into the drivers of their growth. This generates

1 Measuring Human Capital – An OECD Project, 2012 (Gang Lui)
2 The Materiality of Human Capital to Corporate Financial Performance, IIRC, April 2015
3 Alina Barnett et al, Bank of England, Quarterly Bulletin, 2014 Q2

opportunities for an organisation to enhance the productivity of its workforce, both in terms of the quantity and quality of output; this in turn could be of benefit for wider society.

In the business literature, a number of methods have been developed to provide a quantitative measure of the human capital of an organisation[4]. There are, however, few examples of companies that have actually done such analysis, one that has, however, is SSE.

In April 2015, SSE became the first UK company to measure the value of its 'human capital' and publish its findings. Commenting upon the publication, SSE's Director of HR John Stewart stated that: "What does the report tell me? It tells me investing in people, training them for sustainable jobs, retaining them in the business and giving them the opportunity to be promoted all makes good economic sense, and creates value for SSE, the employee and wider society."

The issue is similarly rising up the agenda of many long-term investors. Significant attention is now rightly being given to the importance of stewardship. Given the backdrop of a low-yield environment and heightened attention given to the fees of active managers there is understandably increasing recognition that these issues are ones where engagement upon may unlock value.

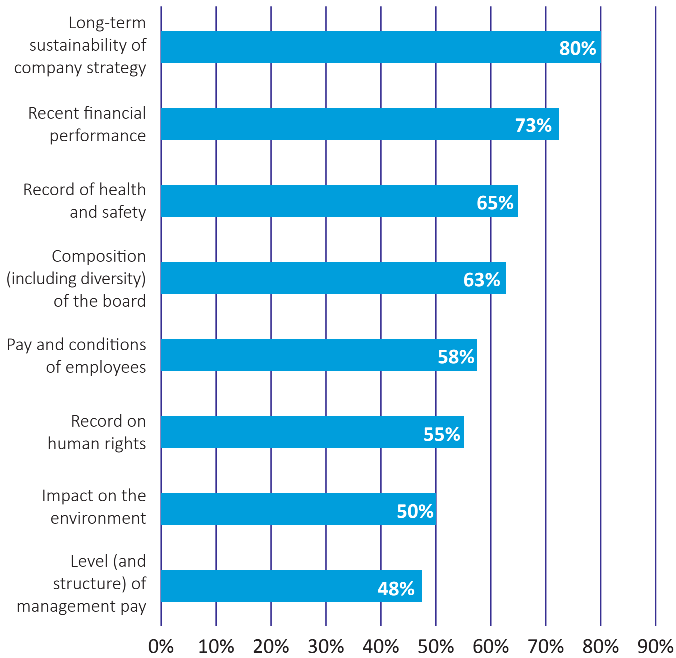
In a recent research report[5] commissioned by the Valuing your Talent partnership and written by the CIPD it was reported that a clear majority of investors interviewed believed that company reporting on human capital management should be promoted and improved, and that the materiality of such issues should be discussed in annual reports.

During 2014 the NAPF surveyed both pension funds and underlying scheme members to better understand which issues were considered most important for investment managers to be taking into consideration when making investment decisions. The results were illuminating and instructive.

Our annual Engagement Survey surveyed 50 large UK occupational pension funds with combined assets under management of £419 billion. These large pension funds were asked how important it is that their fund's investment managers take a range of factors into consideration when making investment decisions and asked to rank each on a scale of 1 to 5.

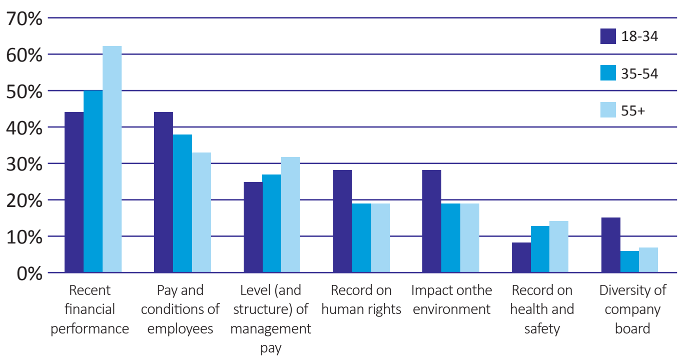
The figure below shows the proportion of respondents which ranked each factor "4" or "5". The results illustrate that pension funds consider that the long-term sustainability of an organisation should take priority over short-term performance when making investment decisions. In a similar vein, greater weighting and recognition was given to health & safety and pay and conditions of employees than to traditional governance topics such as executive pay, despite the political, societal and regulatory focus on this issue in the years since the 2012 Shareholder Spring.

Figure 1 – NAPF 2014 Engagement Survey



These findings closely mirrored those of a similar survey the NAPF commissioned of underlying scheme members earlier in the summer of 2014. With automatic enrolment bringing millions into pension savings for the first time, undoubtedly a very positive development, the NAPF wished to better understand which issues underlying scheme members, who shoulder the investment risk, consider most important for engagement. In this survey 1,064 UK adults were asked which issues they considered most important for their pension provider to take an active role in engaging with investee companies upon. Instructively, results demonstrated that scheme members consider those issues relating to "pay and conditions of employees" to be more important for engagement than those associated with executive pay, environmental impact and diversity.

Figure 2 – NAPF 2014 report: What do pension scheme members expect of how their savings are invested?



4 See for example: Andrade and Sotomayor, 2011.
5 Human capital reporting: investing for sustainable growth, January 2015

An opaque area of reporting

While it is possible to trace how financial capital is gathered, employed and used to generate value there is commonly little to no explanation given by companies as to how their human resources practices are aligned with their objective of generating long-term sustainable success.

Disclosure of data points in this area is particularly lacking. When data is provided, another challenge is making suitable comparisons, companies typically have differing methodologies to collect and report employee related data and thus there is often little scope for making comparisons. Even basic facts like the size and composition of a workforce are commonly difficult to pin down - a pre-requisite to properly understanding what the retention level is, how the staff are treated and developed and how motivated they are.

Without such reporting it is impossible to understand the present value of a company's human capital let alone begin to assess the returns on any investment in its people in order to answer the question of how a board is seeking to maximise the human capital it has at its disposal in a sustainable manner.

Currently discussions over the capacity of some firms to obtain a greater return than others on their investment in people cannot take place as too many pieces of the jigsaw are missing to allow an investor to put together a full picture.

Current levels of human capital reporting – a jigsaw with many missing pieces

An analysis of the data points collected by Bloomberg demonstrates that at a quantifiable level the proportion of UK companies presently disclosing information in this area is low and the detail commonly fairly minimal – the level of disclosure is lower still outside of the largest companies. In 2014 the proportion of FTSE 100 companies making disclosures on relevant issues is set out here[6]:

Metric	Proportion of FTSE 100
Total headcount	94%
Workforce composition, e.g. number of part-time and / or temporary staff	11%
The levels of staff turnover or attrition	47%
The total investment in training and development	24%

Globally the situation is no better. In a 2014 report[7] investigating the extent to which the world's large listed companies are disclosing the seven "first-generation sustainability indicators" which include employee turnover; injury rate and payroll it was found that:

Metric	Proportion disclosing
Rate of employee turnover	12%
Injury rate	11%
Payroll expense	59%

6 Based upon Bloomberg analysis, February 2015
7 Measuring Sustainability Disclosure: Ranking the World's Stock Exchanges, Corporate Knights Capital, October 2014

The current reporting rules

The reporting of how companies manage their workforces is a theme which has attracted the attention of governments of all stripes over the past 20 years. The Kingsmill Review in 2001 was one such notable marker and its fundamental conclusion that good human capital management is routinely underreported - even though it is clearly a crucial element in a company's success - remains true today.

It was in part out of the Kingsmill review that company law reforms were brought forward which included the introduction of the short-lived Operating and Financial Review (OFR) – a narrative reporting on a company's business, performance and future plans. Over the past few years there have been multiple new initiatives to enhance both the quantity and quality of company reporting with particular attention given to non-financial reporting. Rightly the objective of the new requirements is to encourage companies to give more attention to communicating to their shareholders their longer-term purpose and business model and the risks and opportunities which it is facing and managing.

Whilst there is plenty of scope for companies to report workforce matters through narrative reporting there is little to no compulsion to do so and it is clear that as a consequence not many choose to do so. As a result those companies with a good story to tell are failing to get their positive messages across to investors.

New strategic reports

In the UK, the Government published new regulations in 2013 to require publicly listed companies to prepare a strategic report as part of their annual report. The purpose of the new strategic reports is to inform members of the company and help them assess how the directors have performed their duty under section 172 of the Companies Act (i.e. the duty to promote the success of the company).

The regulations require that, to the extent necessary for an understanding of the development, performance or position of the entity's business, the strategic report should include amongst other issues information about the entity's employees. Such information is only required however, if it is considered necessary for an understanding of the development, performance or position of the company's business. These regulations supplemented existing requirements to report the average number of persons employed by a company.

The strategic reports have been a positive introduction and have been welcomed by many investors. However, with respect to the workforce the new disclosures are limited and have to date brought little in the way of new or enlightening information. In general, the additional disclosures are restricted to the area of diversity with other issues evidently not being considered as meeting the materiality threshold.

EU non-financial reporting

The Directive on disclosure of non-financial and diversity information entered into force on 6 December 2014 to be implemented across EU Member States within two years.

The new EU Directive reflects very closely the UK's strategic report regulations and will require companies to disclose in their annual report information on policies, risks and outcomes as regards environmental matters, social and employee aspects, respect for human rights, anticorruption and bribery issues, and diversity in their board of directors.

With respect to social and employee-related matters, the information provided by companies may concern the actions taken to ensure gender equality, implementation of fundamental conventions of the International Labour Organisation, working conditions, social dialogue, respect for the right of workers to be informed and consulted, respect for trade union rights, health and safety at work and the dialogue with local communities, and/or the actions taken to ensure the protection and the development of those communities. As with the UK's strategic report requirements these new requirements appear unlikely to generate many, if any, new disclosures on human capital matters.

It is worth noting that Europe's CRD IV regulations for banks has also introduced new requirements requiring the reporting of employee numbers for all countries of operation, thus adding a small piece to the incomplete jigsaw.

Integrated reporting

The International Integrated Reporting Council (IIRC) is a global coalition of regulators, investors, companies, standard setters, the accounting profession and NGOs. The International Framework[8] published by the IIRC provides principles-based guidance for companies and other organisations wishing to prepare an integrated company report.

An integrated report is described as one which provides insight about the resources and relationships used and affected by an organisation and its principles are consistent with the numerous developments in corporate reporting taking place across the world including those cited previously. It is hoped that, over time, integrated reporting will become the corporate reporting norm.

The Framework emphasises five 'capitals' employed by a business one of which is human capital which in the Framework is described as including the workforce's:

- alignment with and support for an organisation's governance framework, risk management approach, and ethical values
- ability to understand, develop and implement an organisation's strategy

8 International <IR> Framework, December 2013

- loyalties and motivations for improving processes, goods and services, including their ability to lead, manage and collaborate

In its 2014 yearbook the IIRC reported encouraging signs and indicated that 50% of CEOs, CFOs and COOs are according to a survey[9] by CIMA, the AICPA and Black Sun, moving towards integrated reporting.

The Global Reporting Initiative (GRI) is another organisation which seeks to promote the use of reporting as a way for organisations to become more sustainable. Since 1999, the GRI has provided a comprehensive Reporting Framework that is widely used around the world. Some of the employment aspects on which it encourages reporting include the:

- total number of employees and the rates of turnover;
- benefits which are standard for full-time employees but are not provided to temporary or part-time employees;
- retention rates after parental leave;
- types of injury, rates of injury, lost day rate, absentee rate and work-related fatalities for the total workforce;
- average hours of training employees have undertaken; and
- ratio of the basic salary and remuneration of women to men for each employee category.

Analysis of the 2,230 Global Reporting Initiative (GRI) reporters suggests that a number of companies are beginning to make such disclosures providing a useful indication as to what is possible:

- 71% fully disclose their total workforce by employment type, employment contract, and region.
- 52% fully disclose their total number and rate of employee turnover by age group, gender, and region.
- 55% fully disclose their rates of injury, occupational diseases, lost days, and absenteeism, and number of work-related fatalities by region.
- 51% fully disclose the average hours of training per year per employee by employee category.

The IIRC and GRI are just two of a host of global initiatives in various jurisdictions aimed at enhancing corporate reporting across the world. For global investors the recent coming together of many of these initiatives with varying degrees of overlap to form the Corporate Reporting Dialogue (CRD) is a positive step. What is self-evident is the need to raise the bar in a consistent and where feasible harmonised fashion to ensure comparability and to avoid arbitrage opportunities.

A start but what next?

Members of the NAPF have a clear interest in promoting the success of the companies in which they invest. It is for this reason that the NAPF's Corporate Governance Policy[10] emphasises the importance of building a sustainable business model.

As in other areas of governance we believe it fair to suggest that a Board's approach to the treatment of its workforce can be a useful insight into the wider culture of an organisation. Questions which we suggest are appropriate to ask include:

- Is short-term profit generation prioritised at the expense of the workforce and is this likely to impede the generation of sustainable value for the organisation over the longer term?
- Are there potential productivity gains which are not being realised or risks not being sufficiently managed?

Ultimately a failure to foster and invest in a committed, engaged and well trained workforce means that a company may be failing to maximise the value of its human capital. In this scenario short term profitability may not result in long-term business success.

As already highlighted however, the data is currently not available to interrogate. We suggest therefore that it may now be time for a 'paradigm shift' in company reporting.

Compatibility with long-term business success

There is ever more non-financial information being disclosed by companies and utilised by investors. However, we are concerned that there is a danger that with more data to analyse investors risk developing a human capital blind-spot.

Analysis of investee companies traditionally looked towards the balance sheet and the tangible risks and opportunities associated with it. Figures were extrapolated to provide earnings projections and profit forecasts. But many investors are now increasingly incorporating other intangible factors into their valuations and their assessments of a company's sustainability.

In developing an assessment of the sustainability of a company's business model it would be remiss to not cast a scrutinising eye towards the company's return on investment in its workforce and whether that investment is likely to result in long-term business success.

The Accounting for People Task Force of 2003[11] which arose out of the Kingsmill review made a number of key recommendations which are worth revisiting. In particular, it was recommended that human capital reporting should:

9 www.iirc.org/yearbook2014/timeline-assets
10 NAPF Corporate Governance Policy and Voting Guidelines, December 2014
11 Accounting for people: Report of the Task Force on Human Capital Management, October 2003

- Have a strategic focus and be clearly communicated.
- Include information about the size and composition of the workforce; the retention and motivation of employees; the skills and competences necessary for success, and training to achieve these; remuneration and fair employment practices; and leadership and succession planning.
- Be balanced and objective and enable comparisons over time.

These recommendations were not ultimately reflected in the legislation for the information required to be included within the OFR. Of course the requirement to publish an OFR itself was soon retracted in any case.

Better reporting

It should be stressed that the NAPF is not advocating ever lengthier company reports. Instead we are encouraging continued scepticism to be applied to what is presently reported and for companies to question whether they are most effectively communicating their business model, if not, can they do better?

Equally, the objective is not about putting people on the balance sheet – a challenge which if it was agreed has merit is undoubtedly best discussed at an international level with the relevant standard setters. Instead, what is being sought is greater communication to investors of the value and management of their workforce to the operating performance of a business in order to enable a more holistic view to be taken of the risks and opportunities present within an investment proposition. In of itself this should begin to move the discussion about people out of the 'costs' category and into the 'assets' category.

Consistency of disclosures on both inputs and outputs will be crucial to enabling more investors to give this area more scrutiny. Without the ability to compare one company with their peers the value of the reporting for many analysts becomes minimal and it falls into the category of 'noise'.

However, we wish to stress that the challenges should not be a barrier to making progress and perfection should not be allowed to be the enemy of the good. To begin with we suggest disclosures should cover:

1. **The composition of the workforce**
   Who constitutes the workforce? How is it composed? Is the employment model sustainable?
2. **The stability of the workforce**
   What are the turnover figures? Is talent being undesirably lost?
3. **The skills and capabilities of the workforce**
   What investment is made in training and development? Are the talents of the workforce being maximised and productivity gains being achieved?
4. **Employee motivation**
   Is there a positive culture? Is the workforce motivated? Are the employees advocates for the business?

Whilst we have identified the above four categories where we believe all companies could provide better reporting, we have not sought to prescribe particular metrics. We hope to catalyse further discussion about which input metrics may be appropriate across all sectors and importantly which outputs can be reliably measured and disclosed in such a fashion as to provide investors with decision useful information.

In reality each of the above categories interacts with each other and thus the usefulness of one data point in isolation could be limited. Equally, without thoughtful company specific qualitative reporting important context would be lost. As such what is most desired is a holistic approach which provides consistent data points alongside entity specific policies and context.

Moving this agenda forward will likely involve a re-thinking of the content currently provided within companies annual reports and whether there is scope for certain new disclosures to be made via websites or other communication avenues.

Ultimately, we wish to see the articulation of a company's long-term sustainability including a description of the sustainability of its employment model and through this an insight provided into the culture of the organisation.

With investors increasingly being encouraged to act as engaged stewards of the companies in which they are invested, this additional reporting will enable them to have broader and more informed dialogues with company management. Many of the aspects of this agenda are truly long-term in nature – a positive culture can be damaged in a moment but take many years to generate. Self-evidently, whilst there have been multiple corporate governance reforms over recent years it is not possible to regulate for a good culture; inputs can be prescribed but it remains alchemy to believe the output can be guaranteed. For genuinely long-term investors such as pension funds, conversations about the people that constitute company management and the wider workforce are crucial to understanding a company's culture, how well a company is functioning and whether warning lights are beginning to flash.

In the following sections we briefly discuss each of the four categories and explore issues within them that may warrant further debate and metrics that should be relevant to all companies as well as others worthy of adoption by some. Examples are provided of disclosures already made by certain companies; these examples should not be interpreted as endorsement of the approach but do serve to demonstrate what is already feasible and thus indicate that it is possible for much progress to be made.

The potential disclosures discussed should encourage investors to ask more questions of companies in order to understand both how the risks inherent within a workforce are managed and how opportunities for development and growth are grasped.

Category 1:
The composition of the workforce

Core metric: Total number of employees and workers.

Additional metrics: Proportion of full time, part-time and contingent labour; diversity of ages, and gender; divergence in benefits awarded to full-time employees but provided to part-time or temporary employees.

As the earlier figures quoted from Bloomberg illustrate it is still not uncommon for the total headcount of a workforce to not be unreported. Even when such a disclosure is made it usually fails to give more than just a snap shot and does not describe how that workforce is composed. This situation is not satisfactory.

With the introduction of country-by-country reporting for banks and the strategic report for public companies this is an area of reporting where there is beginning to be more detail given. For certain companies it may soon be possible to identify the total number of employees; where these employees are located and the gender diversity amongst these employees at different levels. Even with this progress there would still be many holes in this picture of the workforce.

The 2014 report Valuing Your Talent report described an organisations 'talent' as covering an organisation's "entire workforce" – to be understood as "all employees utilised by an organisation in delivering its own operations."

We suggest that enhanced disclosures around the composition of the workforce should also include the numbers or proportions of permanent, temporary and contingent labour in addition to the mix of ages at different levels of seniority. Such disclosures would provide investors with an insight into whether succession planning is operating appropriately, provide a better understanding of the fundamentals of the employment model and allow judgements to be made about its appropriateness and sustainability. There are companies already disclosing each of these cited elements of workforce composition and as such we believe there is little preventing good practice in this area being adopted more widely.

The mix between permanent and contingent labour

The sustainability of a company's employment model will, as with all areas of corporate strategy, be dependent upon the nature of the business in question, the sector in which it operates and its level of maturity. An understanding of the composition of the workforce should be communicable within this context and enable questions to be asked as to whether an organisation's model is based upon low labour costs or growing and developing its talent.

One particular issue which has brought this area into focus over the past couple of years is that of zero-hours contracts. It is estimated by the ONS that there are approximately 1.8 million contracts that do not guarantee a minimum number of hours and approximately half of businesses which employ more 250 people make some use of these contracts. Similarly, the Labour Force Survey estimates that approximately 700,000 are employed on a "zero-hours contract" in their main job, representing 2.3% of all people in employment.

The use of zero-hours contracts has been debated heavily within the media and political arenas and they featured heavily within the political debates during the General Election. Against this background there is little doubt that the prevalence of zero-hours contracts does mean that many companies are potentially exposed to political and reputational risks. These are risks to which investors may presently be blind.

Zero-hours contracts provide employers, and indeed employees, with an increased level of flexibility. In some circumstances this additional flexibility may be beneficial to both parties. There is concern, however, that in other circumstances this employment status results in an undesirable imbalance of power. Furthermore, there is significant variability in terms of how these contracts are used and the level of benefits that workers are entitled to.

Given this context, many investors are interested in understanding what and how different employment contracts are used by their investee companies in order to understand where there may be reputational or litigation risks and where employment models may not appear to be aligned with longer-term success.

A significant proportion of employees on insecure contracts with no guaranteed hours and associated benefits may risk generating a two-tier workforce; this in turn may have obvious repercussions on the ability to generate a positive culture throughout an organisation. Subsequently, this risks having a damaging impact upon staff morale, potentially resulting in higher attrition rates and thus higher recruitment costs for employers.

Better disclosures about the composition of a workforce will enable investors to have a better conversation with investee companies about their longer-term business model.

Category 2:
The stability of the workforce

Core metric: Employee turnover in period.

Additional metrics: Regrettable turnover; remuneration policies and ratios; number of applicants per post; offer/acceptance statistics; levels of skills shortages; industrial relations issues; retention rates after parental leave; benefit entitlements of employees.

If Category 1 related to how the workforce is composed, the second question is consequently about the stability of the workforce. Greater insight into this should enable an investor to form a judgement as to whether the level of stability is appropriate given the nature of the company in question and its stage of development.

Turnover

Staff turnover has both an implicit and explicit cost. Explicit costs may include the cost of replacing the lost staff and training the new employee. In addition costs will include the decline in productivity as the new employee acclimatises and skills up, the lost knowledge from the organisation and potentially lost business.

Many investors are therefore interested seeing greater company disclosure of staff turnover data with a view that more consistent reporting in this area may prove valuable to their understanding of investee companies. This metric should be applicable to all companies in all sectors and a particular strength of staff turnover data is that, unlike employee engagement, there are clear reporting standards. Whilst, by itself this data point may provide limited value, it is suggested that monitoring turnover figures over time may provide important warning signs.

For people intensive industries – such as fund management itself – issues around staff turnover can be particularly illuminating. In addition, if such disclosures were provided by seniority level – as with gender diversity – then it may be possible to gain an insight into whether the pipeline of talent is being appropriately managed or indeed whether there is a bottle-neck which results in a leakage of senior talent once individuals have reached a particular level.

Similarly, if such disclosures were provided by geography – as with country-by-country reporting of employee numbers – then it may be possible to identify issues at particular business units which may stem from internal cultural dynamics or competitive pressures – e.g. the demand for high quality compliance teams within the financial services sector has in recent years placed significant strain on particular business units in particular banks.

Going further, Barclays Africa Group offers an example of reporting of "regrettable turnover" which may offer greater insight. Whilst at risk of gaming, this information goes beyond the general turnover of staff and provides some insight into how many of those staff were employees the organisation did not want to lose. This in turn adds greater context to the disclosure, especially when significant transformation programmes are underway. It is unsurprising that rising rates of "regretted" turnover could be a leading indicator of falling sales, delayed projects or poorly controlled costs.

Figure 3 – Barclays Africa Group Limited, Integrated Report, 2014

Key indicators	2012	2013	2014	YoY trend
Total permanent employees	41,372	41,433	40,662	▼
Total permanent and non-permanent employees	46,161	46,320	43,817	▼
Permanent employee turnover rate (%)	14.6	11.7	10.8	▼
Retention of high-performing employees	89.1	91.7	94.2	▲
Women in senior leadership roles (%)	24.9	26.2	29.6	▲
Senior black management (%) (South Africa only)	26.93	32.2	32.2	=
Employee opinion survey – sustained engagement score (%)	66	n/a	73	2012 results not comparable
Total training spend (Rm) (South Africa only)	606	932	1,800	▲

Diversity and pay equity

A focus over the past few years has been improving diversity on company boards. Following the Davies Review progress in the UK has been rapid with representation of women on FTSE 100 boards now just shy of the 25% target. However as Lord Davies rightly acknowledged in the foreword to the 2015 progress report, the job is not yet done. Whilst the 25% target will likely be met this is not being seen as the end of the journey but simply the first step on the path to ensuring that companies are making the most of their available talent. Focus will likely turn to the low number of women Chairs and Executive Directors on boards and the loss of talented, senior women from the Executive pipeline. To this end, the newly introduced disclosure requirements with respect to gender representation at different levels of seniority will shine the light in this direction.

In Australia the ASX Corporate Governance Principles recognise that: "the promotion of gender diversity can broaden the pool for recruitment of high quality employees, enhance employee retention, foster a closer connection with and better understanding of customers, and improve corporate image and reputation." In addition to the ASX Corporate Governance Council's recommendations that a company has a gender diversity policy, the Workplace Gender Equality Agency (WGEA) requires companies report against six Indicators:

1. Gender composition of the workforce
2. Gender composition of governing bodies of relevant employers
3. Equal remuneration between women and men
4. Availability and utility of employment terms, conditions and practices relating to flexible working arrangements for employees
5. Consultation with employees on issues concerning gender equality in the workplace
6. Any other matters specified by the Minister in a legislative instrument. The Minister has set sex-based harassment and discrimination as a further indicator.

For employers with more than 500 employees, there are also requirements to actually have some policy (called "minimum standards" by WGEA) in addition to solely reporting the statistics. The reports are publicly disclosed (with the exception of personal information, pay details and pay gaps between men and women).

As the light directed towards gender diversity is shone further down companies there is the possibility that the current debate will, as the above indicates, begin to expand to include wider issues of equality and fairness.

In the UK the Equal Pay Act was passed in 1970 and was further supplemented by the Equality Act in 2010. However, pay differentials for equal work continue to exist. To date the government has been pursuing a voluntaristic approach to pay transparency via the Think, Act, Report scheme.

In the UK there are firms which have already seized the initiative. Friends Life for example (see below) was clear that they could not hope to make their organisation a 'Great Place to Work' if a significant proportion of their workforce was under-represented and feeling that their career/development opportunities will only take them so far. Friends Life acknowledged that gender balance is better for risk management and decision making, which supports growth. To that end the company adopted a transparent approach to reporting which since 2011 included publishing their gender pay gap at grade level rather than at a top-line median salary level. The company acknowledged that the figures provided for higher-pay grades are not hugely informative given that the figures may be skewed by a small number of highly paid females in the organisation but the figures for less senior levels could be enlightening and the direction of travel could be instructive.

Figure 4 – Friends Life, People and community data

Gender pay gap

Metric	Measure – average female pay relative to average male pay
Non-management levels (A-E)	-19.3%
Management levels (F-G)	-8.7%
Executive levels (H and ablve)	+27.4%

Pension provision

With the introduction of automatic enrolment employers, large and small, are now required to contribute to a workplace pension for their employees. Offering employees a good quality workplace pension should be a useful staff recruitment and retention tool. The calculation between the cost to employers of providing a pension against the more intangible benefits which may be accrued through the potential recruitment of and subsequent retention and enhanced motivation of higher calibre individuals is the issue of valuing human capital boiled down to a microcosm. The NAPF's Pension Quality Mark[13], an award which can be achieved by good quality defined contribution pension schemes, demonstrates to current and potential employees that an employer cares enough to offer a decent pension, and go beyond the minimum regulatory requirements. Disclosures around the features and membership levels of a company's pension scheme could inform judgements about the likely stability of their workforce and the PQM assists with this public communication.

As with other aspects of pay and benefits there is also a fairness issue. As set out in the NAPF's Remuneration Principles[14] it is not always clear why some executive directors receive pay increases that are greater than those awarded elsewhere in the organisation, and which feed through to the bonus and long term incentive plan (LTIP) to widen the pay differentials within the company, or enjoy preferential tax treatment or far more generous pension arrangements – or cash in lieu – than less senior colleagues.

In FTSE 250 companies, the median contribution rate to a DC pension for the top full time executive is 20% of salary and 16% for other executive directors. For FTSE 100 companies these figures are higher still at 30% and 25% respectively. This unsurprisingly contrasts with the contribution rates for most employees of private sector occupational pension schemes of 9.1%[15] Boards, in particular remuneration committees, along with HR teams should consider whether they are able credibly to justify any such differentials.

13 www.pensionqualitymark.org.uk
14 Remuneration principles for building and reinforcing long-term business success, November 2013
15 Office for National Statistics, Occupational Pension Schemes Survey, 2013

Category 3:
The skills and capabilities of the workforce

Core metric: Total investment in training and development.

Additional metrics: Average hours spent on training per employee and for each employee category; number of courses taken; leadership/career development plans; internal-hire rate; the proportion of professionally qualified employees.

In terms of the communication around how the employment model contributes to the long-term success of the organisation it is this third category that is perhaps most crucial. It is in a discussion around the investment in the development of the workforce that the discourse moves the workforce from the 'costs' to the 'assets' bucket and is the area in which it may be feasible to eventually calculate and compare a company's return on its investment in its people.

Training and development

Presently, most companies give some narrative around training and development. However, drawing anything useful or meaningful out of what is often reported is difficult although it is an area where a number of companies are endeavouring to communicate more.

Communication around the skills and capabilities of the workforce has the potential to provide an insight into how well a company is preparing for internal succession and how well it is maximising the potential productivity of the assets it has its disposal.

Effective training should increase the skills and capabilities of individuals and in turn increase an individual's productivity resulting in improved business profit. This, in turn, increases the value of the human capital.

Figure 5 – Johnson Matthey, Annual Report, 2014

Training days and spend on training
2013/14

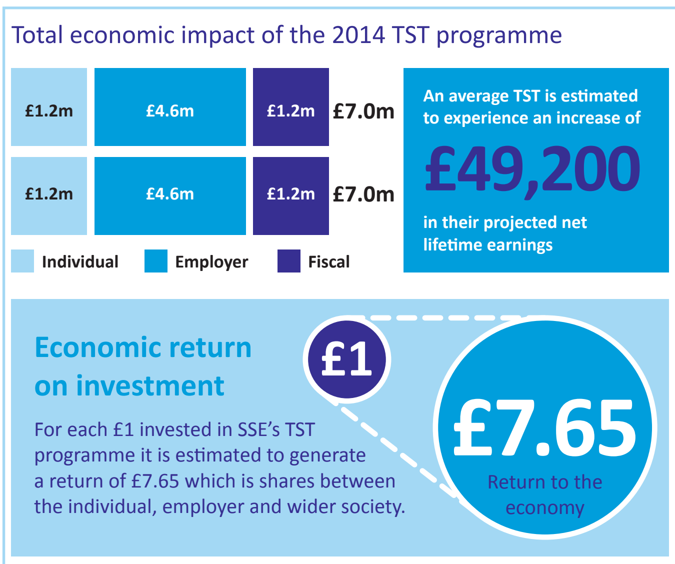
	Total days/shifts training	Number of days/ shifts training per employee	Spend per employee £
Europe	17,008	2.9	593
North America	8,828	2.9	276
Asia	5,202	3.4	351
Rest of World	4,503	8.2	494
Total group	**35,541**	**3.3**	**465**

The winner of the ICSA Excellence in Governance Award for best sustainability and stakeholder disclosure amongst the FTSE 100 in 2014 was Johnson Matthey plc. In reaching their decision the judges were particularly impressed by the focus on the workforce, in particular citing the communications around building a sustainable workforce through talent management. As well as the clear case studies on workforce globally, and employee turnover by region there was also good information provided on training days and spend on training, an example of which is shown here.

Similarly, metrics around internal-hire rates, the proportion of vacancies filled from within, may provide information in respect of whether a company's investment in training and development is adequate/paying off which will in turn feed into judgements about the adequacy of a company's more senior succession plans.

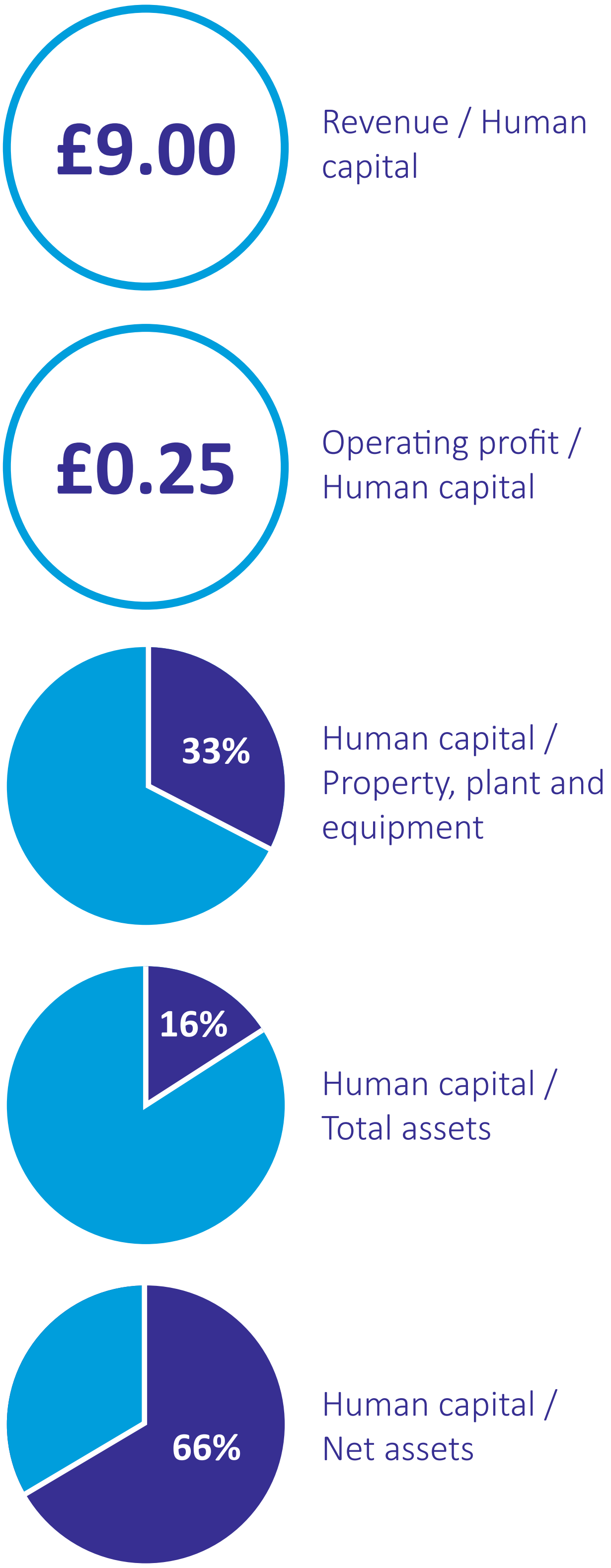
More ambitious still, in producing for SSE its Human Capital report, PwC performed an assessment of the economic impact of SSE's investment in formal staff training. This they suggest can be interpreted as the benefits of the flow in human capital, expressed in terms of the expected uplift in lifetime earnings and productivity. An example of this is presented below.

Figure 6 – Valuable people: Understanding SSE's Human Capital, 2015



SSE further recognised that very few, if any, other companies have sought to quantify the value of human capital embodied in their employees. In order to provide some context to these figures they placed the calculated value within the context of several of their key financial indicators for the financial year enabling these ratios to be tracked over time.

Figure 7 - Valuable people: Understanding SSE's Human Capital, 2015



Category 4:
Employee satisfaction

Core metric: Employee engagement score.

Additional metrics: Absentee rates; number of accidents and work-related fatalities; lost days to injury; occupational diseases rate.

Employee engagement

Despite being one of the aspects where many companies do make disclosures, employee satisfaction reporting is often viewed as the most contentious area for robust reporting given the scope for gaming and the inherent subjectivity involved. Undoubtedly each of the preceding categories will have a bearing on the outcomes of any survey of satisfaction. Equally, however, it is widely accepted and evidenced[16] that employee satisfaction is positively associated with returns.

Historically, employee satisfaction has been viewed by some as a sign of excessive expenditure. However, this view has shifted in recent years and a number of analysts now recommend that investors analyse the level of employee satisfaction or engagement at companies in which they are invested. Unfortunately, disclosure of consistent data in this area is often lacking, therefore when data is provided, another challenge is making suitable comparisons. Even where it is not possible to make direct comparisons, trend data for a particular company could still provide useful insights, for example, if a company's satisfaction data shows a sudden downtick, this could be an interesting signal and be a leading indicator of increased turnover.

ITV provides a good example of how employee engagement scores can be linked with corporate performance. Between 2009 and 2013 employee engagement scores improved rapidly from 65% in 2009 to 91% in 2013, while the participation rate (in the survey) also increased from 62% in 2010 to 88% over the same time period. This change in employees' view of ITV corresponds to a period of significant management and strategic change within the business, which also led to better operational performance.

Absenteeism and health & safety

A metric commonly related to engagement (and also turnover) is that of absenteeism - commonly defined as employees that are absent from work either on sick leave or on an unapproved basis. Absenteeism is recognised as having clear direct and indirect cost implications for a company and is regarded as a lagging health and well-being indicator for the workforce. As such, low absenteeism is typically associated with positive trends in staff morale, engagement and productivity. Encouragingly the average absence rate in the UK has been declining over recent years[17].

For some years companies in the resources and extractive industries sectors have been understandably leading in the area of reporting of many engagement-related metrics with a particular focus on minimising safety hazards which could be a danger to the physical well-being of their workers. In these industries their license to operate is reliant on effectively managing a myriad of social issues including the health & safety of their workforce. For this reason, indicators such as lost time injury frequency rates (LTIR) are commonly reported and monitored closely in these sectors. One issue with some of the metrics most commonly reported is that they are lagging indicators and as such many investors would be at least equally interested in related leading indicators such as safety processes that have been adopted, risk assessments undertaken, education programmes and near miss reporting.

More recently the non-physical well-being of the workforce has received attention with mental health conditions emerging as the most widespread cause of long-term absence from the workforce[18]. Whilst significant attention has been rightly devoted to mitigating physical health & safety risks the recognition of the less visible risks to the well-being of the workforce may warrant further attention.

Employee welfare is crucial to the success of most businesses and from an employee engagement perspective it is suggested that an attentive and engaged workforce is one that is likely to be more stable and less likely to make errors or health & safety lapses. Conversely an environment which is a safe place to work is one which is likely to engender a more positive attitude amongst employees towards their employer.

16 Edmans et al, 2011, "Does the Stock Market Fully Value Intangibles? Employee Satisfaction and Equity Prices", Journal of Financial Economics, and, Edmans et al, 2014, Employee Satisfaction, Labor Market Flexibility, and Stock Returns Around the World", Working Paper, London Business School.

17 Office for National Statistics, Sickness Absence in the Labour Market, 2014 Release

18 2013 CBI/Pfizer Absence and Workplace Health Survey

Further discussion

Whilst there has been much progress globally and within individual jurisdictions to enhance the quality of corporate reporting in recent years we are of the view that both the quality and quantity of company reporting in relation to the workforce is lacking. This means that long-term investors are too often not able to fully understand the risks being taken on by a company, nor the steps that may be being taken to maximise the full potential of the skills and capabilities available to a company through their workforce.

The fundamental issue at present is that where information is provided it too often provides only a few pieces of the jigsaw thus not allowing the full picture to be seen. Furthermore, data is too often inconsistent thus not enabling investors to make comparisons between companies within sectors.

Whilst this discussion paper has deliberately raised some contentious issues, in doing so we are not seeking to suggest that prescribing precisely what each company should report is the desired outcome. Instead, what we have sought to emphasise is that across four distinct but interconnected categories there is scope for more thoughtful and consistent disclosures. What is sought is communication which conveys succinctly how a workforce is composed; how stable that workforce is; how the composite skills and capabilities are being maximised; and, in turn how motivated, engaged and ultimately productive the workforce is. Certain elements of these categories will be more relevant to some sectors and particular companies than others. However, all companies should be able to explain their approach within the context of their stated corporate strategy. For a long-term investor, because good workforce management practices may signal strong company management, analysis of these issues may offer investors the opportunity to identify underlying company strengths, or provide signals of trouble ahead that might otherwise be overlooked if focusing only on a company's short-term financial results.

The argument is not, certainly not yet, to put people on the balance sheet, nor to seek to standardise a calculation for the return on investment in human capital. However, as SSE has demonstrated this year this need not be a goal that should be seen as out of reach for some.

We have also not suggested that regulatory or legislative change is necessarily required. Instead, in articulating a company's long-term sustainability the board should be minded of the need to articulate the sustainability of its employment model. In achieving this, there will likely be a balance needed between encouraging best practice and raising the bar for all; also between encouraging innovation and seeking consistency and comparability. This may thus require action by policy makers, standard setters and stock exchanges as well as by investors and companies.

Ultimately, we are interested in promoting the long-term success of the companies in which UK pension schemes are invested. To that end, we hope to catalyse a wider discussion about what improvements can be made to corporate reporting which can enable investors to make more informed investment decisions with an understanding of the risks and opportunities. We suggest that better reporting of the issues identified in this paper will be good for long-term investors, companies and the wider UK economy.

The NAPF is interested in exploring this agenda further with investors, analysts, companies, policy makers and standard setters over the coming months. Whilst we encourage companies to seize the initiative we will be speaking with relevant parties and hosting a series of roundtables during the second half of 2015 to discuss how more progress can be made. Ultimately conclusions will be incorporated into the NAPF's Corporate Governance Policy & Voting Guidelines.

Notes

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