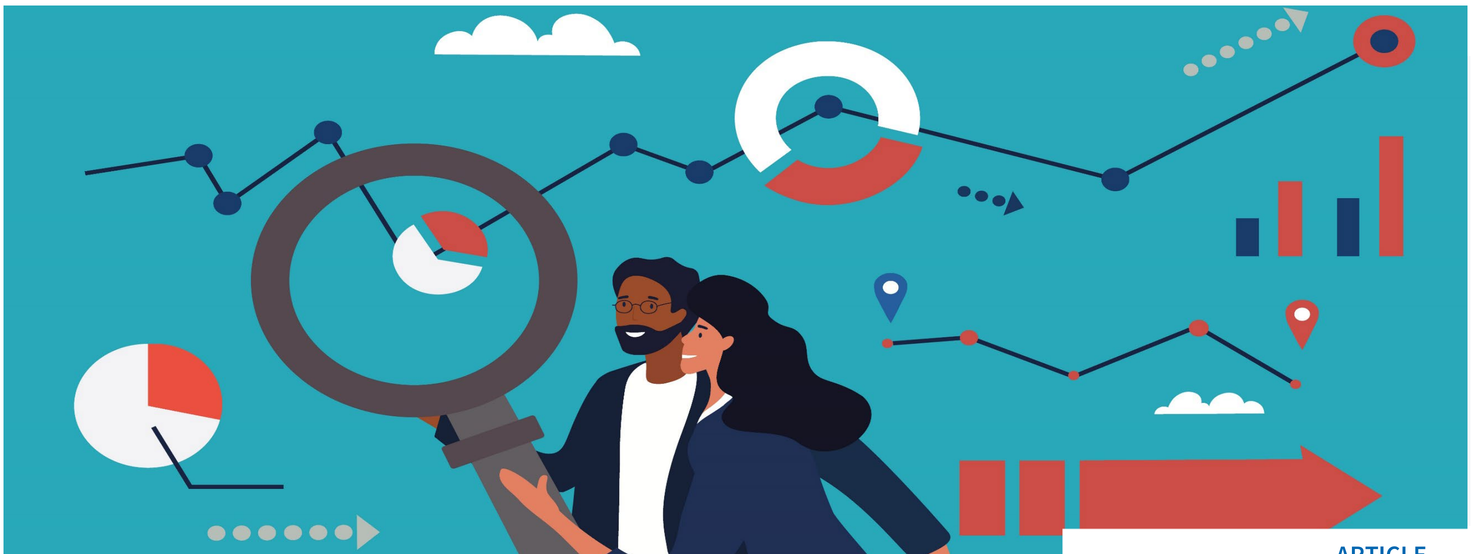


ARTICLE

Workforce: Driving value through Disclosure

How the Workforce Disclosure Initiative can improve practice, enhance ESG credentials and drive corporate value

- The UK regulatory landscape has changed – there is an expectation that employee voices play a role in the Boardroom.

- The market landscape has changed – investors are increasing their focus on employees as a central part of value creation.

- As companies grapple with how best to address this issue, there is an opportunity to leverage the Workforce Disclosure Initiative (WDI). With pressure from all angles, and a framework increasing in popularity, those who do not consider it may become laggards of sorts.

It has been well documented that the COVID-19 pandemic has accelerated the focus on the 'S' or 'social' element of ESG. As the virus spread across the globe, relationships between companies and their workforce came into sharp focus and drew increased attention from investors and the media. Industrial relations, supply-chain issues and workplace health and safety have dominated Board agendas as well as the headlines for much of the past year. As society grappled with the impact of the pandemic across our communities, the health and well-being of essential workers became a priority. And although we were already seeing a shift under way, as companies focused on purpose and workplace culture, the COVID-19 pandemic accelerated these changes at a rapid rate.

In a recent paper titled '*Time to Rethink the S in ESG*,' we looked at examples of how companies implemented 'S' practices, such as labour issues, workplace health & safety, and product safety & quality. It was evident that how companies perform through this lens was a barometer for the strength (or not) of its corporate culture. Where companies have a strong culture that is shared and understood across the organisation, 'S' practices tend to be strong. Where culture is poor or considered 'toxic,' 'S' tends to follow the same pattern.

Across the globe, coronavirus outbreaks in working environments have been linked to companies with poor working conditions, shining an unflattering light on to the supply chains of developed countries. These issues, among many others have led to investors demanding more transparency from companies on issues that affect their workforce.

Now that COVID-19 has put 'S' centre stage (and with workers at the heart of the 'S'), and companies begin to understand business risks as much as the moral obligation to stakeholders, how can they ensure they are meeting investor's expectations when it comes to workforce disclosure? And can this form of risk mitigation lead to an enhanced level of oversight of – and engagement with – workforce practices?

Workforce Disclosure: A background

While the COVID-19 pandemic has provided some of the motivation to re-evaluate the role of workforce disclosure for companies, the move toward recognition of the importance of the workforce to corporate governance and value creation had already gained significant momentum. It has long been considered part of the furniture in other parts of Europe, notably Germany and the Nordics, while the EU Non-Financial Reporting Directive has been transposed by all Member States. In the United Kingdom, failures at companies like British Home Stores (BHS) and Sports Direct contributed to the political momentum which led to Theresa May calling for worker representatives on Boards as part of her successful bid to become leader of the Conservative Party. While that requirement was rolled back on, a parliamentary inquiry was carried out during her time as Prime Minister.

In 2017, Matthew Taylor, chief executive of the UK Royal Society of Arts, carried out an independent review of modern working practices on behalf of the UK Department for Business, Energy & Industrial Strategy, titled The Taylor Review. Within this comprehensive look at the British labour market, the fourth of its *'Seven steps towards fair and decent work with realistic scope for development and fulfilment'*, recommended the following:

> *"The best way to achieve better work is not national regulation but responsible corporate governance, good management and strong employment relations within the organisation, which is why it is important that companies are seen to take good work seriously and are open about their practices and that all workers are able to be engaged and heard."*

The reforms to the UK Corporate Governance Code by the Financial Reporting Council (FRC) in 2018 followed this and represented a further response to a number of wrongdoings involving – among other things – exploitative workplace practices. In inextricably linking good governance and the long-term success of a company to good engagement with its workforce and other stakeholders, the FRC's guidance document deemed that employee policies are a responsibility of the Board. Provision 5 of the Code set out three ways for companies to factor the views of its employees into its strategic outlook:

For engagement with the workforce, 3 one or a combination of the following methods should be used:

- *a director appointed from the workforce;*
- *a formal workforce advisory panel;*
- *a designated non-executive director.*

The FRC guidance places a strong importance on the 'employee voice' and ensuring that this is heard in a substantive way. The FRC stipulates that these efforts should also include the full workforce; extending to those that are not direct employees of the company. The guidance suggests a whole range of formal and informal activities that a company can undertake to formalise employee perspectives but also warns that:

> *"Whichever method is chosen, the new arrangements are not intended to displace established channels of communication and consultation arrangements where these exist, for example, collective bargaining arrangements and existing worker representative systems established through trade unions."*

Unsurprisingly given the overall governance framework in the UK, the majority of companies have opted to designate a non-executive director, which represents the least disruptive approach to meeting the Code's expectations. What will be interesting to monitor over the coming year (and further) is the level of detail provided by companies on their efforts to engage with the workforce. While the first reviews from investors will likely be limited to ensuring an avenue has been chosen, as practice develops, tangible and meaningful disclosure of how the refined principles in the UK Code are being met will be expected.

Read more about the Workforce Disclosure Initiative at: shareaction.org/workforce-disclosure-initiative/

From cost-creator to value-driver

COVID-19 has acted as a catalyst for the growing recognition – among regulators and institutional investors – that employees are viewed as a key driver of value within companies. While labour has historically been factored as a cost to companies, the upside of strong employment practices has increasingly come to the fore. This journey from 'cost-creator' to 'value-driver' manifests itself in recruitment and retention strategies, exemplified by companies' desire to be an 'employer of choice' and in engagement strategies which seek to maximise productivity. While not true of all investors, those with a governance focus are increasingly pushing for investment in human capital, a step change from viewing labour costs as a negative.

The highlighting of attrition (or staff turnover) rates is a common statistic revealed in annual reports but there is a growing need to dig deeper as a means of developing meaningful disclosure for investors on the fundamental aspects of an employee's relationship with their employer – their terms and conditions, their pay, their opportunities for progression and development, and the extent to which the voice of the employee plays a role in the strategic direction of the company. Employee views can be obtained through a number of mechanisms. While regular staff surveys are ubiquitous, more robust channels such as evidence of employee input at Board level, collective bargaining processes or clear monetary evidence of investment in the workforce offer more meaningful insights – both internally to management and the Board and externally, to shareholders and wider stakeholders. The FRC focused on this point in its recent *Review of Corporate Governance Reporting*, pointing to the fact that:

"Work is required in terms of monitoring culture, with only a minority of companies setting out in detail how they plan to assess their culture beyond the use of surveys and site visits."

While the FRC did note that companies fared well when commenting on stakeholder engagement, it was often unclear how issues are raised to Board level and how they impact upon decision making. It found that the overall standard of reporting failed to move beyond process and put *"purpose, culture and strategy at the heart of governance."*

Workforce Disclosure: The Investor Perspective

While there has been significant growth in the focus on ESG over the last 10 years –with responsible investment strategies estimated to reach $50 trillion over the next two decades – environmental and governance issues have tended to be at the forefront of responsible investment strategies up until now. This is not surprising, given the severity of the climate crisis and the impact that governance failures during the 2008 global financial crisis had on capital markets. Therefore, the social aspect has lagged behind in prominence and in momentum; however, that appears to be slowly changing. While entities like ShareAction have consistently raised issues around workforce (and wider), over the past 18 months, there has be a significant growth in interest from wider market participants. An increased investor focus on workforce disclosure is part of a broader trend towards increased focus on risk mitigation factors and other potential ESG opportunities.

Pressure from investors has been a catalyst for change for many important issues over the years, and the issues pertaining to the 'S' (in this case, workforce) are no different. 2020 has seen a record number of resolutions, including socially focused issues, receiving majority support at annual meetings globally. According to Proxy Insight, a total of 21 shareholder resolutions focused on social or environmental issues received the support of a majority of investors so far this year at companies around the world, up from 13 in 2019 and 2018, and just five in 2017. It is evident that investors perspectives are shifting, with support for shareholder resolutions moving from the margin to the mainstream.

As social comes to the fore in responsible investing, investors are looking for clarity and data on the specific steps companies and their Boards are taking to safeguard their workforces and ensure supply chain sustainability. Investors value transparency, and we believe that there is considerable merit in moving beyond the general statements about the contribution that employees make. In other words, if a company points to its human capital or its people as its most important asset, it should be prepared to detail in its reporting what it is doing to protect it.

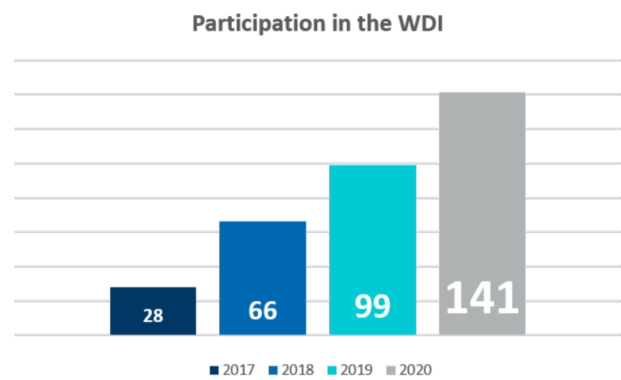
Take the scandal at Boohoo for example. Despite seemingly strong ESG credentials, and a detailed eight-page Modern Slavery Act statement, conditions at the Company's warehouses in Leicester are widely reported to have been "likened to sweatshop conditions", with employees earning as little as £3 per hour. A failure of oversight at Boohoo was a clear example of how policies and statements are meaningless if not accompanied by rigorous workforce protocols and robust channels for employee concerns to be raised at senior management and Board level. If evidence of such work practices had been communicated to the Board, one would expect it to have been addressed immediately. In this sense, Boards and management should view greater insight into work practices as an opportunity to mitigate risk and protect reputation – both their own and that of the company.

Just like environmental and governance, assessment, measurement and goal setting will be important for companies to demonstrate to investors how they are prioritising the 'S'. The WDI is a good place to start for companies beginning the process.

In focus: The Workforce Disclosure Initiative

So where do companies begin when it comes to reporting on 'social' or workforce initiatives? In evaluating thousands of companies' reporting, investors rely heavily upon third party research providers for streamlining information as well as comparable KPIs. Now in its fourth year, ShareAction's WDI was probably ahead of its time in terms of expectations around workforce disclosure; and it is a good place to start.

The WDI works with institutional investors in an effort to enhance corporate workforce transparency and was set up to address employee practices across global supply chains and operations and to provide a uniform way of measuring those practices. With 53 investor signatories with $7 trillion assets under management, there is a growing demand for disclosure of this nature. Investor signatories include: Amundi, Aberdeen Standard Investments, Candriam, Newton Investment Management, Boston Trust Walden, AustralianSuper, PKA Denmark, BMO Global Asset Management and MFS Investment Management. As signatories, they are asking international companies to disclose more standardised data on topics including health and safety, workers' rights, diversity and wage levels. Central to the WDI's mission is making more data on workforce policies and practices available publicly. The WDI encourages increased transparency on important areas of workforce reporting such as workforce composition (including contingent workers), wage levels and pay gaps, human rights due diligence processes and steps taken to monitor and address supply chain risks, that companies traditionally do not consistently disclose. As well as stratifying these issues out from ones that they overlap with, such as culture, diversity and inclusion, engaging with the WDI should also provide a road to better oversight on workforce-related matters.



Companies are encouraged to provide data in response to all 13 thematic sections of the survey, which cover wage levels, turnover, development opportunities and more.

Methodology

The WDI survey includes:

- **131 questions**
- **237 data points across 13 thematic sections**

According to the WDI:

"Designed with the input of investors, companies, trade unions and subject matter experts the WDI survey has been designed to gather the information on the issues most crucial to decent work and human rights in the workplace. The WDI survey is aligned with other reporting frameworks including DJSI, GRI, the UNGPs and the SDGs, and offers a comprehensive and comparable reporting system."

What Investors have to say…

"As a long term-investor focused on sustainability, we are particularly keen to develop better insights into how companies manage and utilize their human capital. We joined ShareAction's Workforce Disclosure Initiative because we believe the information being gathered by the campaign is material for active investors and we support efforts to improve workforce data transparency."

Barnaby Wiener, Head of Sustainability and Stewardship for MFS Investment Management

“The WDI provides a comprehensive data set of both qualitative and quantitative indicators that enhances our insights into how companies manage their workforce and supply chains. The insights inform our independent and proprietary security-level analysis that we conduct prior to committing to an investment. They also facilitate more detailed engagements with companies. These benefits are in addition to the collaborative engagement opportunities and thematic thought leadership that being a member of the WDI brings.”

Ian Burger, Head of Responsible Investment at Newton Investment Management

The prominence of the ‘S’ among investors’ thinking is set to continue and while many companies grapple with measurement, the WDI has a framework that is seeing growing interest from the investor community; and, greater engagement from issuers. In addition to providing potential avenues to develop a greater understanding of workforces, it also offers an opportunity for companies to build a better narrative on how employee views play a role in strategic development and risk assessment. Better too that companies proactively address this issue, rather than reacting to requests for data from a growing number of investors.

The goal(s) of workforce disclosure

If momentum is indeed heralding a new era of workforce disclosure, then there is merit in considering what drives the various constituencies advocating for it. The Taylor Review indicated that strong engagement should provide a basis for workplace harmony rather than legislation. This ultimately means that companies are in the driving seat and employees are essentially at the whim of individual company cultures and hierarchies. With the focus on ‘S’ increasing however, asset managers in particular, operate on the basis that bad actors ultimately increase risk – both at individual companies and systemically in markets.

As we have indicated, a key motivator for companies looking to make strides will be integration into risk management processes that will ultimately increase company value through economic performance and employee motivation.

Often the elephant in the room, dispositions in the corporate world to trade union engagement varies. The WDI too is open about the type of change that it wants to see in workplaces in the UK and around the world, namely better-quality jobs. This is also a core goal of the trade unions, some of whom provide feedback to the WDI through their umbrella organisation, Trade Union Congress, as a means of influencing the corporate governance landscape (TUC General Council Report, 2020). The WDI believes that if companies are genuinely in the business of providing high quality jobs, then they should endeavour to tell the market and wider stakeholders about it. The concept of ‘decent work’ very much centres on the fundamental terms and conditions of employment. Within the WDI framework, this cannot be reduced to just informal engagements or diversity and inclusion initiatives.

It should come as a source of comfort to companies that upon engaging with the WDI, they are asked what they consider the most material risks in terms of its workforce. Dedicating appropriate time and personnel to it can ensure benefits in terms of internal controls and constructive feedback. Companies that demonstrate, through disclosure, that risks are understood and well-managed, are likely to score highly, wherever they may be on their workforce disclosure journey.

Although its efforts are in many respects supported by the TUC, the WDI does not take a view on matters such as the role and purpose of trade unions. Rather, it assesses the quality of the engagement at hand. Poor feedback

mechanisms and poor union relations can tell a story but equally, the strength of a relationship being so that workers have not identified a need to unionise can be similarly informative. In this sense, the WDI's flexibility allows for the differing approaches of companies to workforce management to be brought out. Indeed, taking the steps to engage with the initiative and, thereafter, matching those commitments in public disclosure is good governance in and of itself, as it will challenge a company to evaluate the level of risk and opportunity within its workforce.

In Summary

The world of work, and employee's relationship with employers is in a constant state of flux. Companies will need to demonstrate an awareness of this evolution, while also making it clear to its investor and other stakeholders that it has applied appropriate and sensitive oversight in this regard. We can consider statements like that of the Business Roundtable in 2019, which pointed to a shift in the governance of large entities in the US away from solely shareholder value to a more inclusive approach to stakeholders as indicative of a cultural, political, social and economic shift. Indeed, the World Economic Forum has reaffirmed its commitment to such a shift. Employees are at the heart of this, no longer seen as cost-creators but as value-drivers. Whereas, historically, cutting labour costs may have been the easiest way to attract positive investor sentiment, investing in labour may be gradually taking its place.

As a result of this sea-change, investors now seek a wider range of assurances from companies than ever before. As we move into the 'roaring 20s', there will be less patience for companies that shower their employees with plaudits but do not back this up by disclosing the mechanisms through which their unfettered voice is able to feed into the business' strategic direction. An increasing number of companies are coming around to this way of thinking and have engaged with the Workforce Disclosure Initiative as a means of taking control of their workforce narrative.

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