Part 4: Human Capital: sustaining morale and promoting fairness
Thursday, 9th July at 1300 hours

Covid-19 has elevated the importance of ordinary workers as pivotal to a company’s long-term success in the wake of the Covid-19 pandemic. In this webinar we addressed the importance of recognizing human capital and other intangible assets as sources of value creation – not as costs - so investors can make informed decisions around how it is managed, measured and monitored.

ICGN is grateful to our Speakers as follows:

- Melsa Ararat, Professor of Corporate Governance, Founding Director of Corporate Governance Forum, School of Management, Sabanci University
- Sophie L’Helias, President LeaderXXchange & Lead Independent Director Kering
- Rick Marshall, Executive Director, MSCI ESG Research
- Christine Chow, Global Technology Lead & Head of Asia and Global Emerging Markets, EOS - Federated Hermes, Inc.

Annex 1: Slides from Christine Chow

Introduction

Employees are one of the primary stakeholders of a company. Human capital has recently been widely recognised as a key value driver and maintaining the link between the employees and the companies have become a primary concern in designing the post pandemic economic recovery. While the crisis has affected some economic sectors more than others, it alerted humanity to the fact that certain practices related to human capital management are simply unsustainable.

Before the Covid-19 crisis, liberal democracies were struck by a populist backlash. The consensus was that the rising populism was largely a reaction to perceptions of economic injustice. Many economists attributed the income inequalities to the erosion of labour’s bargaining power and the consequential failure of labor markets. Covid-19 has demonstrated the remarkable mismatches between the social value of what essential workers do and the low wages they receive. Markets seem to fail to value adequately what really matters.

One of the remedies offered by some economists is universal basic income. Some others argue for a radical definition of basic income that provides for “economic dignity” and “meaningful work.” In the mean time, since 2015, United Nations has identified rising income inequality as one of the key development challenges and the root cause of systemic social and political risks.

The policies suggested by the UN includes promoting legal action to foster fairness and incusiveness through protection policies, as well as improving the regulation and monitoring of financial markets and market institutions. The key question is how can it be done without compromising the free markets?
Correlating good ESG (including human capital management) practice with company performance

According to analysis conducted by ‘JUST capital’ into US companies, good ESG practice (including human capital management) was a key element in contributing to outperformance during the Covid crisis. These companies (biased towards the technology sector) were also able to bounce back more quickly from the crisis. (see annex 1)

One factor that makes some companies more resilient than others is having a robust IT infrastructure which allows for staff to work in a more agile manner including working from home and working at different times of the day. Another factor was that these companies were better at examining supply chain resilience. Human capital is not just about how companies treat their employees but also how their suppliers treat their respective employees.

Impact of human capital management decisions

Companies are now publishing more data around human capital management which helps investors and other stakeholders make informed decisions. Data has shown that losing talent has a strong negative impact on a company. Whilst some redundancies may offer an immediate, and sometimes necessary, response to a crisis, the long-term effects may be detrimental to a company.

A recent Morgan Stanley report found that, following redundancies, the remaining employees who were not laid off experienced a 41% decline in job satisfaction, a 36% decline in organisational commitment, and a 20% decline in job performance. When conditions did improve the total cost of replacing the employees can rise to as much as twice their annual salary.

We have a global starting point with Covid and we can measure its effects. Recent studies have shown that there is a positive correlation of the perception of companies by stakeholders with their approach to human capital management. In contrast, there is a negative correlation and declining stock prices for companies that were perceived not to be managing human capital adequately.

Research trends and priorities

At present a lot of the focus in terms of the work being conducted by MSCI has been on health and safety issues, especially in industries where either worker proximity or worker-to-customer proximity are high. Prior to Covid-19, these concerns were not high on anyone’s radar especially in industries that were not previously identified as high risk. For example, the issue of proximity is particularly prominent in industries such as meatpacking or online retailing. The management of these risks then causes disruption in the supply chain that can then affect another raft of industries.

Of the 20 or so industry reports that MSCI has published over the last couple of months, over half have featured human capital management concerns which have arisen following the onset of the virus. Some of the biggest questions MSCI is tracking in this area are income and wealth inequality and, in some markets, unequal access to healthcare and other
critical services. These issues have broad economic implications, and not just for stakeholders but for companies and investors as well.

The current pandemic has cast a particularly harsh light on these kinds of differences. In some markets like the United States for example access to healthcare is tied to employment so when there are huge numbers of individuals who are unemployed there are resultant implications in terms of their access to healthcare and other critical benefits.

Covid-19 has exacerbated another trend which is a movement away in many industries away from low-skilled workers towards high-skilled employees. This is taking place not always in the industries that you would normally associate with high skill, for example in manufacturing or mining.

**Investors engagement on human capital management**

When engaging on human capital issues it is important to have a clear framework to demonstrate how issues can be connected and then escalated throughout a company’s stakeholders including suppliers and customers.

Federated Hermes use a human capital management engagement framework which is a sliding scale categorising six different topics:

- **Health, safety and well-being** - health and safety is a basic labour right; people need to know that they are safe particularly during this Covid crisis. The future well-being of the workforce is also important, not just the basic right to health and safety.

- **Employee engagement, purpose and empowerment** - companies should communicate their expectations around corporate culture and behaviour but ensure that employees find meaning in their work aligned with a company’s purpose.

- **Employee skills, capabilities and training** - the Covid crisis has caused companies to think about how they have changed now and align this with current and future skills requirements.

- **Compensation, incentives and benefits** - companies should ensure fair pay, not just within their organisation but in their supply chains where they will have leverage to influence. It is important to look not just at working hours but at living hours and companies should consider how to create a working environment to align with the lifestyles of employees.

- **Diversity and inclusion** – at a basic level companies should have policies of no discrimination but fair representation in different committees, management and leadership roles is also important. Data and metrics are important, but investors need to be able to engage with companies to interpret it.

- **Freedom of association** - if there are issues which are inconsistent with the corporate culture and mission, employees should be able to speak out to bring about change. Worst case scenario is when employees feel that they can raise an issue but there is subsequently no change.
Changes in board dynamics

One of the things that the crisis has emphasised is a sense that companies that have a strong board culture are likely to have better resilience. Human capital management is being discussed more frequently at board level to navigate responses to the Covid-19 crisis. Corporate boards are keen to understand how employees are doing as a priority and this extends to employees in the supply chain and the communities within which they operate. The Covid-19 crisis has also tested the resilience of crisis management plans and of the IT infrastructure.

Corporate boards are responsible for overseeing management and to ask the right questions around human capital management during the Covid crisis. This includes enquiring about employee welfare, incentives, retention and so on. Companies need the commitment of employees to get through the Covid crisis and this requires flexibility and innovation. It is important that boards do not micromanage as executive management is dealing with the day-to-day challenges posed by Covid-19. The Board should take a ‘light touch’ approach to their oversight activities, noting that blind spots can appear in a crisis.

There is no conflict between companies and stakeholders when you are looking at the long-term horizon and we should incorporate as much information in our decision-making as possible and use good judgement. When people are constrained, immense creativity can often take place. In a crisis, stakeholders are more likely to be aligned as they all strive to ensure the success of the company in which they have a common interest.

Human capital from a stakeholder perspective

2020 is going to be the year of the stakeholder. Particularly after the Business Roundtable in the USA published a statement redefining the purpose of companies and the World Economic Forum also published a similar statement.

MSCI research has found that there is quite a lot of scepticism among shareholders and other stakeholders when it comes to corporate commitments to redefine their purpose - words alone are not enough. The pandemic has strengthened and accelerated stakeholder concerns, particularly when it comes to how companies view, treat and manage their human capital.

Different stakeholder groups are not discrete and separate: employees are also consumers and reside in local communities. But shareholders are currently the only corporate stakeholder group with well-defined rights and channels for input, and most shareholders recognize that their interests are almost always best served when companies are equally responsive to the needs and interests of all stakeholders. In a way this is the very definition of what it means to be an ESG investor: you are taking into consideration ALL of the potential impacts of a particular company’s operations, including but certainly not limited to their human capital management.

The moral case for human capital management

We need to go back to basics when we consider inclusiveness in addition to the business case in terms of the way we treat employees and human capital. A company is a legal entity
and the people who work in the company provide a soul. Stakeholder capitalism works because we all have multiple roles in society and, when thinking about creating value from companies, it is important to achieve holistic return that enables the optimisation of value to everyone.

The responses from governments in terms of how to support those most affected by Covid-19 have been different for example in Europe and in the UK there are furlough schemes and these markets have a safety net in terms of health provision. This contrasts for example with the provision of health care in the USA. In some emerging markets it is a question of affordability and whether they have the means to provide support.

**Gender diversity and inclusion**

Gender cuts across all inequalities. We must reflect on how gender diversity, morale and fairness is linked to human capital management strategy. Research suggests that women are less conventional, more egalitarian and more stakeholder oriented. Companies run by women had less layoffs during the crises.

There is an abundance of evidence that women have been disproportionately affected by the Covid-19 pandemic. For example, despite accounting for less than half of the workforce, women in America accounted for more than 55% of the job losses in April. In the UK one study found mothers to be 1.5 times as likely as fathers to have lost or quit their jobs because of childcare needs. Customer facing businesses that are mostly run by women are more likely to also have financial problems due to the Covid crisis. Higher skilled women are less likely to lose their jobs but they are 50% more likely to be interrupted if they have children and this will have an effect on their career progression and salary levels.

There is a disproportionate number of frontline healthcare workers who are women and who became contaminated by Covid and died. Women also disproportionately comprise a larger part of freelance contractors and hourly workers. And small businesses owned by women have tended to become insolvent more quickly because of the need for women to prioritize family commitments. Finally, the lockdown has brought about a significant increase in domestic violence.

Diversity and fairness are both about inclusion and having a sense of belonging. In this Covid crisis there have been people who have not been treated fairly. Any human capital management decision that excludes women is a proxy for broader exclusion. We need to shift our focus away from just concentrating on the responsibility of the company to look after employees while in work but also outside of work.

**Tracking gender diversity data**

This year MSCI celebrated the 30th anniversary of one of the first social indexes, which is now called the MSCI KLD Social 400 Index. When we compared the number of CEOs at the original 400 constituents of that index who were women in 1990, we could only find two. In the current index, we have nearly 10 times that many, which sounds like wonderful progress until you realize that we're still only talking about 19 women CEOs, or less than 5%.

So while we have seen more progress at the overall board level, progress at the leadership level has been very slow in coming, which is all the more concerning because gender diversity improvements at the leadership level can help accelerate change in other regards,
at the board level, among key executives, at the general employee level, and also with regards gender pay equality.

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**HCM in the face of Coronavirus (US)**

Impact of good HCM on company performance

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**Engagement on Human Capital Management ‘HCM’**

The sliding scale of HCM
Key engagement questions on Coronavirus

► What adjustments will be made to employment contracts and terms?
► Are there any expected changes to the workforce once stay at home orders are lifted?
► What employee benefits and protections are being offered? (Particularly around sick leave).
► What are companies policies surrounding whistle blowers exercising their rights?
► What measures are being undertaken to ensure the physical health of the workforce?
► What measures are being undertaken and resources available in respect to mental health?
► How is the Board overseeing the Coronavirus response?

Impacts on future of work
Acting to accelerate progress to ensuring the future of the workforce

- Flexible working
- Implications on childcare
- Labour unions
- Living wage
- Sick pay and benefits
- Mental health and wellbeing