

## BlackRock Investment Stewardship's approach to engagement on human capital management

BlackRock has an industry leading global investment stewardship program that promotes corporate governance best practices at the companies in which we invest. This program is part of the investment function at BlackRock, fulfilling our fiduciary duty to protect and enhance the value of our clients' assets.

As Larry Fink recently wrote in his 2018 annual letter to CEOs:

*Companies must ask themselves: What role do we play in the community? Are we working to create a diverse workforce? Are we adapting to technological change? Are we providing the retraining and opportunities that our employees and our business will need to adjust to an increasingly automated world?*

For several years, the BlackRock Investment Stewardship (BIS) team has been engaging companies on the topic of human capital which we also identify as one of our 2018 engagement priorities<sup>i</sup>. The BIS team has been in discussions with companies about their management of employees as an investment issue.

This note sets out in some detail our thinking on human capital management (HCM) and explains how we approach engagement on the topic.

### Why human capital management is an investment issue

Most companies BlackRock invests in on behalf of clients have, to varying degrees, articulated in their public disclosures that they are operating in a talent constrained environment, or put differently, are in a war for talent. It is therefore important to investors that companies explain as part of their corporate strategy how they establish themselves as the employer of choice for the workers on whom they depend. A company's approach to HCM - employee development, diversity and a commitment to equal employment opportunity, health and safety, labor relations, and supply chain labor-standards, amongst other things - will vary across sectors but is a factor in business continuity and success. In light of evolving market trends like shortages of skilled labor, uneven wage growth, and technology that is transforming the labor market, many companies and investors consider robust HCM a competitive advantage.

Research has consistently shown the importance of human capital to company performance. Companies included in Fortune magazine's "100 Best Companies to Work For" lists earned, over the long-term, excess risk-adjusted returns of 3.5%<sup>ii</sup>. Another report surveyed a multitude of studies on human capital and found that there is a positive correlation between human resource initiatives and investment outcomes such as total shareholder return, return on assets, return on earnings, return on investment and return on capital employed<sup>iii</sup>. A survey concluded that companies that had a workforce that was not engaged had an average one-year operating margin below 10%; however, those that consistently promoted workers' well-being had an average one-year operating margin of 27%.

### BlackRock's engagement on human capital management

HCM is both a board and a management issue. We would expect a company's board to be deeply engaged in the oversight of a company's strategy and the defining of a company's purpose – to help ensure the effective strategic implementation of HCM throughout their organization. Companies that can better articulate their purpose are more likely to build strong relationships with their employees (and customers), and have a clear sense of their strategic objectives. These are essential components of long-term growth. Employees who do not feel valued by their organization are generally less productive or more likely to leave. Product quality and reputation can suffer when employees are not fully engaged and supportive of the company, its business and

goals. When present, these dynamics make it much more difficult for a company to meet its strategic objectives. For management, it is an issue that is central to their everyday duties. We also expect that boards, acting as fiduciaries on behalf of investors and as those who help set the tone at the top, to be focused on the opportunities and risks associated with HCM.

The BIS team is aware that disclosure of information on HCM is still evolving and that the way HCM risks manifest themselves may vary by industry and market. We are members of the Investor Advisory Group of the Sustainability Accounting Standards Board (SASB), which provides industry-specific HCM metrics. We encourage companies to aim over time to go beyond commentaries and provide more transparency on their practices. Investors recognize that most companies are already in possession of HCM data on their workforce, but are cautious of disclosing this information. We believe that both qualitative and quantifiable indicators can help effectively distinguish companies that are managing this important driver of value in their business.

Our engagements seek to be constructive, aiming to build mutual understanding while asking probing questions. Where we believe a company's practices fall short relative to market or peer practice, we will share our insights and perspectives.

When engaging boards on HCM we are likely to discuss:

- Oversight of policies meant to protect employees (e.g., whistleblowing, codes of conduct, EEO policies) and the level of reporting the board receives from management to assess their implementation
- Process to oversee that the many components of a company's HCM strategy align themselves to create a healthy culture and prevent unwanted behaviors
- Reporting to the board on the integration of HCM risks into risk management processes
- Current board and employee composition as it relates to diversity
- Consideration of linking HCM performance to executive compensation to promote board accountability
- Board member visits to establishments or factories to independently assess the culture and operations of the company

When engaging management teams, the topics we may cover include:

- Policies to encourage employee engagement outcomes and key drivers (e.g., wellness programs, support of employee networks, training and development programs, and stock participation programs)
- Process for ensuring employee health and safety and complying with occupational health and safety policies
- Voluntary and involuntary turnover on various dimensions (e.g., seniority of roles, tenure, gender, and ethnicity)
- Statistics on gender and other diversity characteristics as well as promotion rates for and compensation gaps across different employee demographics
- Programs to engage organized labor and their representatives, where relevant
- Systems to oversee matters related to the supply chain (including contingent workers, contractors and subcontractors)

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<sup>i</sup> BIS' 2017-2018 engagement priorities are publicly available on our website at <https://www.blackrock.com/corporate/en-gb/about-us/investment-stewardship/voting-guidelines-reports-position-papers#2017-2018-priorities>

<sup>ii</sup> Edmans, Alex. "Does the Stock Market Fully Value Intangibles," *Journal of Financial Economics* 101 (2011): 621-640.

<sup>iii</sup> Bernstein, Aaron and Larry Beeferman, "The Materiality of Human Capital to Corporate Financial Performance," Pensions and Capital Stewardship Project, Labor and Worklife Program, Harvard Law School, April 2015