

Investment Stewardship's approach to engagement on human capital management

BlackRock has an extensive program to promote leading corporate governance practices at the companies in which we invest as part of fulfilling our fiduciary duty to protect and enhance the long-term value of our clients' assets.

We consider human capital management (HCM) an important investment issue. As Larry Fink, BlackRock's Chairman and CEO, 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?

The BlackRock Investment Stewardship (BIS) team has engaged with companies regarding their management of employees for several years. Starting in 2017, we identified HCM as one of our engagement priorities.¹ This note describes our thinking on HCM and explains our engagement approach on the topic.

Why human capital management is an investment issue

Most companies that 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 that they are "in a war for talent." It is therefore important for 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, corporate culture, compensation, 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 as 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%.² 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.³ Other studies have demonstrated that a more engaged workforce helps generate positive outcomes both for business operations and financial performance.⁴

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 and sustainability. 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 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. For instance, the Sustainability Accounting Standards Board (SASB) 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 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 and type of reporting on key performance indicators (KPIs) that 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, including KPIs related to corporate culture and the alignment of compensation systems with desired 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:

- Processes to assess areas for investments in HCM and accompanying policies and programs to demonstrate improvements in those areas. This might include employee engagement initiatives and/or wellness programs, employee resource networks, training and development programs, and stock ownership 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), including the factors that may drive that turnover
- Efforts in place to recruit diverse talent and create an inclusive workplace for all individuals, including women, people of color, LGBTQ, and individuals with disabilities
- 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 a company's supply chain (including contingent workers, contractors, and subcontractors), and an articulation of how those processes protect the company's brand value and reputation

Contact BlackRock Investment Stewardship at contactstewardship@blackrock.com

1. BIS' 2020 engagement priorities are publicly available on our website at <https://www.blackrock.com/corporate/literature/publication/blk-stewardship-priorities.pdf>.
2. Edmans, Alex. "Does the Stock Market Fully Value Intangibles," *Journal of Financial Economics* 101 (2011): 621-640.
3. Bernstein, Aaron and Larry Beeferman, "The Materiality of Human Capital to Corporate Financial Performance," Pensions and Capital Stewardship Project, Labor and Work life Program, Harvard Law School, April 2015.
4. For a review of the literature on employee engagement, human capital and value creation, see: <https://www.sec.gov/rules/petitions/2017/petn4-711.pdf>.