ARTICLE

The Path to Strength and Resiliency:
Why Human Capital Management Matters

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At the heart of human capital management (HCM) is how a company motivates and invests in its workforce. HCM recognizes that human capital is a critical asset in driving long-term value and that there's a clear correlation between HCM and return on assets. In fact, Just Capital found that when companies pay their workers a living wage, they have higher returns in the long term. Moreover, during the Nasdaq Governance Solutions Board Engagement team's recent discussions with CEOs and board members, talent attraction, development, and retention have been articulated as both a top priority and key risk to manage.

To assess issuers on both financial and social (the 'S' in ESG) measures, investors are expecting that companies disclose HCM strategies and metrics. According to research by IR Magazine, more than three-quarters of investor relations teams have received questions about diversity, pay, and compensation, among other HCM issues.

According to research from eVestment, a wholly-owned subsidiary of Nasdaq, ESG integrated capital has grown 39% over the past two years to $11.1 trillion globally. HCM has shifted from an internal exercise to attract and retain talent, to a factor viewed by investors as a future prediction of success and, more recently, as a means for both investors and companies to gauge preparedness to respond and act during a crisis.

HCM Accelerators

While interest in HCM certainly isn't new, events in 2020 and 2021 have had a profound impact on corporate governance and responsibility. For instance, the pandemic shined a spotlight on employee health and safety and less responsive companies have been called out for not protecting their employees. Employees at several large companies conducted walkouts, strikes, and sickouts to demand safety precautions and hazard pay.

Meanwhile, the social justice movement centered around George Floyd highlighted the need for human sensitivity and a far deeper sense of understanding among communities. Diversity, equity, and inclusion (DEI) within organizations is not new, but more and more leaders see the importance of all three working together.

A vast majority (79%) of Americans believe that companies should advance DEI. That number skyrockets to 95% for Black Americans. Furthermore, two-thirds say that large companies have more work to do to achieve racial equity not only in the workplace but more broadly across American society. Among Black Americans, those percentages rise to over 80%.

The wage gap between men and women has been an ongoing concern but is magnified by racial inequality. For every dollar paid to white, non-Hispanic men, Asian American and Pacific Islander women are typically paid only 85 cents, Black women 61 cents, Native American women 58 cents, and Latina women 53 cents.

“I cannot recall a time where it has been more important for companies to respond to the needs of their stakeholders. We are at a moment of tremendous economic pain. We are also at a historic crossroads on the path to racial justice – one that cannot be solved without leadership from companies,” noted Larry Fink, Chairman and CEO of BlackRock, Inc., in his 2021 letter to CEOs.

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Changing Company Values

A few decades ago, the hot boardroom topics were profit and loss and balance sheet centric, but there's been a shift to looking at how HCM fuels long-term business value. Boards are also more aware of other ESG issues, such as climate impact, water scarcity, pollution, deforestation, biodiversity, and others.

Companies have historically organized their values around customer expectations and even around the presumed American dream. But today, with a more diverse, younger workforce, customer base, investors, and other stakeholders, that dream is evolving, and businesses need to evolve with it. As the economy reopens, many CEOs see this as an opportune time to reevaluate their business vision, mission, and purpose; how they will spearhead an equitable and inclusive pandemic recovery; and the legacy they want to leave with the world.

Here are just eight examples of how company values are shifting:

1. Beyond Physical Health to Financial Health

Just Capital and PayPal, in collaboration with the Financial Health Network and the Good Jobs Institute, have established The Worker Financial Wellness Initiative to make workers' financial security and health a C-suite and investor priority. Research shows that improving workers' financial wellness benefits not only the workers themselves, but also business outcomes.

Discovering that many of its lowest paid workers struggle financially, PayPal invested in its workforce and realized higher levels of engagement, an increase in the company's Net Promoter Score and retention rate, and a decrease in training costs. Appearing on CNBC's Squawk Box, PayPal CEO Dan Schulman said, "The only sustainable competitive advantage that any company has is the strength of their workforce."

2. A Boardroom that Reflects Company Values

Viewing board member photos on a company website can give an investor insight into what a company values and if the company is forward-looking. A few years ago, youthful members in a bank boardroom may have been frowned upon. Today, investors look favorably on board members with a range of experiences and backgrounds.

Companies are more engaged in board evaluations to ensure that their boards reflect the company's vision, mission, and purpose. Directors agree that measuring effectiveness is a board priority. A PWC survey found that 94% of board members believe diversity in the boardroom brings unique perspectives, enhances board performance (84%), and improves relationships with investors (81%). When asked which types of diversity are important, directors named gender (46%), racial (34%), and age (21%).

In 2020, Nasdaq filed a proposal with the SEC to adopt new listing rules and signed on as a Charter Pledge Partner to The Board Challenge, an initiative seeking to enhance representation in the boardroom by asking companies to retain or add diversity.

Beyond gender, racial, and age diversity, there is a broadened focus on cognitive diversity, or diversity of thinking styles, perspectives, and backgrounds. Cognitive diversity is how individuals think about and engage with new, uncertain, and complex situations. A board of directors that lacks cognitive diversity will have "blind spots" in their decision making.

3. Wellness and Mental Health

Companies are beefing up employee assistance programs (EAPs) and other mental health resources in order to build a culture of wellness. Principal Financial found that 31% of businesses are increasing wellness and mental health offerings.

Costco has increased the number of EAP mental health visits available to employees from six to eight per year. The company also removed co-pays for in-person or telehealth behavioral healthcare. Other companies have provided resources, like mental health apps, to help manage potential burnout and workplace stress.

Companies are also offering flexible benefits that may not be directly related to health, such as student loan reimbursement and other more youth-oriented perks. Just Capital found that 8 in 10 workers place a high priority on flexible work arrangements, such as work from home and dependent care leave. Some companies are planning to permanently shift to flexible remote work offerings. In fact, a McKinsey survey found that, on average, companies planned to reduce office space by 30%.

4. Accelerating Diversity, Equality, and Inclusion Initiatives

Over the past year, a significant number of companies have been hiring for DEI roles, expanding their internal DEI function and integrating it into their overall HCM strategy, and publicizing DEI goals and targets for their workforce. Some are even linking DEI performance to executive compensation. Companies are also recognizing that they need to cultivate a pipeline of diverse employees for all roles.

The pandemic highlighted inequality issues as employees were forced to work remotely—and some not in the most optimum conditions. Companies, like Nasdaq, found ways to help alleviate those issues, such as providing a home office equipment allowance and increasing certain health benefits.

A number of companies are partnering with their workforces to create employee resource groups. These groups connect employees around key DEI topics, such as underrepresented minority groups and the LGBTQ+ community, to facilitate career development and mentoring, host special events, and engage in volunteerism. Efforts such as these not only demonstrate a company's commitment to DEI, but may also help attract and motivate talent.

Moreover, these efforts are often noted by the investment community. The Chief Investment Officer and Head of ESG Research of one of the largest active asset managers globally recently shared with Nasdaq's Global Perception Team, “We see companies with initiatives and resources in this area putting forward goals and really being proactive around their human capital management. I think that the culture they are able to curate with being forward-thinking is a large opportunity.”

5. Innovative Partnerships and Automation

Innovation is everywhere, enabling companies to refine their “secret sauce” and further their HCM initiatives. Banks are partnering with fintechs to offer banking as a service (BaaS). Old manufacturers are using robotics in their factories. Allbird's SweetFoam® is made out of sugarcane, a renewable resource that is eco-friendly.

Upwork created a foundation to fund high-performing nonprofits that cultivate inclusive learning and economic opportunities. Lyft's partnership with United Way allows customers to round up their payment to the nearest dollar and donate the difference to United Way. Amazon's Future Engineer program is designed to inspire, educate, and prepare children and young adults from underrepresented and underserved communities to pursue computer science. Nasdaq has committed financial support to empower businesses in underrepresented communities.

6. Optics Matter

Companies are visibly highlighting their culture to their stakeholders through dress codes, employee resource groups, and the like. For instance, many companies were shifting from suits and ties to business casual or casual Fridays before the pandemic. After months of virtual meetings in casual attire, will companies abandon their former dress codes as employees return to the office? It's probable that companies will use relaxed dress codes to attract and retain employees and increase employee motivation and productivity. Plus, we may start to see more management team members setting the tone at the top and wearing jeans so that employees wouldn't feel self-conscious about dressing down.

7. More Transparency

The pandemic and social unrest prompted CEOs to communicate more with their employees and be more transparent. “Going through the pandemic is such a stressful situation, and what we've heard back from our employees is that in increasing transparency, we took away a lot of the stress. That was a big lesson learned for me as a leader, that we needed to be stress absorbers for the organization,” said Jean Hynes, CEO, Wellington Management Co.

8. CEOs are Being Held to a Higher Standard

The last year has emphasized reliance on leadership that sets positive and realistic goals. Whether its talent attraction, navigating ESG matters, or directing a business strategy, CEOs are being watched closely by investors and other stakeholders. More than in the past, CEOs are being held to a higher standard and may benefit from an internal governance support team that understands stakeholder expectations.

Dan Schulman, CEO of PayPal, provided insight that captures the spirit of this evolving higher standard, noting, “When you focus solely on valuation and market share, you win some and you lose some. When you focus on the needs of your customers and help them achieve their dreams, you win every time.”

CEOs who ignore evolving stakeholder expectations may be in the hot seat for lack of action, such as around pay gaps.

The Art of the Disclosure

HCM is changing what companies disclose and discuss with investors. Proxy statements and annual reports today include not only financials and shareholder returns, but ESG and HCM topics that impact long-term sustainability. For instance, Nasdaq now publicly discloses the race and ethnicity statistics of its U.S. workforce.

What companies say—and how they say it—matters. Nasdaq found that companies in the S&P 500 that discussed their company culture had sentiment scores that were 9.1% higher than those that did not mention workforce culture. Companies that highlighted their training and development efforts had scores that were 7.22% higher than companies that did not disclose their practices. Just Capital reports that Russell 1000 companies that fully disclose workforce demographics outperform companies that do not disclose data by 22.5%.

Earnings calls are changing as well. General discussions about DEI increased 20% and 89% of companies analyzed DEI during their earnings calls, according to Nasdaq data. Other ESG topics saw spectacular increases, such as emissions (116%) and climate change (331%).

It can be difficult for companies to find their voice on racial justice and other provocative issues—but they are expected to have a voice. Not speaking out draws criticism. Harvard Law School Forum on Corporate Governance recommends that companies stay attuned to the expectations and views of their core stakeholders, revisit their business's core purpose and values, and ensure alignment among the board and management.

But actions always speak louder than words: stakeholders won't tolerate messaging that is not consistent with corporate behavior.

HCM as a Path to ESG Strength and Resiliency

The global pandemic was a crisis management wake-up call for companies. It's important that companies understand that, now more than ever, they need resiliency to weather crisis. As a result, forward-thinking companies are not only focusing on short-term financial results, but also on long-term sustain-ability and they're sharing this focus with their stakeholders.

One of the most pressing issues is developing and supporting a skilled and diverse workforce to drive sustainability while being mindful of employees who may get left behind. McKinsey estimates that a larger share of workers will need to transition out of the bottom two wage brackets and that half will need new, more advanced skills to move to occupations one or even two wage brackets higher.

For example, Nasdaq notes in its 2021 Proxy Statement that the company has defined and articulated its purpose to champion inclusive growth and prosperity, launching a new Purpose Initiative, comprising its philanthropic, community outreach, corporate sustainability, and employee volunteerism programs.

The pandemic accelerated digitization and automation, and agile companies quickly communicated to stakeholders that these changes are proving to be beneficial to workers and humanity at large.

We have learned that highly effective corporate leaders are speaking out about social issues, albeit judiciously, and engaging employee fair pay, demonstrating a commitment to DEI, and retraining workers to meet modern market expectations. Addressing societal events is now a part of a company's short- and long-term strategy. Companies that practice this have learned that building trust and engagement is important to stakeholders, and more broadly leaving a positive mark on their worlds. ■

*The article has been authored for **Nasdaq Governance Solutions** by their internal team.*

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