The future of narrative reporting – a consultation

Submission to the Department for Business, Innovation and Skills

Chartered Institute of Personnel and Development (CIPD)

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Background: CIPD

1. The CIPD's primary purpose is to improve the standard of people management and development across the economy and help our individual members do a better job for themselves and their organisations. The Public Policy team at CIPD promotes an agenda for productive workplaces to boost economic performance and improve the quality of working life.

2. As Europe's leading professional body for those involved in the management and development of people, we are ideally placed to contribute to the development of public policy across the spectrum of workplace and employment issues.

3. We are able to draw on the experience and knowledge of our 135,000 members and our wide range of research to provide a pragmatic stance on public policy that is based on solid evidence and the real world.

4. Our membership base is wide, with 60% of our members working in private sector services and manufacturing, 33% working in the public sector and 7% in the not-for-profit sector. In addition, 76% of the FTSE 100 companies have CIPD members at director level.

General comments in response to the consultation paper

In responding to this consultation, CIPD's focus is on human capital management (HCM) and reporting. Our response is based on discussion of narrative reporting with senior HR directors at companies which have extensive experience in this area, and Henderson, a major global investment firm that has led the field in exploring the use of HCM to help investors gain a more accurate view of company prospects.

Earlier this year CIPD commissioned Zella King of Henley Business School to look at investors' views of HCM and reporting and compare them with those identified by earlier CIPD research in 2006. *Her report is due to be published next month and we should be happy to make it available to BIS.* Our previous research found that, whilst most investors believed that people add value to organizations, they failed to identify evidence of good management or the people contribution which would influence their investment decisions. Where they did take account of the value of people this was limited to the value of the top team. They were also sceptical of the quality of the data that was available on human capital and ambivalent to the new models for reporting that were being proposed.

Our latest report finds that the views of the investment community have not changed since 2006 as much as might have been hoped. However the research has identified some very positive developments. **There appears to be a growing awareness among mainstream analysts of environmental, social and governance factors that have a bearing on long-term company performance.** This awareness may have been stimulated by the growing market

for SRI funds, greater emphasis by companies on sustainability reporting and the emergence of new Environmental, Social and Governance (ESG) indices such as GS Sustain. As time goes on, we can expect analysts' and investors' exposure to information about ESG factors to increase further, and people management issues should feature in that.

The CIPD believes that human capital evaluation and reporting are crucial to long-term sustainability and performance, because the practice of collecting, evaluating and reporting on human capital should enable better business decision making and deepen understanding of the link between HR, business strategy and performance. This view has been reflected in much of the CIPD's recent work and we are currently engaged in research identifying the drivers of sustainable organization performance. One of the key issues that research has identified as a driver of sustainable performance is the ability to measure a range of performance indicators and assess the impact of action taken to address the areas measured.

Our conclusion is that the Government should:

(a) promote the use of HCM reporting by quoted companies and investors on a voluntary basis;
(b) publish examples of existing good practice;
(c) draw on the MacLeod report to support the proposition that employee engagement drives financial performance.

Specific issues raised in the consultation paper

We comment below on some of the key issues raised in the consultation paper.

Question 1: Are company directors providing useful and relevant information on the company's:

i. forward-looking strategy and
ii. principal risks and uncertainties?

CIPD members believe that the majority of current HCM reporting – *as reflected in company annual reports* - is not useful. This may be largely because it is seen as a statutory requirement and not as a way of throwing light on key performance indicators. HCM needs to be seen as integral to business strategy and priorities, and not just in the context of corporate responsibility or governance. Where businesses collect data without understanding why, it is unlikely that investors will derive much benefit from it. Data must be relevant, qualitative and outcome-focused - in the sense that the links are made between data and performance outcomes - if it is to be meaningful and useful.

Risk management may be the best framework to raise the profile of HCM reporting with both company boards and the investment community. It is important to frame HCM as being about downside risk (e.g. reputation) as well as about opportunities. **When CEOs are**

questioned about key risks for their organisation, people-related risks tend to come near the top of their list.

Employee engagement measures can be most meaningful as an indicator of how effectively employees are being managed. Although there is no absolute definition of employee engagement, provided metrics are based on careful survey design and follow-up, CIPD believes that employee engagement can be a very useful 'leading' indicator of business performance. Engagement measures need of course to be supplemented by other data, including measures of resource deployment and employee wellbeing.

Investors have historically been interested in the quality of senior management. The report on employee engagement for BIS by David MacLeod in 2009 demonstrated convincingly the links between an engaged workforce and financial performance. **The report listed a large number of major UK companies that are committed to the use of engagement data to help drive their business forward and deliver sustainable performance.** Engagement data on its own may not tell an unequivocal story, but can provide the basis for an informed board-level debate about the relative performance of business units across different areas and over time.

There may be a temptation to dismiss HCM as a tool to support investors' decision-making because of its limitations for benchmarking purposes across companies in different sectors. This was the broad conclusion of the Kingsmill report. Nevertheless trend data for individual companies can be very useful. **Companies need to report on what is useful to the business.** Standard Chartered, for example, report on the attrition rate of their top 10% of performers but are not interested in attrition rates of the worst performers. Statutory reporting requirements should build on the good practice already evident in major companies, and should encourage them to share meaningful data more widely with investors (and others).

Employee data may also be helpful in looking at relative performance across a specific sector: in the energy sector, for example, firms that can demonstrate high levels of employee engagement and reduced stress are likely to be safer.

Context is critical, not just in terms of helping to set the scene in terms of what the company's 'footprint' is (so it is possible to see what journey it is trying to make in terms of start – end destination), but also its operating environment (e.g. specific market dynamics, challenges, and drivers – past, current, future). Context provides a perspective in which to interpret the absolute data and evaluate effectiveness. Context impacts on the appropriateness of different approaches at different times.

Narrative and qualitative information is just as important as the raw numbers. For example, Standard Chartered operates across 74 different countries which have a wide mix of union membership and activity. The variety in different employee relations landscapes and legal frameworks across the different countries the company operates in means that the narrative is critical in making sense of the numbers. Legal requirements can also interfere

with consistent reporting: for example, reporting on age profile is difficult in the US because of discrimination laws.

Question 2: What are the constraints on companies providing information on these issues?

Companies may be reluctant to share management information if they feel that this will damage their share price, or their reputation. This may point to the need for companies to develop closer relations with investors, so that more meaningful communications can take place on sensitive issues. Equally it would be helpful in building dialogue for investors to develop longer-term relationships with individual companies. In the absence of developments on these lines, the quality of dialogue between companies and investors will tend to be constrained.

Other constraints on companies providing information are:

- HCM is a long-term strategy, yet investors have short-term priorities – this is a major challenge.
- Although there is a need for common/standardised metrics, there is also a need for sector/context specific metrics.
- Companies may need disaggregated data, where for example they are only interested in the performance of a sub-group of the workforce e.g. short term tenure (<12 months) rates among high potential staff.
- Some metrics will be more important at different times in specific instances e.g. at RBS issues of leadership and staff morale came more into focus following the financial crisis.

Question 14: Do the current disclosure requirements provide clear and usable information about:

- ***the total remuneration paid to directors, and how this is made up;***
- ***the performance criteria for payments to directors, and how these relate to the company's strategic objectives;***
- ***company performance against these criteria, so that there is a demonstrable link between pay and performance;***
- ***the process by which directors' remuneration is decided?***

While the current disclosure requirements can be regarded as providing clear and usable information, the more important question is do they provide useful information. There are concerns that the information requirements have led to group-think mentality, with firms discouraged from coming up with innovative and creative solutions that meet the needs of executives, the owners and the organisation as a whole.

Of greater value is narrative around the process of how the directors' remuneration is decided to give an idea of the quality of the decision making in this area. For instance, we would like to see narrative around such areas as who's involved in the decision, what

expertise do these individuals have, how has this expertise been gained (such as through experience or internally/externally provided coaching), what understanding do these individuals have of the business, the contexts in which it operates and the nature of the organisation, what information has been used, why was it used and how had it been used?

The quality of the narrative around how decisions are made is just as important as the narrative around the outcome.

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