Podcast: Human capital management

The following is a transcript of an episode of the Freshfields podcast looking at human capital management, which forms part of our corporate governance capsule collection.

Speakers

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Elizabeth K. Bieber: Hi listeners. Welcome to episode 5 of the corporate governance capsule collection with Pam Marcogliese and Leza Bieber, where we invite you join us as we discuss what you need to know about the topics that are at the top of the boardroom and governance priority lists. Today we are joined by Maj Vaseghi, an executive compensation and benefits partner in our Silicon Valley office. We'll be discussing human capital management, particularly how companies can get it right with their stakeholders, set appropriate expectations and ensure they have the right level of board oversight. Human capital management has been a trending topic for a few years, but this year we've really seen an acceleration in terms of stakeholder focus, and we expect that as we enter the recovery period it's going to be top of mind. What is it about this point in time that puts it at the top of all the priority lists?

Maj Vaseghi: It's a good question, Leza.

So, absolutely, I think over the last few years we have seen increased attention from investors on human capital management. We've seen more shareholder proposals on that topic and we've also seen investors put pressure on the SEC to adopt new human capital disclosure rules, which the SEC did in fact adopt, although the rule is not as prescriptive as many investors wanted.

Earlier this year, BlackRock clearly stated that, given most companies identify their employees as their greatest asset, they want to see board oversight over human capital management and its strategies.

Investors are very keen to see what health and safety measures companies have put into place, particularly in light of COVID. I also think investors are looking to see where companies had to have rifts or furlough employees or to reduce wages, what comp programmes they put into place to protect their workforce. So, if that was sick pay, if they provided any form of severance or health insurance.

Something related to that is really there seems to be a disconnect over the next few months in terms of the corporate timeline and then the appetite for HCM information. Do you agree with that and what can companies do about it?

Pamela L. Marcogliese: I absolutely agree with that, Maj. If you think about the timeline for the pandemic, it started I guess, in earnest, February and March and, by then, many companies had already put out their proxy statement and, in any event, it was just at the very beginning so there wasn't all that much to say with respect to their response to the pandemic at that point.

But the next time the proxy statement is due isn't until next spring, so March or April, and so that in many ways will be too late if you think about the number of folks who are focused on understanding the issues you were describing.

And so, I think that companies should be mindful that, as they engage in their shareholder engagement efforts, which many of them do around this time, they should be very thoughtful about some of the issues that you were describing and making sure that

that's on the agenda, so that their investors understand what companies have been up to and all the good work that they've been doing.

I think another way that companies can get this information out is through the use of their website. There are some very good places there that investors and employees and, frankly, others consult in order to get this information.

And then, finally, depending on the publication schedule, the sustainability report can be a good place.

I think the reason it's so important is, as investors think about submitting shareholder proposals to companies, they're looking at the information they have available now. And so, if companies wait until the proxy statement to put out the information, they'll be receiving shareholder proposals that they possibly could have avoided if investors had been aware of all the good work that companies have been doing in this area.

| **EKB**: I think there's another aspect too to this and that piece of it is the employees. Employees themselves want to understand what their companies are doing with respect to human capital. They want to know what's affecting employees and what could affect them, and it's also not crazy to think that, as companies rehire or conduct more hiring, that one of the questions that they're going to get is, "how did you take care of employees during COVID and during the pandemic and what were the types of initiatives you had that made you more likely to take the types of actions that were a value-add for employees?" So, even if companies had to have RIFs or layoffs or furloughs, you know there were companies that did it in a way that was perceived to be more employee-friendly than others and then there were also companies that took really big steps and made real sacrifices in order to keep as many employees around as possible, and so there's really a multi-stakeholder focus in terms of how you provide human capital management information and doing it six months down the line, for many companies, may be late for those other interests as well.

| **PLM**: And I guess this leads into another related question which is: "What's the role of the board in these issues? What board oversight should there be over HCM issues?

| **EKB**: I mean, that's an excellent question and I think one that many directors are asking and asking themselves. And I think directors go into the boardroom and they say, "well, nobody has said the words 'human capital management' to me, so how do I know we're doing it?" And I think the answer is not that there should be a session on the board called human capital management, but that executives and the company secretary should be taking stock of all of the things that their board is responsible for and all of the information that they're feeding up to the board and ensure that the kinds of initiatives, the kinds that, Maj, you mentioned: diversity and promotion and retention of employees and compensation, that all of them have a human capital element and that the board is being really thoughtful in this area.

| **MV**: I also think, at a lot of companies, a lot of directors have expressed interest in having more oversight in these areas. And I think investors want to see the board of the comp committee have oversight in these areas. I don't necessarily think these areas may potentially be the types of issues that, from a Delaware law perspective, you must have oversight over, but there is interest in having oversight over human capital management and different categories that might be important to a particular company. I also think certain issues – for example, if there's a violation of the Code of Ethics, or certain types of issues do arise to the type of significant harm – that then you really do get to the board oversight level.

So, I think it's going to vary company to company. It depends on which categories under human capital management are important to a company and the level of interest that that particular company's board or comp committee has to have oversight over it.

| **EKB**: Yes, and I think an important thing to remember is that along with oversight comes risk management, and so there is definitely a risk management lens through which companies should think about reviewing human capital management issues.

| **PLM**: What kind of information do you think would be helpful for boards to consider?

| **MV**: It really depends on the type of information or category that the committee or the board has oversight over. For example, if they want to have oversight over diversity initiatives, you can see the type of, potentially, the objectives or type of information that would be presented to the board regularly, but if there may be other more strategic areas that the board or the committee may want to have oversight over, for example, recruiting or retention of employees. The board may want to review attrition or turnover rates. It really is specific to the category under human capital management that the board has oversight over.

| **PLM**: And what about compensation? What do you think the board should consider from that perspective when it comes to HCM?

| **MV**: I think historically the board and the comp committee has been focused on executive compensation and then also board-level compensation. I think what you're going to end up seeing is that the same philosophies that hold true for the companies when it comes to exec comp, those same types of philosophies should apply company-wide. So, I do think a primary category under human capital management is compensation for employees company-wide. You will see the comp committees and the boards put more attention and focus on how those incentive programs are structured, so they can incentivize their employees beyond the exec comp level.

| **PLM**: Speaking of executive comp issues, what do you think about tying executive comp to HCM or even ESG issues?

| **MV**: Yes, we're already seeing somewhat of a push towards doing that, especially ESG issues. I haven't seen as much HCM goals in exec compensation. Where I do see it, it's typically part of the cash incentive program and it's typically one of a number of objectives, and usually a lower-weighted objective. I think the key there is to make sure that the company has really considered the objective. It's one that's strategic and appropriate for each company, but I do see a move in that direction, and I think we'll start seeing it more and more.

| **EKB**: This area has become increasingly hard to quantify in some respects and so there's a real push to define the things that make human capital management most relevant to investors, to their employees and to other stakeholders. Pam, how do companies really demonstrate their efforts in a way that shows that they're really committed versus companies that are kind of disclosing what they're doing, but paying more lip service to the idea of human capital management? What do you think the differentiators are?

| **PLM**: I really think it comes down to doing the work and I think that there really are a lot of companies out there who are putting in a phenomenal amount of work in this area, and I think that's what really will demonstrate the difference. So, by putting in the work, what I mean is all the issues we've been talking about, thinking about the hard issues, figuring out what they mean to the company, figure out how they support the company's objectives and the company's strategy, really getting a good handle on what the information is.

And then, related to that, I think the other piece is understanding who the audience is, and for each company it will be different. So, who for each company is interested in this information? Obviously, investors are very interested in this, have been interested in it for a while, so that's easy. But we've seen, employees are obviously incredibly interested in this and the consumer public at large is often at times very interested in these issues, and social media just increases the attention that some of these issues can draw.

So, understanding both the issues and the audience I think will put companies in a really good position to then craft a message that really resonates with all the people that they're speaking to on issues that matter to them, because they will have thought about it in advance. I think one thing that's important to keep in mind though is that, what I've just described is very different from what at least I'm expecting to see when it comes to the HCM disclosures that we'll start seeing in companies' 10-Ks as a result of the new SK requirement.

I think that, from that perspective, you'll really start seeing a staged approach. For the very first disclosures, you'll probably see much more limited disclosures as companies figure out what to put in their disclosures, and then over time I suspect that you'll see a progression. But what I was describing was really a way of putting together a thoughtful message, but that's not what I'm thinking will find its way into companies 10-Ks, at least not in the initial set of disclosures.

| **EKB**: I very much agree with all of that and I think it will be incumbent upon companies to really take stock, like you said, of what their investors and their stakeholders want, but to do so in really a very thoughtful way and to distinguish themselves from the inclination that occurred when ESG started to first be an area of interest and avoid listing every single small item that makes sense. You know, in equivalencies, you don't want to hear about every recycling program and LED lightbulb that a company puts in and, similarly in HCM, there are companies that are doing the work in particular that are going to have a litany of things to say. I mean, that list can just go on and on. So, finding a way to demonstrate that they're being thoughtful and responsive, but also know enough and have thought enough to know what is most relevant and most tangible to those who are digesting the information, that is their employees, their stakeholders and their investors.

| **PLM**: And to add to that, Leza, and of course to present a balanced view. Not to highlight every great thing that the company's doing, but to present a more balanced view, especially in their SEC disclosures.

| **EKB**: Exactly. I think it's not going to be credible for every company to say that, "we're knocking it out of the park".

There are companies for whom the authentic message will be, "we're looking at what we're doing, and we have room to grow and we're committed to growing" and that could be just as powerful a message as "we've done 75,000 things and here's a list of what they are".

Thank you to Maj and Pam for this engaging session and thank you to all of you for joining us today.

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