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# **HIDDEN TALENT 2: HAS WORKFORCE REPORTING BY THE FTSE 100 IMPROVED?**



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## ABOUT THE PLSA

We're the Pensions and Lifetime Savings Association; we bring together the pensions industry and other parties to raise standards, share best practice, and support our members. We represent over 1,300 pension schemes with 20 million members and £1 trillion in assets, across master trusts and defined benefit, defined contribution, and local government schemes. Our members also include some 400 businesses including asset managers, investment consultants and other service providers.

Our mission is to help everyone to achieve a better income in retirement. We work to get more people and money into retirement savings, to get more value out of those savings, and to build the confidence and understanding of savers.

## ABOUT THE HIGH PAY CENTRE

The High Pay Centre is an independent, non-partisan think tank focused on the causes and consequences of economic inequality, with a particular interest in top pay and corporate governance. It runs a programme of research, events and policy analysis involving business, trade unions, investors and civil society focused on achieving an approach to business that enjoys the confidence of all stakeholders.

For more information visit: [highpaycentre.org](https://highpaycentre.org) or [twitter/com/highpaycentre](https://twitter.com/highpaycentre)

# FOREWORD – RACHEL REEVES MP

UK productivity has been lower than that of many of our G7 and OECD competitors, and has only declined since the financial crash of 2007/08. There are a number of possible reasons for this but, as this report highlights, productive companies – which form the backbone of our economy – rely on a workforce which is motivated, fulfilled, and financially secure.

In my role as Chair of the Business, Energy and Industrial Strategy Select Committee, I have sought to shine a light on the challenges facing UK businesses and make recommendations to government designed to improve productivity, rebalance the economy and spread prosperity more widely throughout the country.

Over the course of our inquiries into issues such as the gender pay gap and executive remuneration, I have often heard companies say that ‘people are our greatest assets’. Yet in many cases, the reality fails to match the rhetoric. Fair pay is vital for maintaining staff morale, but most companies have significant gender pay gaps and are too slow to develop the policies likely to reduce them. We have called out huge, unjustified pay awards and called for the profits of companies to be more evenly shared by senior executives and ordinary employees alike.

It’s often said that what gets measured, gets managed. And it’s often also true that what gets reported, gets done. This is why my Committee has consistently recommended more transparency, better reporting on key metrics and tougher sanctions when companies fall short on these fronts. Investors have always understood the value of meaningful information on issues that affect a company’s bottom line – so that they can use this to shape their corporate engagement and dialogue. Pension schemes in particular, with their long-term investment horizons and £2.2tn of assets under management, are well placed to influence companies for long-term economic success. We look to them to engage positively and drive good corporate governance. I believe there is a strong link between good governance and strong performance, and the evidence bears this out.

I therefore welcome this important research from the PLSA and the High Pay Centre on how well the largest UK firms do at reporting on the composition, stability and satisfaction of their employees. If pension scheme investors and their advisers are to hold companies to account on how they motivate and engage with their workforce, they need the right kind of information. I hope that investors will use this report to work together with companies and solve the UK’s productivity puzzle.



**Rachel Reeves MP**  
CHAIR, BUSINESS, ENERGY AND INDUSTRIAL STRATEGY SELECT COMMITTEE

# WHY WORKFORCE DISCLOSURE MATTERS

The value of individuals' savings ultimately depends on the success of the companies their pension schemes invest in. Investing in companies with a robust strategy and forward-looking approach that enables them to flourish over the long-term will help achieve a better income in retirement for savers.

This is why the PLSA has been at the forefront of debates around stewardship and corporate governance for nearly 30 years. And with over £2 trillion in assets under management, pension scheme investors wield significant influence in encouraging corporate best practice and success.

Yet although the risks that environmental, social and governance (ESG) factors can pose to investment portfolios are increasingly understood, it has long been apparent that the 'S' of 'ESG' has been relatively neglected. So while topics like executive pay have received several pages of attention in companies' annual reports, issues affecting the rest of an organisation's workforce remain under-explored.

In 2015, we asked *Where is the workforce in corporate reporting?* This started our work to identify a framework and metrics for investors to use when examining company disclosures to assess the motivation, stability, composition and skills of a company's employees. This was followed in 2016 by an investor workforce 'toolkit' and our Hidden Talent research in 2017, which assessed how well FTSE 100 companies report on these issues in their annual reports.

With the intense level of policymaker, industry and public interest in workforce issues in the last few years, it remains important to examine whether there has been any improvement in the quality and level of workforce disclosure. This report builds upon our previous research and goes further, examining new metrics on the gender and ethnicity pay gaps and supply chain ethics to reflect the shifting debates and regulations.

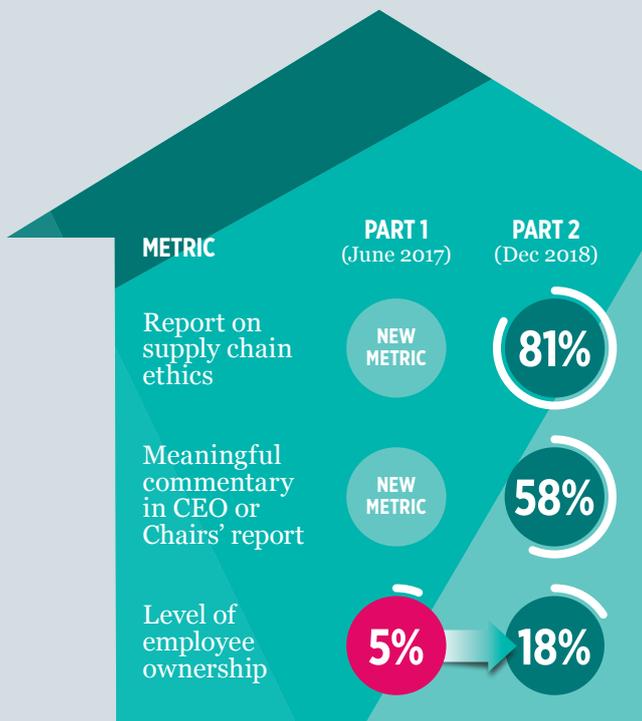
Our thanks go to the High Pay Centre for undertaking this research. We believe this report will prove a useful contribution to the evolving discussion on workforce issues and help investors and companies work together in ways which are good for workers, UK PLC and ultimately, the UK economy.



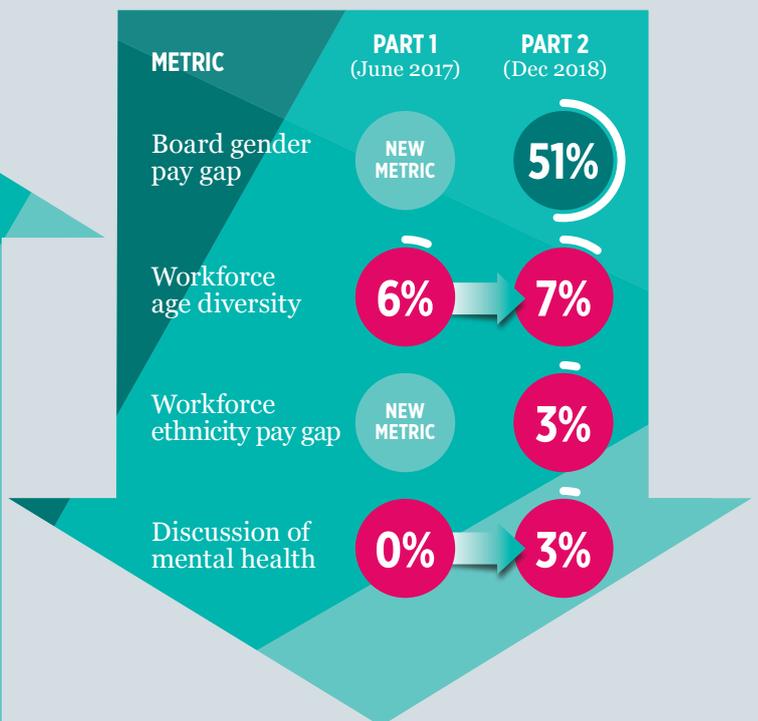
**Caroline Escott**  
POLICY LEAD: INVESTMENT AND STEWARDSHIP, PLSA

As part of the PLSA’s work to support investors in understanding employment issues, we asked the High Pay Centre to examine disclosures in FTSE 100 annual reports to find out how workforce reporting has changed since the first *Hidden Talent*<sup>1</sup> report in 2017.

## POSITIVES



## ROOM FOR IMPROVEMENT



## CONCLUSION

Despite recent policy initiatives aimed at encouraging companies to build capable, skilled and engaged workforces, there remains considerable variation in the quality of workforce-related disclosures and reporting in FTSE 100 annual reports. Investors, policymakers and civil society must continue to work together to ensure companies give clear, meaningful information on their employment models and practices.

If you would like to find out any more about our work, please contact  
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<sup>1</sup> The PLSA commissioned the High Pay Centre to conduct analysis of FTSE 100 companies’ annual reports to find out what companies say about the people who work for them. The most recent annual reports as of 1 December 2018 were used to undertake the analysis. Ninety-seven FTSE companies were included in reporting, as three were ineligible for the study. Please see Methodology section for further details.

# EXECUTIVE SUMMARY

Although encouraging an engaged, diverse and fulfilled workforce should be an end for companies in itself, there is a growing body of evidence to show that the long-term success of a company – regardless of sector, strategy or market – depends on a stable, motivated workforce with staff who feel financially secure, professionally fulfilled, and appropriately skilled to carry out the responsibilities of their job.

Therefore, comparable information about employment models and working practices matters substantially to investors and should figure prominently in companies' annual reports – an important tool for investor communication. Such information should not just include isolated data points or statements made in the abstract, but be placed in the proper context and within a narrative which relates the information to a company's broader strategy and purpose.

This report is the second in our series on workforce reporting, with research carried out by the High Pay Centre (HPC). It follows *Hidden Talent: What do Companies' Annual Reports Tell Us About Their Workers?* (2017).<sup>2</sup> These reports examine corporate reporting on employment models and working practices across the FTSE 100 and are intended to be read alongside our 2016 *Worth of the Workforce* toolkit for investors.

In this year's report, we assess for the first time the quality and availability of company reporting on the gender and ethnicity pay gap as well as supply chain ethics. We also examine the progress made on workforce reporting since the publication of our 2017 research in the context of a UK regulatory environment where policymakers and investors have been increasingly pushing for better corporate transparency and accountability.



<sup>2</sup> By the PLSA and Lancaster University Management School (LUMS).

## THE FINDINGS

The research revealed a significant variation in the quality and levels of FTSE 100 company reporting on four themes previously identified in our *Hidden Talent* and *Worth of the Workforce* work; composition, stability, skills and capabilities, and engagement.<sup>3</sup> On almost every metric there was some degree of disclosure in each annual report, but there were no universal disclosure practices across the group over and above statutory requirements.

Across these themes, there were some instances where workforce reporting by FTSE 100 firms had improved though on some metrics, this was from a low base. These included more reporting of aggregated turnover rate, proportion of full and part time staff and evidence of motivation and commitment towards corporate goals, such as employee awards and schemes designed to foster teamwork.

However, there remains significant room for improvement in reporting on other key workforce issues. One of the most interesting findings is that meaningful reporting<sup>4</sup> on issues achieving prominence in recent policy debates such as mental health, the ethnicity pay gap or age diversity remains rare. We hope this will improve over time, particularly as new regulation comes in, although we would expect forward-looking companies to anticipate policy changes on material workforce issues.

### GENERAL REPORTING PRACTICES

#### REPORTING PRACTICES THAT REFLECT THE ROLE AND SIGNIFICANCE OF THE WORKFORCE IN CORPORATE GOVERNANCE OVERALL

*How important do companies perceive the workforce to be in relation to strategy and success? How is the workforce assessed in relation to performance, target, and risk management? How prominently and clearly does the workforce figure in company disclosures?*

- ▶ Many companies provided broad, generic statements about the importance of their workforce. The proportion of CEO or Chairs' statements which mentioned the workforce in a meaningful way was 58%.
- ▶ 35% of companies provided meaningful disclosures of how their workforce contributes to value creation or the execution of company strategy. In the first report, the figure was 43%.
- ▶ 38% of companies provided forward-looking workforce commentary, including concrete targets or plans to deliver improvements (compared to 49% in the first report).

### COMPOSITION

#### WIDER QUESTIONS ABOUT WORKPLACE DIVERSITY AS WELL AS RECENT CONTROVERSIES ABOUT PART-TIME WORK, FLEXIBLE CONTRACTS AND AGENCY STAFF

*Who are the company's workers and on what terms are they employed?*

- ▶ 11% of firms provided a breakdown between full-time and part-time staff (up from 4% in the first report).
- ▶ Just over half (51%) of companies disclosed the gender pay gap<sup>5</sup> at the level of the board and managerial staff, while 52% disclosed the gender pay gap among all staff and subsidiaries. Most of these firms referred to their UK gender pay gap report by providing a link to their website.
- ▶ Other measures looking at reporting of the ethnicity and age diversity found that just 3% of companies disclosed the ethnic pay gap within their workforce and only 7% of companies disclosed the age diversity of their workforce.

<sup>3</sup> Please see pages 8 and 9 for definitions.

<sup>4</sup> In this report, meaningful reporting is considered to include the provision of context and narrative which is underpinned by concrete data. Please also see our section on methodology in the Appendix.

<sup>5</sup> New measures introduced in 2017 require any organisation with 250 or more employees must publish and report specific figures about their gender pay gap i.e. the difference between the average earnings of men and women, expressed relative to men's earnings.

## STABILITY

### BROADER ISSUES AROUND PRECARIOUS WORK AND SUSTAINABLE EMPLOYMENT MODELS

*How stable and secure is the current workforce and how might it change over time?*

- ▶ The proportion of companies reporting their aggregated turnover rate has increased from 18% in the first report to 31% now.
- ▶ The number of companies disclosing information about serious injuries and accidents has increased from 5% in the first report to 7%. Similarly, 31% of companies reported time lost due to injuries (compared to 26% in the first report).
- ▶ Only 3% of companies disclosed meaningful data on the mental wellbeing of their workforce.

## SKILLS AND CAPABILITIES

### ISSUES PERTAINING TO THE PRODUCTIVITY GAP AS WELL AS TRAINING AND INVESTMENT IN HUMAN CAPITAL

*How equipped is the workforce to meet the company's future skills needs?*

- ▶ 24% of FTSE 100 companies provided concrete data<sup>6</sup> on their training programmes compared with the first report's figure of 23%.
- ▶ Similarly, there was no change in the number of companies that disclosed material details of training arrangements for young workers, graduates or apprentices (1%) and managers (1% compared with none in the first report).

## EMPLOYEE ENGAGEMENT AND VOICE

### QUESTIONS AROUND LONG-TERM SUSTAINABILITY AND THE QUALITY OF WORK AS AN INDICATOR OF ECONOMIC PERFORMANCE ALONGSIDE MORE TRADITIONAL MEASURES LIKE EMPLOYMENT LEVELS AND GROWTH

*How motivated is the workforce? How fulfilled do workers feel in their jobs and how committed are they to corporate goals?*

- ▶ There was an increase in the number of companies which provided indicators to measure the motivation and commitment of the workforce towards corporate goals<sup>7</sup> (37% compared to 30% in the first report).
- ▶ The proportion of companies providing details on the level of employee share ownership increased to 18% (up from 5% in the first report).
- ▶ The percentage of companies that provided a meaningful narrative discussion of procedures for employee engagement in their annual reports remained consistent (33% this year compared with 34% last year).
- ▶ However, only 35% of companies provided concrete data on their employee satisfaction score, compared to 42% last time.
- ▶ Similarly, 53% of companies referred to their procedures for workforce engagement – down on the first report's figure of 64%.

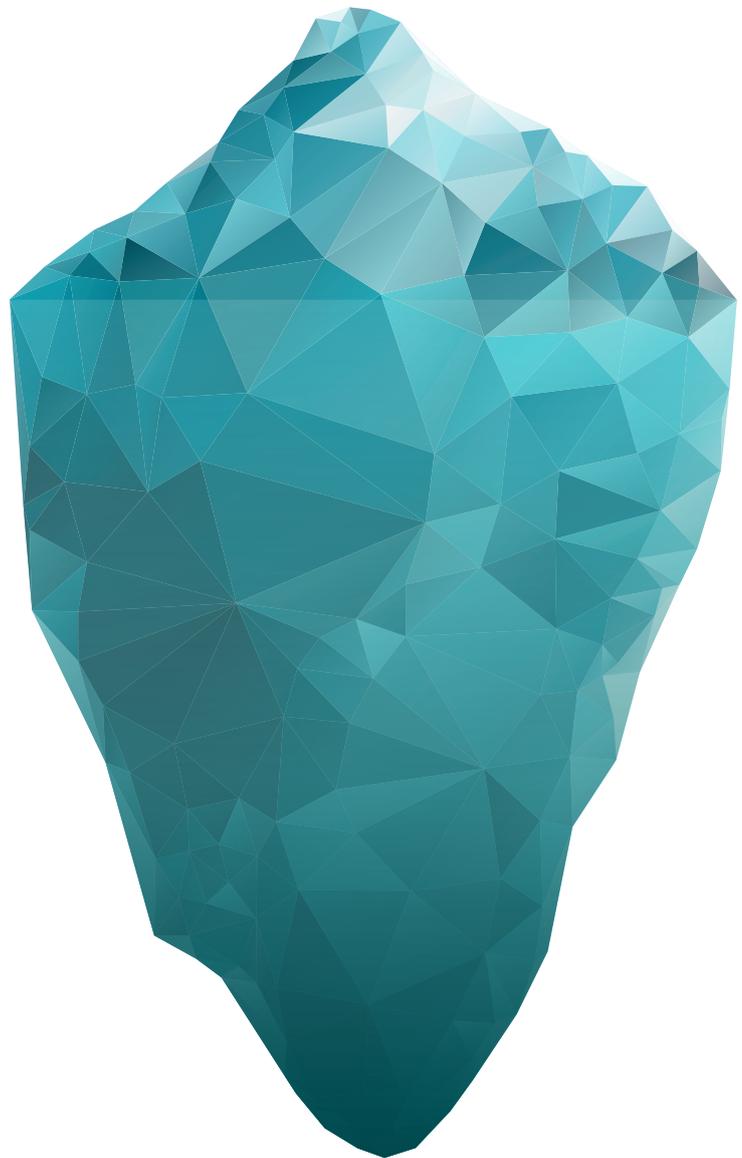
<sup>6</sup> Concrete data includes the number of employees trained in the reporting year or the budget for training and development.

<sup>7</sup> Including employee awards and schemes to foster teamwork and build corporate culture.

## CONCLUSION

As with our first report in 2017, there remains considerable variation in the quality of workforce-related disclosures and reporting in FTSE 100 annual reports. Despite recent policy initiatives and growing investor appetite for such information, many FTSE 100 companies still do not disclose or discuss workforce issues over and above statutory requirements.

Although there have been some minor improvements in a few metrics, more work is required to improve the overall quality of workforce reporting across the FTSE 100. Reporting on many issues remained at similar levels and of similar quality to those of the previous report and cases of best practice are still the exception rather than the rule. High-quality workforce reporting is key to better outcomes for companies, investors, and workers. Therefore, investors, policymakers and civil society must continue to push companies to provide better information on these areas.



# BACKGROUND

In recent years, policymakers and investors have shown a growing interest in employment models and working practices as a means to understand growth and value. Taken alongside ever-greater concern from the public that companies ensure fair and decent working conditions<sup>8</sup> and that investors fulfil their role as stewards for responsible business practices, the time is right to gauge how well firms report on their employment models and approaches.

*Hidden Talent II* analyses corporate reporting on employment models and working practices based on research by the High Pay Centre (HPC) commissioned by the PLSA. The report is the latest in the long-running programme of PLSA research on this issue and its importance to pension fund investors.

The companies analysed in this report operated in the penultimate year of the previous Corporate Governance Code<sup>9</sup>. From 1 January 2019, the new Corporate Governance Code, which will affect annual reports from 1 January 2020, places more emphasis on the responsibilities of boards to stakeholders over and above their shareholders. An important new reporting requirement is the disclosure relating to how directors take employee and other stakeholder interests into account in accordance with Section 172 of the Companies Act (2006)<sup>10</sup>, including communication channels between the board and workforce. Businesses will also need to disclose their relationships with customers, suppliers, and others.

## WHERE IS THE WORKFORCE IN CORPORATE REPORTING?

In 2015, the PLSA published a discussion paper - *Where is the Workforce in Corporate Reporting?* - which argued that investors need more detailed information about the workforces of firms competing for their investment<sup>11</sup>.

The paper showed that the organisational culture and performance of any company is shaped by the people who work for it and, therefore, companies should discuss workforce-related issues more in their communications with investors. The PLSA identified four particular themes – **composition, stability, skills and capabilities, and engagement**<sup>12</sup> – that should be included in annual reports for a fuller understanding of corporate employment models and working practices.

## UNDERSTANDING THE WORTH OF THE WORKFORCE

Following the discussion paper, in 2016 the PLSA produced *Understanding the Worth of the Workforce: A Stewardship Toolkit for Pension Funds* (henceforth *Toolkit*) based on consultations with investors, company representatives, professionals, academics, and trade unions<sup>13</sup>.

The *Toolkit* established some key standards for workforce reporting so that pension fund investors can promote them. It re-stated the four themes – composition, stability, skills and capabilities, and engagement – and argued that companies should meaningfully discuss these themes in annual reports as part of a broader discussion about how their employment models and working practices relate to their long-term organisational strategy and purpose.

The *Toolkit* also proposed key metrics that could serve as proxies and shed light on the four themes, underpinning shareholder-company discussions with concrete, consistent, and comparable data points. This would also enable historic and intra-sector comparisons by investors and civil society. These metrics formed the basis for the first report produced by the PLSA and Lancaster University Management School (LUMS) in 2017.

<sup>8</sup> The Edelman Trust Barometer 2019, which measures trust in and the credibility of key institutions, found that 80% of respondents said they believed CEOs should drive change instead of waiting for government to impose it. 76% of respondents believed that how a business treats its employees is a key indicator of trustworthiness, while “treating employees fairly” was considered the greatest obligation for businesses by 65% of respondents.

<sup>9</sup> The UK Corporate Governance Code, set by the Financial Reporting Council (FRC), sets out the principles and standards of good governance at companies.

<sup>10</sup> Section 172 (s.172) imposes a general duty on every company director to act in the way they consider would be most likely to promote the success of the company for the benefit of its shareholders as a whole and to have regard to factors such as the interests of employees and other stakeholders. Its intention is to ensure that the broader implications of decisions are considered by directors.

<sup>11</sup> NAPF (now PLSA) (June 2015), *Where is the workforce in corporate reporting?*

<sup>12</sup> Please see pages 8 and 9 for further details on these themes.

<sup>13</sup> PLSA (July 2016), *Understanding the worth of the workforce: A stewardship toolkit for pension funds*

### THE METRICS INCLUDED:

- ▶ Employment type: full-time, part-time or agency workers
- ▶ Diversity: gender, ethnicity or social background
- ▶ Staff turnover rates
- ▶ Workplace accidents, injuries and illnesses
- ▶ Pay ratios between CEOs and workers
- ▶ Investment in training and development
- ▶ Worker engagement score

For this report, further metrics that we consider to be of particular interest given recent policy developments and trends in UK shareholder engagement have been added:

- ▶ Pay gaps by gender and ethnicity
- ▶ Ethnic diversity of the workforce
- ▶ Ethics in the supply chain

### THE BROADER CONTEXT

Against a background of stagnating wage growth<sup>14</sup> and following the publication of the PLSA's *Toolkit* and the first *Hidden Talent* report, policymaker and investor interest in issues relating to employment models and working practices has grown. Below we summarise some of the key developments of relevance to pension scheme investors and their advisers.

#### A. POLICY AND INITIATIVES

A key plank of the Conservative Party Manifesto in 2017 was measures aimed at improving corporate accountability in a number of areas, including proposals to ensure employees' interests were represented on company boards and tougher measures to tackle modern slavery. This overarching commitment has filtered through to specific policy and regulatory initiatives in a number of ways, from changes to the UK Corporate Governance Code (please see below) to the programme of work outlined by the Department for Business, Energy and Industrial Strategy (BEIS) in its *Insolvency and Corporate Governance* papers.

### THE CHANGING UK CORPORATE GOVERNANCE DISCLOSURE FRAMEWORK

One of the most significant regulatory developments on workforce disclosure since the last *Hidden Talent* report has been the revision of the UK Corporate Governance Code. On 1 January 2019, BEIS and the FRC introduced the new Code<sup>15</sup> which will apply to financial years beginning on or after 1 January 2019; this means the first disclosures will begin from 1 January 2020.

The new code introduces a requirement to involve some form of employee stakeholder voice in corporate governance structures. It also mandates listed firms to report on how directors have fulfilled their requirement to have regard for the interests of all stakeholders under Section 172 of the Companies Act (2006). The introduction of these new requirements rests on the assumption that public disclosures drive business culture and corporate governance. To succeed on current assumptions, firms must disclose in detail with meaningful discussion to avoid the impression that they are engaged in a box-ticking exercise.

This year, the majority of FTSE 100 companies noted or referred to the new Corporate Governance Code. However, because the annual reports within scope of our research were released before the code was introduced, most companies have opted to wait until the new financial year before disclosing the new requirements.

<sup>14</sup> The International Labour Organisation (ILO) found that, between 2008 and 2017, the UK experienced losses in real wage growth of 5% - among the lowest in the G20 (Global Wage Report 2018/19: What lies behind gender pay gaps)

<sup>15</sup> Financial Reporting Council (July 2018), *The UK Corporate Governance Code*

**OTHER RELEVANT INITIATIVES INCLUDE:**

- ▶ The proposed 2019 changes to the UK Stewardship Code<sup>16</sup> in line with the European Union’s work on the Shareholder Rights Directive II (SRD) which seeks to improve the quality of shareholder engagement with companies. As part of its work on the new Code, the FRC highlights issues including “workforce matters”<sup>17</sup>.
- ▶ The Taylor Review of Modern Working Practices (2017) which highlighted the precarious nature of working life in the UK and recommended that companies be required to disclose details of their employment models with reference to flexible contracts and agency workers. The review also recommended that companies carry out independently verified employee engagement surveys and disclose the results<sup>18</sup>.
- ▶ The introduction of gender pay gap reporting requirements, which came into effect from 6 April 2017, and required companies with 250 employees or more to publish prescribed statistics relating to the average rate of pay for men and women.
- ▶ Government changes (September 2018) to clarify in the *Occupational Pensions Schemes (Investment) Regulations* how trustees can take account of “financially material” environmental, social and governance (ESG) factors<sup>19</sup>. Given the materiality of workforce issues, we believe this should include workforce issues for some schemes and their investment portfolios.
- ▶ BEIS’ 2018-2019 work to build upon recommendations in Baroness Ruby McGregor-Smith’s report, *Race in the Workplace* (2017), that employers must report ethnicity pay data<sup>20</sup>. At time of writing, it appears that some kind of requirement for companies to report in this area is likely.
- ▶ Since 2010, the NHS has aimed to achieve “parity of esteem” between mental and physical health. This – and supporting policy developments such as the 2017 government review of the *Mental Health Act 1983* or the Independent Mental Health Taskforce’s 2016 report *The Five Year Forward View for Mental Health* – has helped encourage a more open debate on mental health in the UK, including the role of employers in supporting employees who experience mental health issues to cope and recover.

**B. INDUSTRY INITIATIVES AND REPORTS**

- ▶ Every year, the PLSA updates and produces its *Corporate Governance Policy and Voting Guidelines* to highlight market best practice and emerging areas of interest in consultation with its members. The document supports investors in promoting long-term corporate success, holding boards and management to account, and understanding the latest developments in corporate governance. The guidelines for 2019 state: ‘How well a company engages with, and considers the views of, its workforce should be a critical topic for shareholder engagement.’<sup>21</sup>
- ▶ The Department for International Development (DFID) funds the \$13 trillion Workforce Disclosure Initiative (WDI) run by ShareAction to encourage investors to push for decent work with high quality and secure jobs around the world in their operations and supply chains.<sup>22</sup>
- ▶ The Business & Human Rights Resource Centre (BHRRC) has undertaken an assessment of FTSE 100 disclosures on their action to tackle modern slavery in their operations and supply chains.<sup>23</sup> This follows the Modern Slavery Act (2015), which requires organisations with a turnover or group turnover of at least £36m that are incorporated or operate in the UK to disclose their action to do so.
- ▶ The Resolution Foundation’s report *Low Pay Britain 2018* found that 22% of women were low-paid compared to 14% of men and that companies with 5,000 or more workers employ 28% of all low-paid people. Nearly 16% of low-paid employees work for just 20 firms.<sup>24</sup>

<sup>16</sup> The Stewardship Code, also administered by the FRC, looks to improve the quality of engagement between investors and companies to improve risk assessment and shareholder returns.

<sup>17</sup> Financial Reporting Council (July 2018), *Feedback Statement: Consulting on a Revised UK Corporate Governance Code*, p. 25.

<sup>18</sup> Department for Business, Energy & Industrial Strategy (July 2017), *Good Work: The Taylor Review of Modern Working Practices*, pp. 110-11.

<sup>19</sup> The Pensions Regulator (November 2018), *Investment Guidance for Defined Benefit Pension Schemes*, p. 22; The Pensions Regulator (November 2018), *A Guide to Investment Governance*, p. 7.

<sup>20</sup> Department for Business, Energy & Industrial Strategy (February 2017), *Race in the Workplace: The McGregor Smith Review*, pp. 4-5. The PLSA’s response can be found at [www.plsa.co.uk/Policy-and-Research/Document-library/Ethnicity-pay-reporting-consultation-PLSA-response](http://www.plsa.co.uk/Policy-and-Research/Document-library/Ethnicity-pay-reporting-consultation-PLSA-response).

<sup>21</sup> The 2019 guidelines continue that ‘fair pay policies are necessary (but not sufficient in themselves) to ensure good employee morale. Significant pay discrepancies, including those based on issues such as gender or ethnicity, as well as between a company’s senior executives and the rest of the workforce can also be a signifier of wider problems with a workplace’s culture and processes.’

<sup>22</sup> ShareAction, *Workforce Disclosure Initiative*, <https://shareaction.org/wdi/>

<sup>23</sup> Business and Human Rights Resource Centre (2018), *FTSE 100 & the UK Modern Slavery Act: From Disclosure to Action*, p. 3.

<sup>24</sup> Resolution Foundation (May 2018), *Low Pay Britain 2018*, pp. 5-6.

# METHODOLOGY

Commissioned by the PLSA, the HPC analysed the most recent annual reports of the FTSE 100<sup>25</sup> as of 1 December 2018.<sup>26</sup> The report does not include the addition of Hiscox and Spriax-Sarco to the FTSE 100 index on 24 December 2018 and, in turn, the deletion of Just Eat and Royal Mail. The analysis excludes Scottish Mortgage Investment Trust, Coca-Cola Hellenic Bottling Company and Carnival.<sup>27</sup>

The research analyses each annual report, identifying whether there has been meaningful narrative discussion of each of the four key themes of composition, stability, skills and capabilities, and engagement, by looking at whether companies have provided concrete disclosures – with the appropriate narrative and context – in relation to individual underlying metrics proposed in the PLSA's *Understanding the Worth of the Workplace: A Stewardship Toolkit for Pension Funds* as proxies for each of the four key themes. The research also assesses whether each report fulfilled what are considered general characteristics of good workforce reporting.

For further information about the methodology, please turn to the appendix.



<sup>25</sup> The FTSE 100 undergoes a reshuffle of constituent firms every quarter. This means that although many of the same companies will have been within scope of our assessment for both this report and our first, there will have been some change.

<sup>26</sup> The previous Hidden Talent report looked at Annual Reports as of 1 June 2017 so figures in this report are not a direct comparison a year on.

<sup>27</sup> Scottish Mortgages Investment Trust and Coca Cola Hellenic Bottling Company were also excluded from analysis in Hidden Talent Part 1; Scottish Mortgage Investment Trust was removed because of its status as an investment trust, Coca Cola Hellenic Bottling Company was removed due to its relationship with the Coca Cola company and Carnival due to its listing in New York which results in a very different annual report and is therefore not a like-for-like comparison.

## RESEARCH FINDINGS

The standards of reporting identified by the research indicate significant variation regarding how FTSE 100 businesses engage with different characteristics of the workforce. On almost every metric or characteristic assessed, there was a degree of reporting across all the reports. But, other than where particular disclosures are mandatory, there were no aspects of reporting that were practised universally across the FTSE 100. In some areas of particular investor interest, companies providing meaningful reporting were the exception rather than the rule.

Before examining the four distinct themes of composition, stability, skills and capabilities, and engagement, it is useful to examine companies' overall approach and quality of reporting on workforce issues.

### GENERAL REPORTING OF WORKFORCE-RELATED ISSUES

As in the first report, our research examined whether discussion of employment models and working practices was consistent with good reporting practices.

#### OPPORTUNITY AND RISK

Many companies provided broad, generic statements about the importance of their workforce such as 'Our people are our strength' and 'Our colleagues are our greatest asset'. However, we found that 58% of firms mentioned the workforce in a meaningful way (over and above general statements) in CEO or Chairs' reports.

Some annual reports discussed workforce issues in terms of both opportunity and risk. It is appropriate for companies to classify their workforce within the rubric of risk and performance management. For instance, there are obvious risks relating to reduced output, productivity, reputational damage or reduced quality of output or service resulting from employee issues such as industrial relations, quality of training or pay and conditions. There is also a widespread consensus in company reports that those with a highly motivated, skilled workforce and the additional reputational value for being perceived as a fair and generous employer had a clear competitive advantage.

Around nine in 10 (87%) companies discussed the quality of the skills, capabilities and engagement of their workforce as a key *risk*. This compares with a figure of 91% in the first report. These discussions might be in relation to specific issues such as health and safety or legal and ethical standards. But they may also be more general. As Micro Focus reported in its risk management framework:

***'The retention and recruitment of highly skilled and motivated employees, at all levels of the Group, is critical to the success and future growth of the Group in all countries in which it operates. Employees require clear business objectives, and a well communicated vision and values, for the Group to achieve alignment and a common sense of corporate purpose among the workforce.'***<sup>28</sup>

Meanwhile, only 35% of companies provided meaningful disclosures of how their workforce contributes to *value creation* or the execution of company strategy. In the first report, the figure was 43%. Johnson Matthey noted:

***'Our strategy directs investment choices across the group so that our people can translate our world class science and technology as efficiently as possible to solve our customers' complex problems and tackle major global challenges: the need for clean air, improved healthcare and the most efficient use of our planet's natural resources.'***<sup>29</sup>

Despite passages thanking the workforce and the references to the workforce as valuable assets, there is clearly more time and effort dedicated to analysing the workforce as part of risk and performance management than to nurturing them as an asset to the company. This provides useful indications about the cultures and processes of UK business, especially corporate governance, and how business leaders approach central challenges like productivity and the quality of working life.

#### ETHICS IN THE SUPPLY CHAIN

Workforce-related issues reach beyond domestic workers: direct employees, agency, and third-party workers operate throughout the supply chain. The 2015 Modern Slavery Act now requires certain companies to publish an annual statement explaining how they are tackling modern slavery in their operations and supply chains.

Although not all FTSE 100 companies operate on an international basis, 81% of them provided a discussion of ethics in the supply chain, including modern slavery. However, many of these discussions were generic. Better examples of

<sup>28</sup> Micro Focus PLC (2017), *Annual Report and Accounts 2017*, p. 40.

<sup>29</sup> Johnson Matthey PLC (2018), *Annual Report 2018*, p. 15.

disclosures explained business policies and the political and legal operating context, including the importance of social licence to operate, and were backed up with data and case studies. The more effective disclosures made a principled commitment to maintaining high ethical standards throughout the supply chain. Marks & Spencer noted:

***‘As one of the most trusted brands in the high street, we believe we have a responsibility to be a fair partner to our suppliers. This covers the prices we pay our suppliers to the support we provide to the communities where we trade. It also means ensuring good working conditions throughout our supply chains and sourcing our products with integrity.’***<sup>30</sup>

### QUALITY OF REPORTING

As with the disclosure of specific themes and metrics, the extent to which workforce-related issues were articulated in a way that was useful for investors also varied.

Workforce-related issues were judged to be fully integrated into the annual reports of 53% of companies – compared with 56% in the first report – with systematic cross-referencing throughout the report and discussion of workforce-related issues in relation to the different relevant sections.

Around a third (34%) of reports could be described as ‘clear’, 48% as ‘reasonably clear’, and 18% as ‘opaque’ in terms of their use of language and presentation. In the first report, the corresponding figures were 30%, 48%, and 22%.<sup>31</sup>

Around a third (34%) of companies provided a direct assessment of performance relative to a target when presenting information on workforce themes and specific metrics. The first report’s figure was 30%. Examples of more transparent reporting include London Stock Exchange, which reported:

***‘We have set ourselves a stretching target of 40% female representation in senior roles by the end of 2020. We are currently at 33%.’***<sup>32</sup>

While GlaxoSmithKline reported:

***‘Our employee engagement score was 79%, and we will be setting this as a baseline year for improvement.’***<sup>33</sup>

Targets and honest measurements provide valuable context for investors. If the target has been stated in previous reports or provides a benchmark for future reporting, it shows that the company is willing to present itself accurately and openly.

Just under two fifths (38%) of companies provided forward-looking workforce disclosures, including concrete targets or plans to deliver improvements (down from 49% in the first report).

Only 11% of companies discussed workforce-related issues at a disaggregated level. The first report’s figure was 14%. While cost considerations, space constraints and avoiding congestion in reports may be considered reasons for not presenting disaggregated information, companies frequently detail *financial or operational information* for each of their different markets, divisions or product lines. Given the salience of workforce issues, disaggregated information about strategic workforce-related issues should therefore also be considered good practice; headline data can hide localised problems for companies operating in a number of different markets or providing a wide range of products and services. Examples of good practice include Rolls-Royce, which provides a headcount by location and business unit, and Intertek, which divides its employee figures by both location and gender as well as providing an infographic showing the relationship between headcount and revenue.

The annual report is intended to provide investors and other stakeholders with a realistic overview of the company. It is unlikely that the outlook for even the best-run company would be uniformly positive. A balanced annual report is likely to be more accurate, reflecting an approach to leadership that is alert to the risk of complacency. However, only 16% of companies discussed issues relating to their workforce in a balanced fashion i.e. disclosed areas where improvements on workforce performance is required. Landsec, for instance, reported:

***‘As always, there were some areas highlighted for improvement. These included the performance management system, which a number of respondents feel is too narrowly focused on KPIs rather than behaviour.’***<sup>34</sup>

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<sup>30</sup> Marks & Spencer PLC (2018), *Annual Report & Financial Statements 2018*, p. 31.

<sup>31</sup> Clarity was judged on two criteria: (i) whether information on the workforce was easy to find and (ii) whether disclosures provided the necessary information on workforce-related issues. Those that fulfilled both criteria were judged to be ‘clear’ and those that fulfilled one of the two were ‘reasonably clear’.

<sup>32</sup> London Stock Exchange Group PLC (2018), *Annual Report 2017*, p. 5.

<sup>33</sup> GlaxoSmithKline PLC (2018), *Annual Report 2017*, p. 48.

<sup>34</sup> Landsec PLC (2018), *Annual Report 2018*, p. 9.

## COMPOSITION OF THE WORKFORCE

A majority of companies (61%) provided detailed information and commentary about who their workers are and how this relates to their strategy and business model. Commentaries almost always involved a discussion of diversity. The best reports explained the benefits of diversity to their business model; Aviva's, for instance, reported that:

***'Inclusive diversity is at the heart of how we do business and a key requirement for the workforce of the future. If people can be themselves, they'll be happier and contribute their best thinking. They will also be more in tune with our diverse customer base and better able to serve their evolving needs.'***<sup>35</sup>

Reports that referenced diversity without discussing the benefits of diversity or measures in place to achieve workforce diversity were judged not to have provided meaningful narrative reporting.

Two in five (39%) companies omitted a meaningful discussion of workforce composition in their annual reports despite the salience of the topic among policymakers and in public debate. In addition to measures on the gender pay gap previously mentioned, the Davies Review (2011) sought to increase the proportion of women on boards of directors to 25% among FTSE 100 companies. By 2015, representation of women on boards had doubled to 26.1% on FTSE 100 boards.<sup>36</sup> Meanwhile, the Hampton-Alexander Review aims for 33% representation of women on FTSE 350 boards, executive committees, and direct reports by the end of 2020, tracking progress every year.<sup>37</sup>

Further, in July 2017, the Parker Review found that, among the 1,050 director positions in the FTSE 100 index, only 2% were filled by those from an ethnic minority. Of 85 individual directors of colour, four held board positions.<sup>38</sup>

## GENDER DIVERSITY AND PAY

The annual reports in the sample were published after the introduction of mandatory gender disclosures, including the pay gap and the gender balance at different levels of the organisation.

It is important to understand the figures below in relation to statutory requirements. Only companies with more than 250 employees are required to provide their gender pay figures on the reporting website. All FTSE 100 companies this year met this requirement.

All firms in our sample disclosed the gender balance data for their boards, managerial staff, and overall workforce. However, much like the first report, these figures are significantly higher than the number of firms that offered a meaningful contextual explanation of how the composition of the workforce met the needs of their business.

Our research this year dug deeper into analysis of the disaggregation of the gender pay gap within the board, at managerial level, and among the general workforce in the annual report. Around half (51%) of the companies disclosed the gender pay gap at the level of the board and managerial staff and 52% disclosed the gender pay gap among all staff and subsidiaries.

Most of these firms referred to their UK gender pay gap report by providing a link to their website. All of them provided a meaningful discussion about the pay gap by taking account of, for example, industry benchmarks and legacy challenges or discussing targets and strategies to reduce the gender pay gap. For example, Berkeley noted:

***'The industry is known for its lack of diversity and we believe there are real benefits in ensuring diverse views, skills and perspectives which can lead to creative thinking and more effective problem solving.'***<sup>39</sup>

Overall, although a small number of FTSE 100 firms are non-UK companies with London listings, nearly half of companies in the FTSE 100 index have opted not to disclose disaggregated information about the gender pay gap in their annual reports and failed to refer to their separate UK gender pay gap reports. This is surprising, given the growing importance of diversity to investors, policymakers and the public.

## ETHNIC DIVERSITY AND PAY

Reflecting the growing salience of ethnic diversity in public debate, 10% of companies disclosed full disaggregated data on the ethnic diversity of their workforce, representing a small decrease of five percentage points on the first report. Eight of these firms employ workers on an international scale, disaggregating the social and national backgrounds of their staff. For example, Mondi, which has key operations in countries like South Africa, where issues of workforce

<sup>35</sup> Aviva PLC (March 2018), *Annual Report and Accounts 2017*, p. 13.

<sup>36</sup> Women on Boards, KPMG, and Cranfield University (October 2015), *Improving the Gender Balance on British Boards*, p. 2.

<sup>37</sup> FTSE Women Leaders (November 2018), *Hampton-Alexander Review: Improving Gender Balance in FTSE Leadership*.

<sup>38</sup> Sir John Parker (October 2017), *A Report into the Ethnic Diversity of UK Boards*, p. 7.

<sup>39</sup> Berkeley Group Holdings PLC (2018), *Annual Report 2018*, p. 43.

exploitation and economic inequality remain prominent, broke its staff down by nationality and provided a clear and considered discussion of human rights protection.<sup>40</sup>

As well as the government's recent proposals on company reporting of ethnicity pay data, a high-profile report by the Resolution Foundation argued that the ethnicity pay gap was an urgent matter for public policy. The report demonstrated that the average hourly pay gap between white men and Indian women was 14% in 2016/17. For white men and black men, it was 19% and, for white men and Pakistani and Bangladeshi women, it was 26%.<sup>41</sup>

For this year's report, we assessed how many companies disclosed the ethnicity pay gap within their workforce. Just three firms did so. Of this group, only 3i Group provided a meaningful benchmark against national trends:

***'As at 31 March 2017, the representation of UK-based BME employees as a percentage of total 3i employees was ahead of the one in eight proportion of people of BME background in the UK working age population. In addition, the proportion of employees of BME background as at 31 March 2017 in mid to higher salary brackets also exceeded one in eight'.<sup>42</sup>***

### OTHER FORMS OF DIVERSITY

Other than ethnicity, the PLSA *Toolkit* highlights supplementary metrics of employee diversity including age and sexual orientation. Although they also have legal status as protected characteristics, these metrics enjoy much less attention than gender and ethnicity. Just 7% of companies disclosed the age diversity of their workforce. Those which did were often better at disclosing across the full range of diversity metrics. For example, Barclays disclosed that 19% of its apprentices identified as black, Asian, minority ethnicity (BAME), eight percentage points above the national average. The firm also disclosed the profile of its workforce by age and whether employees identified as LGBT or disabled.<sup>43</sup>

However, companies like Barclays are the exception rather than the rule and, over and above gender and ethnicity, diversity remains an area for substantial improvement.

### PAY RATIOS

The Enterprise and Regulatory Reform Act (2013) requires companies to calculate a single figure for their executive directors, meaning all companies report CEO pay relative to other executive directors. However, while this information tends to be presented in remuneration and governance reports, no company provides meaningful discussion about the scale of the difference, its rationale, and its significance. This omission is significant because the ratio of CEO pay with the next highest executive can be understood as an indicator of corporate culture and succession planning. The Chartered Institute of Personnel and Development (CIPD) noted that 'CEOs who have more self-serving tendencies negotiate higher rewards' and that there is 'a need for rewarding more shared leadership, with a more balanced distribution of accountability and reward across the executive team'.<sup>44</sup>

From 1 January 2019, listed firms with more than 250 employees are required to report the pay ratio between their CEO and workers at the 75th, median, and 25th percentile of the company's pay distribution, or those in the top, middle, and lower quartile of the pay scale. A majority of companies noted the changing disclosure requirement in some way but opted to wait until 2019 before reporting their pay ratios. Just 5% of firms – compared with 7% in the first report that disclosed the ratio between their CEO and median worker's pay – were sufficiently forward-looking to already disclose the ratio between CEO pay and each quartile of their organisation.

### EMPLOYMENT TYPES

Few companies chose to disclose meaningful data about the types of employment within their structures, although there has been an increase on the first report. Whereas only 4% of companies provided a breakdown of their full-time and part-time staff in the first report, 11% chose to do so this time. However, there has been little change in the number of firms disclosing the number or proportion of agency staff (6% compared to 7% in the first report).

It remains surprising that so many firms have chosen not to explain their employment types given the salience of insecure and precarious employment, especially widespread claims that zero-hours contracts can be or are exploitative. The lack of disclosure of meaningful information in this area suggests that the Taylor Review recommendation that companies report more about their use of agency and flexible workers remains urgent.

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40 Mondi PLC (2018), *Annual Report 2017*, pp. 16, 36.

41 Resolution Foundation (July 2018), *Opportunity Knocked? Exploring Pay Penalties among the UK's Ethnic Minorities*, p. 4.

42 3i Group PLC (2018), *Annual Report and Accounts 2018*, p. 55.

43 Barclays PLC (2018), *Annual Report 2017*, pp. 89-90.

44 Chartered Institute for Personnel and Development (December 2015), *The Power and Pitfalls of Executive Reward: A Behavioural Perspective*, p. 4.

Research by the Resolution Foundation suggests that there is a strong relationship between the type of employment and low pay and that large companies are more likely to employ low-paid people. Since agency, casual, and temporary workers have less bargaining power than permanent and full-time ones, disclosure of meaningful information about employment types may affect disclosure about pay ratios across the workforce. If a company chooses to disclose information about employment types, it may now be anticipating public concern about the relationship between casual, precarious, and insecure work and pay inequality in the private sector.

## STABILITY OF THE WORKFORCE

Alongside the use of casual, part-time, and agency staff, we also measure how many FTSE 100 firms undertook a meaningful discussion of workforce stability in their annual reports. There has been little noticeable change on this metric: last year, 10% of reports contained such a discussion, the figure for this report is 11%.

Although they remain a minority in the index, where companies discuss workforce stability, they set a very high standard. Firms like Fresnillo chose to discuss turnover as a key risk indicator or key performance indicator.<sup>45</sup> Informa cautioned against:

***‘Increased turnover of colleagues with associated increased costs, loss of knowledge, decreased efficiency, and a demotivated workforce with the associated erosion of corporate value.’***<sup>46</sup>

Others, like SEGRO and Taylor Wimpey, set themselves challenging targets and benchmarked their retention rates against industry or sector averages.<sup>47</sup>

Some companies provided more detailed measures of workforce stability by connecting them with other metrics. BHP broke retention rates down by gender and related the differentials to company restructuring and the growth in flexible working.<sup>48</sup> BT noted that:

***‘...we have converted almost 840 skilled agency workers to permanent employees because we recognise how important it is to keep experience inside our business.’***<sup>49</sup>

## TURNOVER

Turnover rates remain the most common proxy metric for workforce stability in annual reports. Whereas 18% of companies in the first report chose to disclose aggregate employee turnover rates, 31% did so this time. In the first report, only 3% of companies disclosed turnover or retention rates disaggregated among categories of employees. This time, 9% did so. Therefore, disclosure of this metric is increasing (albeit from a low base). Further improvement is needed in providing context: businesses that explain why turnover rates are changing and relate it to wider performance provide much more useful information for investors.

Turnover and retention are significant indicators of morale, workplace culture, knowledge retention, and investment in human capital and internal progression so – despite some improvements – the relative lack of reporting in this area is concerning. Alongside detailed narrative discussions explaining workforce longevity and investment, understanding how companies attract and retain staff is a crucial indicator of their long-term stability and prospects, especially the extent to which they must rely on casual and agency staff. High or low rates of turnover by geographic locations or among particular grades or types of employee may also alert companies to particular weaknesses and strengths. There is, therefore, a strong case for investors to push companies to disclose more meaningful information and discussion on this topic.

## ACCIDENTS AND INJURIES

The treatment of accidents, injuries, and employee welfare varies substantially across the FTSE 100 index, in part because these companies operate in a wide range of sectors. In some industries – often those which are considered ‘high risk’ – disclosures can be extensive and very detailed: these include food producers, mining, aerospace and defence, oil and gas producers, tobacco, construction and materials, chemicals, and gas, water, and multiple utilities. Each of the eight mining companies, both the oil and gas producers, and each of the five companies involved in sectors like gas, water, and multiple utilities disclosed meaningful data.

Employee health and welfare are also significant issues among low-risk industries and some companies in this area provide a range of different metrics relating to accidents and injuries, though often without disclosing data. Among low-risk industries, ITV (media) and Bunzl (support services) provided particularly informative disclosures. In ITV’s

<sup>45</sup> Fresnillo PLC (2018), *Annual Report and Accounts 2017*, p. 46.

<sup>46</sup> Informa PLC (2018), *Annual Report and Financial Statement 2017*, p. 30.

<sup>47</sup> SEGRO PLC (2018), *Annual Report and Accounts 2017*, p. 45; Taylor Wimpey PLC (2018), *Annual Report and Accounts 2017*, p. 40.

<sup>48</sup> BHP Group PLC (2018), *Annual Report 2018*, p. 38.

<sup>49</sup> BT Group PLC (2018), *Annual Report 2018*, p. 43.

case, the disclosure included lost time due to accidents, specified injuries, and incidents in accordance with Reporting of Injuries, Diseases and Dangerous Occurrences Regulations.<sup>50</sup> For Bunzl, relevant metrics included fatalities, incidence and severity rates, and lost days.

However, much like our first report, which found that – overall – 48% of companies disclosed no information relating to accident, emergencies, and welfare, 41% of companies chose not to do so this time round. This could represent a small improvement but could also reflect fluctuations in the FTSE index. It remains the case that a significant proportion of companies, therefore, disclose no information or analysis at all relating to the health & safety and welfare of their staff.

### ON THE SPECIFIC METRICS:

- ▶ 33% of companies disclosed data relating to deaths and dangerous occurrences (34% in the first report).
- ▶ 7% of companies disclosed information about serious injuries and accidents (5% in the first report).
- ▶ 31% of companies reported time lost due to injuries (26% in the first report).
- ▶ 34% provided the total number of injuries (32% in the first report).
- ▶ 8% provided figures on occupational disease rates (6% in the first report).

As noted in the PLSA's *Toolkit*, UK workplaces are required to report accidents and injuries to the Health and Safety Executive, so reporting on these measures is not additionally burdensome to companies with extensive UK operations. Therefore, these figures remain perhaps a little lower than expected.

Within high-risk industries, there remains substantial variation in the extent, detail, and analysis of accidents, injuries, and welfare. Like the first *Hidden Talent*, this report considered the mining, oil and gas, and construction and materials sectors, in which the number of metrics to measure accidents and injuries ranges again from three to 11. The ways in which companies measure accidents and injuries varies from counting time lost and recordable accident rates through to recording occupational diseases, fatalities and lost time injury frequencies.

The most detailed reports provide the widest range of measures and extensive detail in their associated commentaries. They also tend to provide targets and measure their performance systematically against them, breaking down the information according to market, location or division. Best practice reports will also include a discussion of investigations into failures and measures to avoid repetition of such failures in the future.

### MENTAL HEALTH AND WELLBEING

Mental health is not simply an important societal issue, but a significant indicator of corporate and workforce culture. It is instructive to compare the level of detail in disclosures in industries where physical injuries are commonplace with those relating more generally to mental health and wellbeing, themes that are equally as relevant to corporate culture and a risk for productivity. Despite the rising prominence of mental health as a public policy issue, businesses – as well as society as a whole – have historically not treated it as seriously as physical health. However, it is noticeable that for the first time this year two companies – BT and Johnson Matthey – disclosed meaningful data on the mental wellbeing of their workforce compared with none in the first report.

This small increase possibly reflects the general shift in policy and public debates regarding mental health issues. This includes publication of the Stevenson / Farmer Review into employee mental health, which was published in October 2017; it recommended that all UK employers adopt a series of 'mental health core standards' and that the 3,500 private sector companies with more than 500 employees deliver enhanced mental health standards to at least 46% of employees. These enhanced standards include increasing transparency and accountability in reporting, demonstrating accountability, improving disclosures, and ensuring provision of tailored in-house mental health support and signposting to clinical help.<sup>51</sup>

This is clearly a sensitive topic. As it has grown in prominence in society, aspects of mental welfare that would not have been discussed in the public sphere are now being given attention. Since companies have rarely, if ever, disclosed mental health rates in the past, it could be argued that to do so now may present a reputational risk and this may in part explain the extremely low levels of disclosure.

<sup>50</sup> Also known as RIDDOR, this is the 2013 law that requires employers, and others in charge of work premises, to report and keep records of work-related accidents which cause deaths of certain serious injuries (reportable injuries), cases of certain industrial diseases and certain incidents with the potential to cause harm.

<sup>51</sup> Department for Work and Pensions and Department of Health and Social Care (October 2017), *Thriving at Work: The Stevenson / Farmer Review of Mental Health and Employers*, pp. 8-9.

The Taylor Review also emphasised the relationship between the quality of work and stress and mental health problems.<sup>52</sup> Furthermore, in emphasising the responsibility of boards to stakeholders rather than shareholders alone, the new Corporate Governance Code implies that companies should deliver good outcomes for their workers, which arguably includes good mental health through quality work.

BT provides a good example for other companies in discussing mental health and support. Endorsing the Stevenson / Farmer Review, the company noted that:

***‘work-related problems account for 16% of people seeking psychological support, compared with 36% five years ago’ and that ‘our success rate in getting people with mental illness back to their normal work has risen to 97%’.***<sup>53</sup>

Other businesses such as Lloyds, while not disclosing data about mental health occurrence rates, discussed mental health in a positive manner, describing preventative measures to promote wellbeing and to support those employees who may be experiencing mental health problems at a general level. Lloyds introduced a section entitled ‘Supporting colleagues’ mental health’, describing work with Mental Health UK to deliver awareness training to 28,000 employees and providing an estimate that at least 25% of employees discussed mental health during the reporting year. It also provided mental health resilience training to its top 120 leaders.<sup>54</sup>

### SKILLS AND CAPABILITIES OF THE WORKFORCE

Under half (46%) of the companies surveyed included meaningful narrative discussion about the skills and capabilities of their workforce in their annual reports. In the first report, the figure was slightly higher at 52%.

Weaker disclosures simply stated the importance of developing workforce capacity and skills without either quantifying workforce training or explaining how or why. Some of the strongest disclosures made a commitment to workforce development in principle. Severn Trent reported:

***‘Of course, investing in training is good for our business, because it helps us be more technically competent. But it’s also good for our colleagues, because it gives them a platform for growth, promotion and more rewarding careers – and it’s good for local communities and industry too, because it improves the skills base across the Midlands.’***<sup>55</sup>

While other strong examples quantified their commitments. Lloyds – a company with nearly 70,000 employees – stated:

***‘We are making our biggest ever investment in people, increasing colleague training and development by 50 per cent to 4.4 million hours per annum and embracing new technology to drive better customer outcomes.’***<sup>56</sup>

Rolls-Royce noted:

***‘During 2017, we invested £31.2m in employee training and development, delivering over a million hours of employee training in subjects ranging from HSE, quality, product safety, export control and ethics.’***<sup>57</sup>

Often, companies might list failing to develop the capacities of their workforce or to build the skills of their workforce as a key risk.

However, not all companies that provided meaningful discussion about the importance of workforce capability and skills provided quantitative data to back up their discussion. Companies that failed to provide such discussion might disclose a small amount of data without the vital narrative discussion around them.

### INVESTMENT IN TRAINING AND DEVELOPMENT

Roughly a quarter (24%) of FTSE 100 companies provided concrete data on their training programmes compared with the first report’s figure of 23%. Concrete data includes the number of employees trained in the reporting year or the budget for training and development. However, the universe of possible metrics is large and there is a great deal of variation both within and across industries and sectors. This heterogeneity makes comparisons between companies difficult.

<sup>52</sup> Department for Business, Energy & Industrial Strategy (July 2017), *Good Work: The Taylor Review of Modern Working Practices*, p. 14.

<sup>53</sup> BT Group PLC (2018), *Annual Report 2018*, p. 46.

<sup>54</sup> Lloyds Banking Group PLC (2018), *Annual Report and Accounts 2017*, p. 22.

<sup>55</sup> Severn Trent PLC (2018), *Annual Report and Accounts 2018*, p. 20.

<sup>56</sup> Lloyds Banking Group PLC (2018), *Annual Report and Accounts 2017*, p. 5.

<sup>57</sup> Rolls-Royce Holdings PLC (2018), *Annual Report 2017*, p. 47.

As we found in our first report, the better examples provided case studies and explained how firms' training programmes were structured to meet their long-term skills needs. Weaker examples contained broad statements regarding the value of a well-trained workforce and the importance of skills and training without explaining directly how it reinforces their business strategy or adds value to the organisation.

In the first report as well as this year, only one company disclosed material details of training arrangements for young workers, graduates or apprentices. The first report found that no company disclosed material details of training programmes for managerial-level staff. Our current research found that one company did so, including discussions of succession planning arrangements.

Whereas in the first report, 9% of companies provided details of internal hire rates, 7% of companies did so this time. This indicator matters because it provides clues regarding how well a company is developing its staff and the opportunities for progression – both aspects of corporate culture that encourage higher levels of engagement and commitment.

It is surprising that the figures remain relatively low, as it is not simply that FTSE 100 companies tend to be large employers, but it is also that they are likely to invest significant resources in training and skills.

It is possible that commercial sensitivity is one reason for the failure to disclose in this area; retention and development of staff is a competitive advantage and the means by which companies foster such competitive advantage are precious. It may also be that it is difficult to generate accurate data because separating training time and expenses from other staff costs like induction procedures and management oversight is a challenging task.

### EMPLOYEE ENGAGEMENT AND VOICE

The new 2018 Corporate Governance Code places greater emphasis on stakeholder, especially workforce, engagement than its previous iteration.<sup>58</sup> The Code states that the board should understand the views of key stakeholders over and above shareholders, describing 'in the annual report how their interests... have been considered in board discussions and decision-making'. Similarly, boards must continually review engagement mechanisms and at least one of the following methods must be used to engage the workforce:

1. A director appointed from the workforce
2. A formal workforce advisory panel
3. A designated non-executive director.

In the event of failure to institute at least one of these methods, boards must explain their alternative arrangements and why they consider them to be effective.

Finally, boards are required to provide the means for workers to raise concern in confidence or anonymously as well as for proportionate and independent investigation with follow-up action.

Despite greater emphasis on employee engagement and a clear recognition of the workforce as a source of value in the new Corporate Governance Code, there was no essential change, this time, in the proportion of companies (33% compared with 34% last year) providing a meaningful narrative discussion of procedures for employee engagement in their annual reports. This remains a relatively low proportion given the importance of morale, consultation, and employee commitment to corporate goals for the success of a business.

On employee satisfaction, 42% of companies provided concrete data on their employee satisfaction score last year, compared to 35% of companies which chose to do so this time. Moreover, this usually took the form of a survey response without any meaningful explanatory narrative.

A third (37%) of companies provided indicators to measure the motivation and commitment of the workforce towards corporate goals, including employee awards and schemes to foster teamwork and build corporate culture, which is an increase compared to first report when 30% of companies reported on this.

### OTHER FORMS OF FOSTERING ENGAGEMENT

Other disclosures provided indications of how firms seek to align their staff with long-term corporate success. Around a fifth (18%) of firms disclosed the levels of employee share ownership – an improvement on the first report's figure of 5%. Share-based payments like long-term investment plans are a substantial part of executive remuneration in FTSE 100 companies, relying on the assumption that business leaders with significant shareholdings are more likely to take

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<sup>58</sup> Financial Reporting Council (July 2018), *The New UK Corporate Governance Code*, p. 4.

decisions in the long-term interest of the company because that will maximise the value of their shares. A growing number of companies appear to be applying the same logic to the wider workforce, at least by ensuring they disclose the rate of share ownership in the workforce.

In general, reporting on employee engagement, well-being, and satisfaction remains highly varied in terms of both quality and quantity of disclosed data and the supporting discussion. The best disclosures reported on mechanisms to foster engagement and commitment, and a discussion of the role and responsibilities of the board and management to foster workplace engagement in order to drive long-term strategy and purpose.

Barratt provided a good example of best practice by integrating workforce engagement and its various measures across the report. It provided engagement targets and measured performance against them, benchmarked its scores with the industry, listed worker engagement as a key performance indicator, connected workforce engagement with broader environmental and social governance objectives such as water resource and efficiency, counted engagement as a principal risk, explained the methodology of its engagement survey, established a new employee forum, showed how feedback affects business culture, and explained its employee share scheme.<sup>59</sup>

### VERIFYING ENGAGEMENT

There is a risk that companies gloss over workforce issues in annual reports. It is, therefore, important that companies disclose verifying data in their narratives about workforce issues. But only a minority of companies do so.

An engaged workforce is more likely to be a stable and committed one. Barratt noted the importance of good workforce satisfaction to minimise regretted turnover in its discussion on engagement:

***‘During the year, employee turnover decreased by 1% to 17% (2017: 18%). There continues to be a significant demand and multitude of opportunities for skilled employees elsewhere in the industry. It is therefore even more important to continue to focus upon developing talent within our business, including succession planning, to ensure that we have the necessary skills within our business for continued operational delivery, as well as focusing on remuneration and benefits to ensure retention measures are in place and are effective.’<sup>60</sup>***

This suggests that staff turnover figures might also help provide an insight into engagement levels and to verify the engagement score. The same principle applies to sickness absence rates and retention rates after parental leave. Likewise, pay, benefits, and entitlements are likely to affect how businesses attract and retain workers. However, just 5% of companies provided information about sickness absence rates and 2% disclosed data about post-parental leave retention rates. Much like the first report, the use of any of these measures to underpin discussion of employee engagement with clear data and evidence was rare.

### EMPLOYEE VOICE

Ensuring employees can contribute to strategic decision-making is an effective way to safeguard against risk as well as driving ideas, innovation, and productivity.

Measuring employee engagement is a more subjective matter than the composition, stability or skills and capabilities of a workforce. Even when companies undertake rigorous, independent surveys of employees’ views, it is helpful for investors to know the methodology of these surveys as well as the concrete mechanisms in place for engaging the workforce, communicating workers’ insight to the company leadership, and resolving problems.

This time, 53% of companies referred to their procedures for workforce engagement – down on the first report’s figure of 64%. Information was mostly available either in directors’ reports or a dedicated subsection and most of the disclosers use some form of employee survey, ‘town hall’ meetings, and staff intranets for two-way communication.

Just 8% of companies discussed their trade union coverage compared with 9% in the first report. Businesses can communicate with trade union representatives to find out valuable information about their working practices that may not otherwise be available in conventional employee engagement structures.

<sup>59</sup> Barratt Developments PLC (2018), *Annual Report and Accounts 2018*, pp. 37, 11, 35, 52, 71, 117.

<sup>60</sup> Barratt Developments PLC, *Annual Report and Accounts 2018 (2018)*, p. 38.

# CONCLUSION

The analysis in this report shows that there remain substantial variations in the quality of reporting of workforce-related issues. Most companies still do not use their annual reports – a vital tool for investor communication – to comprehensively detail the composition, stability, skills and capabilities, and engagement levels of their workforce in a way that explains how these relate to the company’s performance, strategy, and purpose. To avoid the risk that companies gloss over material workforce issues in annual reports, it is important that companies disclose meaningful data and an accompanying narrative – yet only a minority of companies do so.

While each company has its own unique features, these four themes are important for investors regardless of industry, sector or employment model. It is too simplistic to say that companies that score highly in relation to the themes and metrics in this report will perform better, but these themes and metrics are certainly among the factors that contribute to strong performance as better disclosures to investors are an indicator of a company’s commitment to a stable, engaged and skilled workforce.

Other than those categories where legislation mandates very specific disclosures such as executive pay data or gender diversity, there are many useful and widely applicable measures of how a company has managed its workforce that rarely appear in annual reports. We would expect a company which takes a forward-looking and proactive approach to its strategy and business model to pay attention to broader developments in policy and investor sentiment.

In some areas, especially workforce stability, levels of reporting are still low despite public interest in precarious employment and low pay as well as the importance of information in this area for investors. Likewise, the overwhelming majority of companies provide only positive information, which could be considered to fail to adhere to the requirement that annual reports be fair, balanced, and understandable.

The nature and volume of reporting is changing as the weight of the UK Corporate Governance Code is shifting from shareholders to stakeholders. That is, the law recognises more clearly that company directors’ responsibilities are not simply to their shareholders, but also to stakeholders, including workers. We are hopeful that this may mean the quality of reporting in future improves with the better disclosers – who chose to provide meaningful information about their workforce in this evolving context rather than simply note that the Corporate Governance Code is changing their obligations – being joined by a broader range of companies.

Although inconsistent, there are several examples of good practice from a range of different companies in reporting workforce-related issues to investors. The majority of companies in the FTSE 100 index provided some meaningful information on at least two of the four themes, showing a recognition of our claim that information about employment models and working practices is important for investors. However, there remains significant space for investors and policymakers to work together and push for better information on workforce issues.

# APPENDIX

The PLSA's *Understanding the Worth of the Workforce: A Stewardship Toolkit for Pension Funds* (2016) provides the basis for scoring annual report disclosures according to the amount and quality of workforce-related information. The manual scoring approach involves the research team comparing the content of each annual report against an agreed scoring template that includes three broad categories: the four workforce themes highlighted in the *PLSA Toolkit*, the seven workforce metrics and associated measures relating to those themes, and the overall quality of narrative reporting on workforce matters.

## THEMES AND METRICS – OBJECTIVE ASSESSMENTS

The four fundamental workforce-related themes are coded on a binary (yes/no) basis depending on whether material commentary on a given theme is present in the report. For example, a report scores one point if it contains any meaningful commentary on the type of workforce on which the entity's business model is based, whereas reports that make no direct reference to workforce composition are allocated zero for the composition theme. The same approach is applied to the remaining three themes.

Since the scoring procedure relies solely on determining whether or not disclosures on a particular theme are present in the report, the requirement for researcher judgement is limited and so the resulting scores are objective and easily replicated. An audit trail is also created by recording page number(s) for the relevant disclosure(s) together with brief notes summarising the nature of the information provided and any notable features (good or bad) associated with the disclosure.

The same binary approach is applied to the workforce metrics category. Each metric is first decomposed into its component measures and then each measure is scored according to whether relevant quantitative data is provided. For example, in the case of gender diversity (part of the composition theme), an annual report scores one point if it contains gender statistics for the total workforce and zero if no information on gender composition for the total workforce is reported. Similarly, a company scores one point where gender statistics for the board of directors (management-level employees) is provided and zero otherwise. The process is repeated for all measures associated with the remaining six *PLSA Toolkit* metrics. As before, the scoring procedure requires little or no researcher judgement because it relies solely on determining whether or not details of a given measure are disclosed in the report. To ensure scores are verifiable, page number(s) associated with the relevant disclosure(s) are recoded along with notes detailing the information provided.

## GOOD REPORTING PRINCIPLES – SUBJECTIVE ANALYSIS

The third category of workforce-related disclosures relates to the overall quality of reporting. Quality is assessed along the following nine dimensions:

**Acknowledging the link to strategy, business model and risk management.** High-quality reporting on workforce themes and metrics should demonstrate a clear association with the entity's business model and its approach to creating and maintaining value in the long term. This approach contrasts with a boilerplate style of disclosure that eschews company-specific features and considerations. Reports are awarded one point where the discussion clearly links workforce issues to strategic objectives and business model, and zero otherwise.

The *PLSA Toolkit* also highlights the importance of addressing workforce-related issues explicitly when discussing *future risks and opportunities* facing the business and how to deal with them. Reports are therefore awarded one point where the commentary includes an analysis of workforce-related risks and opportunities facing the company, including the strategies for mitigating the risks and seizing the opportunities, and zero otherwise.

**Forward-looking commentary.** The *PLSA Toolkit* emphasises that workforce reporting should include a forward-looking element that highlights anticipated risks and opportunities together with plans for future improvements. Reports containing forward-looking commentary on at least one workforce theme or metric scores one point otherwise they score zero.

**Assessment of performance against a clear target.** Informative reporting on workforce themes and metrics involves identifying clear performance targets and discussing performance measured against those targets. Disclosures that provide a meaningful evaluation of performance during the reporting period on at least one workforce theme or metric score one point otherwise they score zero.

**Balanced reporting.** Provision of balanced, self-critical analysis is central to establishing credibility: anything less risks workforce reporting being viewed by annual report users as, at best, uninformative and, at worst, as potentially opportunistic. Reports that highlight one or more aspects of workforce themes or metrics where improvement is required are considered more balanced and are awarded one point, otherwise they score zero.

**Prominence.** Whether or not workforce-related information is disclosed in the annual report is only part of the disclosure story: where the information is present in relation to the main commentary on strategy, business mode, and value creation provides a signal about the perceived importance of workforce issues in the company's list of priorities. Reports where the narrative makes direct reference to the importance of workforce engagement when describing business model and strategy, including, for example, highlighting workforce explicitly as a resource, therefore score one point otherwise they score zero.

**Additional disaggregation.** Although the PLSA *Toolkit* is not prescriptive about the way metrics should be reported, it nevertheless highlights the benefits of supplementing headline company-wide data with disaggregated information by product market, business segment, organisational hierarchy, and so on. Reports are allocated one point if they contain disaggregated analysis for at least one workforce theme and metric otherwise they score zero.

**Integration of workforce themes throughout the annual report.** Workforce contribution and value is a topic that pervades all aspects of business activities. The universal nature of employee-related issues suggests an integrated approach to reporting whereby workforce themes and metrics are discussed at appropriate locations throughout the annual report narrative including commentary on strategy, operating and financial performance, governance and risk management, compensation, and so on. In contrast, a silo approach to workforce reporting implies a disconnected, compliance-driven perspective on the subject. We gauge integration using three measures. The first measure captures the presence of explicit cross-referencing to workforce-related issues in the annual report (as evidenced by direct references to specific page numbers and sections). We create an indicator variable equal to one for reports that contain systematic cross-referencing on workforce-related matters and zero otherwise.

The second measure distinguishes presentation of material workforce commentary throughout key sections of the annual report narrative (integrated approach) from presentation in single standalone sections (silo approach). We create a binary variable equal to one where reporting is diffuse through the annual report and zero where reporting is concentrated.

The third measure captures presentation of a large number of employee-related commentary within the annual report versus the outside document such as a separate corporate social responsibility report or a document on the company's website. All else being equal, discussion of substantive employee-related matters within the annual report is more consistent with an integrated reporting approach. We create a binary variable that takes the value of one where limited or no cross-references are made to externally-provided workforce disclosures, and zero otherwise.

**Communication channels and dialogue.** Procedures for encouraging two-way information flows and dialogue between management and the remainder of the workforce are viewed as a critical aspect of high-quality engagement. Effective reporting on this dimension requires detailed information on the types of communication channels and how they are managed. This reporting approach differs from one that merely highlights the importance of employee engagement for business success without providing granular information on communication methods. Reports that provide detailed information on one or more specific dialogue mechanisms therefore score one point otherwise they score zero.

**Overall clarity of presentation.** Clarity is an acknowledged feature of high-quality narrative reporting. A three-level categorical variable is used to classify the clarity of workforce disclosures as either high, medium or low. Reports are assigned to a clarity category based on the researcher's assessment of (i) whether information is easy to find and (ii) whether disclosures present a clear picture of workforce features and their importance to the company.





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