
Human Capital - Preliminary assessment of evidence of effects on an entity's prospects

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Discussion agenda

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 - Approach to literature review
- Preliminary findings
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 - Key sector risks and opportunities
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Research objectives and approach



Research objectives

The overarching research question that this presentation aims to address is:

Whether, how and to what extent do human capital-related risks and opportunities affect an entity's cash flows, its access to finance or cost of capital over the short, medium or long term?

The findings outlined in this paper are preliminary in scope and intended to update the ISSB on progress on the research. They build on extensive market outreach and preliminary desk research, the scope of which will be expanded upon when the staff brings final findings to the ISSB in a future session.

The ISSB is not asked to make any decisions in this session.

Note: The term '**an entity's prospects**' will be used throughout the paper to refer to *cash flows, access to finance or cost of capital over the short, medium or long term*.

As outlined in [Agenda Paper 2B Biodiversity, ecosystems and ecosystem services and human capital research projects — Research design and approach](#) (July 2024), this research area focuses on evidence of effects on an entity's prospects.

Key activities* for this area of research will include:

- (a) a review of existing research on how human capital-related risks and opportunities could affect an entity's prospects, to improve understanding of human capital-related subtopics and industry-specificity affecting such prospects;
- (b) engagement with investors and preparers in order to identify examples of effects on an entity's prospects that have materialised or are being considered in decision-making;
- (c) exploring the use of artificial intelligence (AI) tools to analyse discussion of effects on an entity's prospects from human capital-related risks and opportunities in entities' public reporting; and
- (d) analysis of previous research that the ISSB or its predecessor organisations conducted to build evidence of effects on an entity's prospects

* This paper does not cover activities (c) and (d)

Approach to market outreach

Bilateral engagements

- Outreach conducted in conjunction with the investor interest research staff, with targeted questions on effects on entity prospects*
- Met with individuals from 31 entities up until 11 October 2024 including: institutional investors, data providers, other RFI respondents to the 2023 Request for Information [Consultation on Agenda Priorities](#) and a few preparers

Roundtables

- Held five investor focused roundtables and a preparer roundtable

Next steps

- Targeted outreach to investors from Latin America, the Caribbean, Middle East, and African countries for more regional diversity
- Engage more sell-side analysts given valuable insights gleaned

Sample questions for market outreach:

- What correlations have you observed between human capital-related topics (such as, labour relations, diversity, or supply chain working conditions) and an entity's financial performance? Have they involved specific industries, geographies or specific aspects of financial performance?
- What are the key drivers or sources of financial implications from human capital-related risks and opportunities, such as regulations, shifting consumer demand, litigation, input prices/volatility, physical disruptions?
- What is your approach to assessing the financial implications from these sources for investees or potential investees over the short, medium or long term?

* For more details on bilateral engagements and roundtables (excluding preparer and academic roundtables), see Agenda Paper 4A *Preliminary assessment of evidence of investor interest* (December 2024).

Approach to literature review

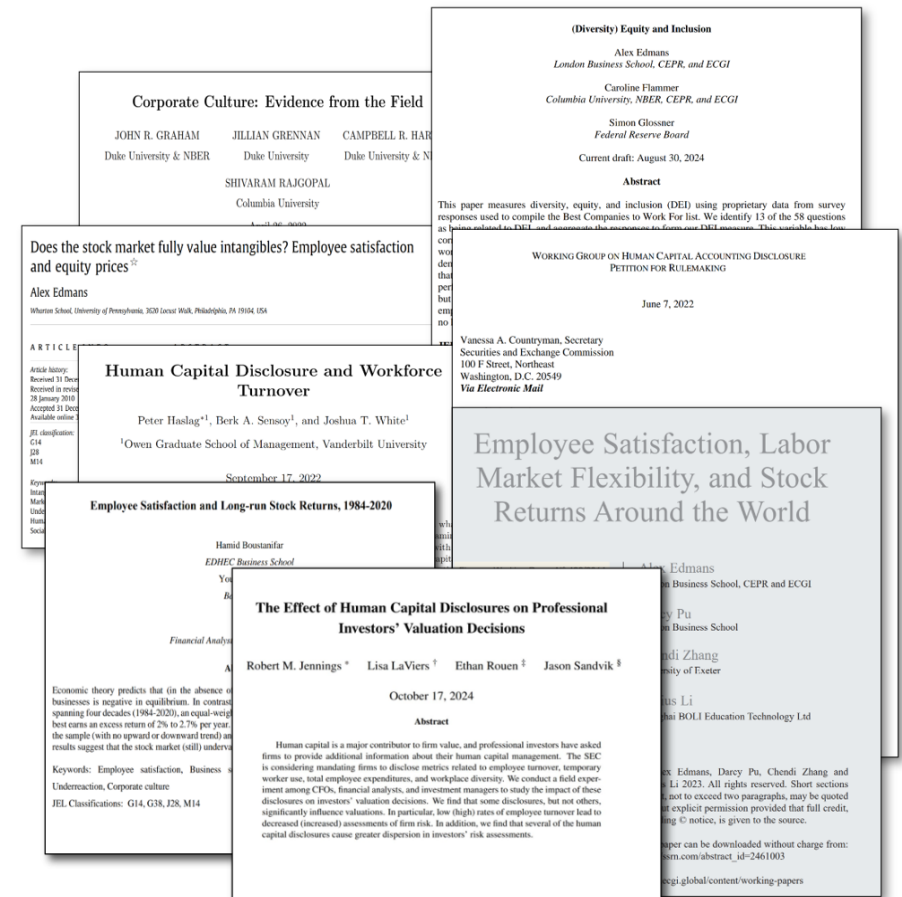
The staff collated and commenced analysis of research publications addressing the implications of human capital-related risks and opportunities, seeking evidence of whether and how they are likely to affect an entity's prospects

A variety of tools were used to identify relevant literature, including desk research on reputable publications, investor and third-party recommendations and ISSB member recommendations*

Such publications include:

- Academic papers
- Reports from institutional investors and sell-side research
- Publications by ratings and data providers

Examples of literature reviewed



The collage features several overlapping document covers and abstracts:

- Corporate Culture: Evidence from the Field** by JOHN R. GRAHAM, JILLIAN GRENNAN, CAMPBELL R. HARRIS, and SHIVARAM RAJGOPAL.
- (Diversity) Equity and Inclusion** by Alex Edmans, Caroline Flammer, and Simon Glossner.
- Does the stock market fully value intangibles? Employee satisfaction and equity prices** by Alex Edmans.
- WORKING GROUP ON HUMAN CAPITAL ACCOUNTING DISCLOSURE PETITION FOR RULEMAKING** dated June 7, 2022.
- Human Capital Disclosure and Workforce Turnover** by Peter Haslag, Berk A. Sensoy, and Joshua T. White.
- Employee Satisfaction, Labor Market Flexibility, and Stock Returns Around the World** by Alex Edmans, Darcy Pa, Chendi Zhang, and Li Li.
- Employee Satisfaction and Long-run Stock Returns, 1984-2020** by Hamid Bostanfar.
- The Effect of Human Capital Disclosures on Professional Investors' Valuation Decisions** by Robert M. Jennings, Lisa LaViers, Ethan Rouen, and Jason Sandvik.

* This literature was assessed based on a combination of factors such as sample size, study design, credibility of report author(s) and recency of the report

Preliminary findings



Effects on an entity's prospects

Type of risk	Event	Potential effects on an entity's prospects
Regulatory risk	Non-compliance with mandatory due diligence requirements (e.g., modern slavery)	Fines/penalties, compliance costs, share price decline, barriers to market entry, access to finance, customer loss
Legal risk	Health and safety violations	Legal costs, settlements/penalties, costs linked to absenteeism
Operational risk	Prolonged strike action	Forgone sales due to reduced production, increased costs from renegotiated contract terms, share price decline, customer loss, access to finance, cost of capital
Operational risk	High voluntary turnover	Costs linked to severance, recruitment, temporary work, onboarding and training
Reputation risk	High profile allegations of employee harassment/exploitation	Decreased sales for failure to meet consumer expectations, share price decline

Note that risk and opportunities are illustrative versus exhaustive, often triggering ripple effects

Opportunities	Potential effects on an entity's prospects
<ul style="list-style-type: none"> - Employee training and development - Internal mobility and advancement 	Enhanced engagement, retention and recruitment linked to high productivity, innovation and customer service, driving outperformance
<ul style="list-style-type: none"> - Employee wellness (physical & mental) - Diversity & inclusion 	Employee retention, high morale and innovation can drive outperformance and lower downside risk
<ul style="list-style-type: none"> - Fair working conditions (direct workforce and supply chain) 	Enhanced satisfaction, productivity, retention, supplier and customer loyalty and social license to operate, linked to profitability and lower downside risk
Investment in strong workplace culture and employee satisfaction	Return on investment linked to market value, earnings resilience, lower volatility and outperformance over extended time horizons

Source: Staff preliminary analysis from literature review and stakeholder outreach.

Key topics with effects on entity prospects

Strongest evidence of effects on entity prospects covering most industries:

Turnover/retention:

- evidence of positive correlation between low voluntary turnover and long-term financial performance
- high attrition presents operational costs such as recruitment and training and hidden costs linked to morale and productivity
- notion of a healthy level of attrition versus zero turnover¹

Employee satisfaction:

- consensus that strong workplace culture and employee satisfaction lead to higher intrinsic motivation, retention and productivity with positive effects on an entity's prospects
- view that *"culture is the biggest off balance sheet asset of the company"*²

Diversity and inclusion:

- mixed signals on correlation between demographic diversity and effects on entity prospects, whereas cognitive diversity and inclusion are viewed as long-term value drivers³

Evidence of variable effects on entity prospects depending on sector:

Employee health, safety and wellbeing:

- health and safety violations come with hard costs (e.g., settlements and lost-time), alongside morale
- mental health and burnout can also drive operational costs through attrition and absenteeism, while impacting productivity and morale

Working conditions and exploitation:

- direct workforce: including labour and wage disputes, strikes and freedom of association (via settlements, production disruptions and reputational risks)
- suppliers and subcontractors: including child and forced labour, amidst tightening regulation on due diligence (via penalties and reputational risks)

Key sector risks and opportunities

- Human capital is considered significant for **all sectors and regions**, yet shaped by evolving market trends and industry nuance
- Industries relying on **highly skilled labour** (e.g., engineering, software and services) have greater exposure to specific workforce-related risks and opportunities, such as turnover and high labour costs, to ensure market competitiveness⁴
- **Labour intensive sectors** (e.g., autos, airlines and transportation), including those utilising subcontractors, are more exposed to strikes and wage negotiations via direct workers and contractors, with effects on entity prospects⁵
- Sectors undergoing **structural transformation**, such as oil and gas industry's **just transition**, require specialised reskilling, driving the need for retention as return on investment and to ensure market competitiveness⁶
- **Heavy industries** (e.g., extractives and industrials) face heavy exposure to health and safety risks, whereas **professional and financial services** (e.g., investment banking) have come under scrutiny for mental health and burnout, with effects on entity prospects
- **Consumer facing sectors** are more exposed to reputational risks and opportunities from issues such as child and forced labour, strikes and labour disputes, impacting purchasing decisions, which can drive customer attrition or attraction
- Regional considerations include degree of flexibility versus rigidity of **labour markets**, stringency of labour laws, the recognised value of **intangible assets**, and **workforce skills and demographics** (e.g., age, diversity)

Case studies



Case Study 1: High costs of labour strikes

- A large publicly listed manufacturing company reached a deal with a trade union to **increase pay by 38%**, amongst other benefits, **after a 7-week strike**⁷
- Reasons for the strike included worker compensation, employee benefits and demands for improved worker health and safety
- The company reported more than **US\$6 billion loss** over the course of the strike, while causing immense financial strain for suppliers⁸
- Prior to the strike, the company had already **faced a 40% decline in share price, with market value reducing by US\$58 billion**,⁹ due in large part to its 'broken safety culture'¹⁰
- The company also faced a potential downgrade by credit rating agencies alleviated by a capital raise through stock issuance¹¹

Analysis

According to the US Department of Labor, support for unions is on the rise, with membership increasing by 500,000 in the last 2 years in the US. Public support for unions has also dramatically increased from 48% in 2009 to 71% in 2022, driven in part by social media, posing reputational risks for companies linked to strikes and anti-union efforts.

Strikes and negotiations over collective bargaining agreements can trigger ripple effects on an entity's prospects, also impacting suppliers. Such effects include:

- *Foregone sales from halt in operations,*
- *Increased costs from renegotiated terms*
- *Reputational damage that can affect share price, recruitment and retention, consumer boycotts*
- *Increased operating losses can impact access to finance and cost of capital*

This case study highlights the importance of providing competitive salaries and benefits for long-term value creation, especially for industries relying on specialised skills in tightening labour markets.¹² It also highlights the potential link between labour strife and product quality which can manifest when companies prioritise short-term cost-cutting measures at the expense of working conditions and product safety.¹³

Case study 2: Employee satisfaction as value driver

- A multinational consumer goods retailer has differentiated itself from its peers by its longstanding commitment to human capital management, linked to its profitability
- Its employee satisfaction strategy is focussed on competitive pay and benefits, a commitment to promoting from within, and increasing the ratio of full-time employees
- The company attributes the success of this strategy to its 2023 **employee retention rate of 90%**,¹⁴ compared to a 60% retail industry average¹⁵
- The **stock price has steadily increased** since its inception in the 1980s and over the past 3 years, the **cashflow growth rate is between 10-12%** year-over-year^{16, 17}

Analysis

There is widespread consensus on the important role of employee satisfaction as a corporate value driver. Leading academics identify employee satisfaction as a factor that "reliably outperforms in flexible labour markets and industries that rely on skilled labour".¹⁸

While challenging to measure, outside of employee satisfaction surveys (rarely disclosed), many investors have turned to alternative rankings and indices to identify market leaders.

Key drivers of employee satisfaction are both extrinsic (compensation and benefits) and intrinsic, including training and development, internal mobility, diversity and inclusion, engagement and autonomy, to name a few key attributes.

According to a 2023 study, companies that develop human capital and manage it effectively experience "greater earnings resilience and a superior ability to attract and retain talent, key advantages as businesses face economic headwinds and a war for talent".¹⁹

Case study 3: Low wages prompt market value losses and investor action

- In 2020 a large UK-based fast fashion retailer's **share price dropped by 40%, generating market value losses of £1.5 billion**,²⁰ based on allegations of modern-day slavery in its local supply chain, including wages well below the national living wage and breaches of health and safety protocol during COVID
- The company was temporarily dropped by several online retailers and faced widespread backlash on social media
- In response to the allegations, the company committed to **investing £10 million to "eradicate supply chain malpractice"**²¹
- The company is currently facing a **lawsuit by 49 institutional investors** that suffered losses from the fall in share price due to exposure of labour rights violations at supplier factories, alleging breaches of disclosure obligations under the *Financial Services and Markets Act 2000*, citing failure to disclose material information²²

Analysis

Fast fashion companies rely on the flexibility of suppliers for the production and quick turnaround of high-volume goods. Low wages, overtime hours and poor working conditions are prevalent in this high-pressure context, exposing companies to violations of workforce-related laws including fines and penalties.

The UK was one of the first countries to introduce a Modern Slavery Act in 2015, including a legal requirement on transparency in supply chains. Since then, many jurisdictions have followed suit, alongside a growing number of mandatory due diligence regulations requiring companies to report on their supply chains. The EU Corporate Supply Chain Due Diligence Directive (CSDDD) includes fines of up to 5% of an entity's net worldwide turnover.

High profile supply-chain incidents can also cause considerable reputational damage that may affect an entity's prospects in terms of access to finance (e.g., debt issuance, IPO) or market valuation, alongside consumer backlash.

Case study 4: Culture of harassment

- A U.S.-based consumer products company reached a **US\$54 million** settlement with a State Civil Rights Department to resolve allegations relating to a culture of sexual harassment over a five-year period²³
- The majority of this settlement will support a workers' compensation fund for employees that were sexually harassed, paid less than their male counterparts and denied promotions
- This State settlement followed a 2022 **US\$18 million settlement** with the U.S. Equal Employment Opportunity Commission (EEOC) to resolve a lawsuit alleging violations of federal law "by subjecting female employees to sexual harassment, pregnancy discrimination, and related retaliation"²⁴
- The company's subsequent acquisition by a leading technology conglomerate in 2023 included firm requirements to improve its workplace culture²⁵

Analysis

Sexual harassment in the workplace constitutes an ongoing problem affecting women and LGBTQ, particularly among racial minorities. It is more common in male-dominated STEM sectors such as technology. Approximately 44% of harassment complaints filed with the EEOC included claims of employer retaliation, suggesting that harassment is more prevalent than reported.²⁶

Direct effects of sexual harassment in the workplace on employees include mental health challenges and low job satisfaction, which can trigger absenteeism, turnover and decreased productivity. A culture of sexual harassment can impact morale across the broader workplace.

Companies that promote an inclusive work environment and gender pay equity tend to experience higher employee satisfaction and retention, often outperforming their peers. Conversely, companies with poor track records on diversity and inclusion or cases of sexual harassment are exposed to risks relating to recruitment and retention, turnover, litigation, penalties and consumer backlash, jeopardising their social license to operate.

Takeaways and next steps



Key takeaways

- Human capital is a valuable resource that investors seek to capture in their valuation of companies despite its absence in statements of financial position
 - Numerous studies have demonstrated positive correlations between employee satisfaction, retention and development, and (cognitive) diversity and inclusion, to earnings resilience and firm value; whereas poor human capital practices can drive considerable direct and indirect costs or otherwise be value depletive
 - Companies implicated in exploitative working conditions in their direct workforce, supply chain or via subcontractors face a range of potential effects on entity prospects including operational costs, penalties and litigation, barriers to accessing markets or capital, alongside reputational damage
 - Human capital is relevant to an entity's prospects in all sectors though there is industry variation for particular topics; it is also shaped by regional workforce trends and demographics
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Next steps

- Continue literature review to delve deeper into topics and real-world examples which advance our understanding of effects on entity prospects
- Continue strategic market outreach targeting key regions and stakeholders
- Analyse previous research that the ISSB or its predecessor organisations conducted to build evidence of effects on an entity's prospects
- Collaborate with staff working on SASB enhancements to share resources and research on human capital-related risks and opportunities affecting SASB Standards prioritised for enhancements

Question for the ISSB



Does the ISSB have any comments or questions on the matters covered in the paper, or general guidance for the staff on areas of focus for specific human capital-related subtopics or types of risks and opportunities that is important to frame our research?

Appendix - References



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