AN INVESTOR GUIDE TO ENGAGING RETAILERS ON EMPLOYEE RELATIONS

An investor initiative in partnership with UNEP Finance Initiative and UN Global Compact

THE SIX PRINCIPLES

1 **We will incorporate ESG issues into investment analysis and decision-making processes.**

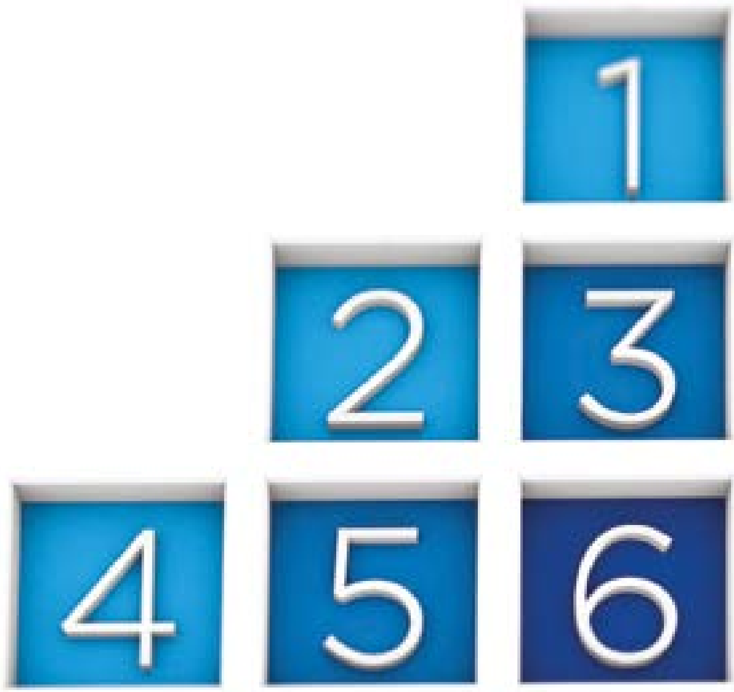
2 **We will be active owners and incorporate ESG issues into our ownership policies and practices.**

3 **We will seek appropriate disclosure on ESG issues by the entities in which we invest.**

4 **We will promote acceptance and implementation of the Principles within the investment industry.**

5 **We will work together to enhance our effectiveness in implementing the Principles.**

6 **We will each report on our activities and progress towards implementing the Principles.**



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CONTENTS

Employee relations[1] refers to how a company manages the skills, engagement and retention of its employees.

Employee relations are particularly relevant in the retail sector given the large number of employees, many of whom are customer-facing and can therefore directly impact on customer satisfaction and sales. Yet reporting on employee relations in the retail sector remains low despite a growing body of academic evidence.

From 2013-2015, the PRI coordinated a collaborative engagement with the aim of improving reporting and practices at 27 global retail companies. An analysis after the engagement period showed that the companies improved in reporting, particularly in the areas of employee training and employee engagement.

There is however still much scope for these retailers to improve how they measure and report on employee-related data. Investors should ask for this information because good employee relations may signal strong company management. Therefore an analysis of these issues can help investors identify underlying company strengths (or provide early warning signs of trouble), which might otherwise be overlooked.

The Quick reference guide: Engaging retailers on employee relations provides investors with an overview of lessons learnt, red flags, and tested questions for engaging retailers. This document provides greater detail on why to engage and how to engage as well as areas for engagement going forward. Appendices include the scoring methodology used in the engagement, and further details on the engagement's outcomes and lessons learnt.

1 To describe how a company manages its employees some companies and investors use the term 'employee relations' whereas others refer to 'human capital management'. The Employee Relations Steering Committee agreed on the term 'employee relations' instead of 'human capital management' to emphasise that employees are more than just an asset.

1. WHY ENGAGE?

1.1 EMPLOYEE RELATIONS – WHY SHOULD INVESTORS CARE?

Happy employees are good for business: highly engaged employees tend to stay longer, and are more likely to be productive and provide good customer service.[2] Many studies show a positive correlation between employee relations and a company's financial performance.[3]

> Global companies with highly engaged employees on average grow earnings more than 2.5 times faster than those with below-average engagement.[4]

Employee satisfaction also positively correlates with stock returns in markets with high labour flexibility.[5]

Employees are crucial for all companies, but they are particularly key in the retail sector because most employees are in constant contact with customers. As a result, they have a more direct impact on customer satisfaction and sales compared to other sectors. An analysis of a large retailer found that one additional dollar invested in an employee would lead to between four and 28 dollars in new sales.[6] US retailers Costco, QuikTrip, and Trader Joe's as well as the Spanish retailer Mercadona all invest significantly more in their employees than other retailers while being highly profitable.[7]

Many retailers still report little to no information on how they manage this issue, despite this growing body of evidence supporting the link between good employee relations and business success. Organisations such as the National Association of Pension Funds (a UK body promoting the interests of pension funds), note that "there is very limited quantitative or qualitative reporting by companies on their approach to managing their workforce".[8] Researchers at UBS found that many companies and investors still underestimate the importance of employee relations because "markets may fail to recognize under-investment in the workforce as a negative signal".[9]

1.2 BACKGROUND TO THE PRI-COORDINATED ENGAGEMENT

Based on this larger context and on interest from PRI signatories, the PRI initiated a collaborative engagement on employee relations in the retail sector. In 2013, the PRI Employee Relations Steering Committee[10] identified 30 academic and industry research papers and books looking at the materiality of employee relations in the sector. From this, the four key performance indicator (KPI) categories that were most strongly correlated with financial performance were identified:[11]

- Employee turnover
- Employee absence
- Employee training
- Employee engagement

Baseline research was undertaken on the reporting and performance of 80 global retailers against those indicators, as well as reporting on additional indicators the steering committee considered important, such as board and CEO remuneration and labour rights. Using this research, the steering committee developed an engagement programme that aimed to:

- Identify and assess existing company practices
- Encourage improved company practices
- Encourage enhanced company assessment and reporting
- Heighten board and senior management attention regarding the issue

2 James Harter et. al. (2013) – "The Relationship Between Engagement at Work and Organizational Outcomes. 2012 Q12 Meta-Analysis", Gallup Inc. This meta-analysis of 263 research studies across 192 organisations in 49 industries and 34 countries focuses on determining the relationship between employee engagement and performance. Looking at nine outcomes - customer loyalty/engagement, profitability, productivity, turnover, safety incidents, shrinkage, absenteeism, patient safety incidents, and quality (defects) - the study found a substantial and highly generalisable relationship between employee engagement and performance at the business unit level.

3 IRRC Institute (2015) – "The Materiality of Human Capital to Corporate Financial Performance". The IRRC Institute reviewed 92 papers looking at the link between employee relations and financial performance across industries.

4 The Gallup Management Journal: Byrant Ott (2007) – "Investors, Take Note: Engagement Boosts Earnings".

5 Alex Edmans, Lucius Li, and Chendi Zhang (2015) – "Employee Satisfaction, Labor Market Flexibility, and Stock Returns Around the World".

6 The New Yorker: James Surowiecki (2012) – "The More the Merrier" and Wharton (2007) – "Out of Stock? It Might Be Your Employee Payroll — Not Your Supply Chain — That's to Blame".

7 Harvard Business Review: Zeynep Ton (2012) – "Why Good Jobs are Good for Retailers".

8 NAPF discussion paper (2015) – "Where is the workforce in corporate reporting?".

9 UBS Investment Research (2013) – "Corporate culture: Relevant to investors?".

10 The initial work was undertaken by the PRI Employee Relations Steering Committee comprised of 10 signatories: APG Asset Management, Bâtirente, BMO Global Asset Management, Groupama Asset Management, Middletown Works Hourly and Salaried Union Retirees Health Care Fund, MN, Standard Life Investments, Threadneedle Asset Management, UFCW International Union Pension Plan for Employees and UNISON.

11 For further details on the studies or the selection of indicators please see PRI (2013) – "PRI-coordinated engagement on employee relations".

In 2014, 24 PRI signatories with combined assets under management of US$1.5 trillion initiated engagement with 27 global retail companies on the issue. The companies included retailers with a very large workforce, companies that were lagging behind their peers, and those with inconsistent reporting on the topic.

Investors sought dialogues with the retailers' human resources departments, boards, sustainability and investor relations teams, with the aim of better understanding their employee relations strategies and encouraging improved disclosure and performance on the issue.

In 2015, after 16 months of engagement, the reporting and performance of the 27 companies were re-evaluated. Details on the outcomes can be found in appendix 2, and recommendations for further engagement in chapter 3.

Out of the 27 companies with which the investor group engaged, 22 companies improved their reporting, and three companies improved their performance. Employee engagement was one of the most improved areas of reporting, with 17 of the companies reporting in this area, up from 10 in 2013.

2. HOW TO ENGAGE

2.1 HOW TO GET STARTED

This section outlines what investors have learnt from their dialogues with global retailers. To improve the level of reporting and performance on employee relations, suggestions on how investors can engage retailers on the topic are provided below.

2.1.1 REVIEW REPORTING FOR RED FLAGS

Even if a company reports that it "values its employees", there are several red flags indicating that the company might underestimate the importance of its employees to its business:

1. No reporting on employee-related KPIs

A retailer that reports no employee-related KPIs sends the signal that it doesn't recognise the contribution and relevance of its employees to the business. Employees are an integral part of the retail business and companies should provide shareholders with an indication that employee relations are managed well.

2. No reporting on performance against KPIs, or narrative on that performance over time

Reporting on performance against KPIs is more meaningful when companies provide data over time. It is not however possible to rely purely on quantitative metrics; investors need to know the context to be able to assess risks and understand levels of, and changes in, performance.

3. No demonstrated awareness of employee relations at the most senior level

Customer satisfaction is key in the retail sector, and employees are the face of the company. Companies should provide evidence that employee relations are part of their overall strategy and drive the success of the business, rather than being isolated to the human resources department.

2.1.2 ASK TRIED-AND-TESTED QUESTIONS

Retailers' business models differ, and not all employee relations metrics are relevant for all companies. As mentioned however, the dialogues with many companies confirmed the relevance of the key metrics below, which were identified based on academic and industry research. These metrics are interrelated and tend to positively correlate.

On employee turnover:

- How does the company's annual employee turnover rate compare to previous years and industry peers?
- Based on its business model, what rate is the company aiming for?
- What is the company's strategy to achieve or retain its desired turnover rate?

On employee training:

- How does the company assess what current and future skill sets it requires?
- To meet this need, what training is provided, how much (e.g. hours of training or money spent) and how regularly (to each employee or group of employees)?
- How does the company measure the effectiveness of its training?

On employee engagement:

- How does the company identify the needs and engagement levels of its employees on a regular basis, and what are they?
- How does the company respond to the findings and ensure that its workforce is motivated and enabled to contribute to the success of the business?

> Looking at the changes in reporting and performance of the 27 companies over the course of two years, most companies included in the engagement improved, with an average score increase of 5% across all companies. Improvements could be seen across the whole sample, from companies that were relative leaders in the 2013 benchmark to companies that were lagging behind peers in the original review.

In addition to the above questions, when raising employee relations issues with retailers' boards and senior management, investors can consider the following questions:

- How does the company's employee-related strategy link to the company's overall business strategy and growth model?
- How often are these issues discussed at board level and how does the board ensure that its employee-related expectations are implemented at all levels?
- What are the key employee relations challenges and opportunities for the company (as well as by geography/market where relevant)? How are these managed?

2.1.3 EVALUATE THE COMPANY'S RESPONSE

"But we haven't done anything wrong. Why are you contacting us?"

This response, expressed by a supermarket during the engagement, is a reminder that investors need to be clear on how managing environmental, social and governance considerations, such as employee relations, is not only about risk, but provides opportunities and potential competitive advantage.

Leading companies are able to go beyond the numbers and explain context such as:

The rationale behind their employee-related KPIs:
Collecting data can be very valuable, but only if the data is used to identify gaps or to verify whether the company is on track with its targets. The company must then follow-up by improving processes and performance. If a company is unclear on why it collects data, or how it uses the outcomes, this points to a lack of understanding on its part as well as a missed opportunity to use the data as an early warning system or to improve processes.

The outcomes of those KPIs over time and compared to peers:
Outcomes of KPIs need a narrative around them to provide a full picture of the company's efforts, not all of which might be quantifiable at this stage, such as on-the-job training. A narrative further helps to put outcomes in context and to compare a company's performance over time and against peers. It further provides the company with an opportunity to explain the outcomes, both the positive and any negative changes or anomalies. Lastly, companies should also be able to explain how they measure the effectiveness of their employee-related policies and practices, such as training.

How their employee-related strategy links to their overall strategy and business model (bearing in mind demographic changes and competition for workforce):
Leading companies were able to explain how their employee-related strategy links to their overall business strategy and how employees contribute to the growth of the business. Based on their specific business models and changes in customer demand, these companies demonstrated a strong understanding of the skillsets that their employees require now and in the future, and how to achieve this. Those companies were also aware of, and prepared for, demographic changes and competition, such as wage increases from competitors.

2.1.4 RESPOND TO COMMON COMPANY CONCERNS

Engaging in dialogue with a number of companies and exchanging information with each other helped investors to better respond to the concerns and challenges that companies raised. Below is a summary of the most common reasons that companies provided for not measuring or disclosing employee-related data, and suggestions on how investors can respond.

"The information is commercially sensitive. My peers don't report this information and it would be a competitive disadvantage to do so."

Many retailers across different sub-sectors and regions already report such information (for example, the German supermarket Metro reported its employee turnover and the Mexican hypermarket Walmart Mexico reported its spend on employee training). Companies can also find a reporting method that suits their circumstances: for instance, instead of reporting the total spent on training, a company might choose to report the average hours of training per employee.

"It is too difficult to measure training."

Where quantified metrics cannot fully capture activity, measurement and reporting should not be abandoned, but reinforced with explanatory narrative. Companies should also collaborate with sector peers, investors, other stakeholders and experts to develop solutions for quantifying different types of training, such as on-the-job training or informal mentoring.

"The data is not consistent enough between peers/countries to allow meaningful comparisons."

Leading companies provide data over time, to identify improvements or anomalies, and, where needed, break it down, e.g. by country, to allow more meaningful comparisons. Companies are encouraged to put consistent data collections in place across countries, which allow them to track and understand on a global level how well they manage employees, including the impact of measures such as training or increased benefits across geographies.

Answering concerns about comparability with peers, employee engagement rates are not comparable as companies use different questions in their employee engagement surveys. This is why investors seek evidence that a company has conducted a year-on-year survey, and is able to demonstrate an improvement in its own performance over time. Companies are encouraged to work on comparability of data by publishing the key questions from their employee surveys.

Leading companies provide a clear narrative to put their data into context, and are clear on the definitions they used. Good sector practice, or international standards such as the G4 Sustainability Reporting Guidelines or SASB's Sustainability Accounting standards for the consumption sectors, can provide further guidance.

2.2 HOW TO ENGAGE ON KEY ASPECTS OF EMPLOYEE RELATIONS

2.2.1 EMPLOYEE TURNOVER

Employee turnover not only provides an indication of employee retention, but also employee satisfaction as well as recruitment and training costs for new employees. Some companies have started to report on the length of reporting, but the annual turnover rate remains the key measure that both companies and investors use.

What is good practice?

Current good practice includes reporting the company's annual employee turnover rate, outcomes over time as well as an explanation of changes in performance. It is also important that retailers explain their desired turnover rate, the rationale for that rate and link to the company's business model, and how the company aims to achieve it. A review of industry and sector studies identified 20% as a very good global turnover rate for the retail sector, and below 30% as good. Turnover rates may however vary significantly by country. As a result, companies may want to provide a country breakdown.

Which retailers are already disclosing their turnover rates?

The German retailer Metro AG[12] reports comprehensively on employee turnover rates, providing breakdowns both by year and region. In addition, the company reports the average job tenure as well as measures taken to develop and retain employees. Other retailers that report their annual turnover rate include the US food retailer Whole Foods[13], the South African apparel retailer Truworths[14] and the Chilean department store Falabella[15].

What were key challenges in the engagement dialogues?

Conversations around turnover were often challenging; companies track this information, but many were hesitant to report it for competitive reasons. Reporting on the annual turnover rate decreased, and even where investors had a positive dialogue with relatively advanced companies, several companies were reluctant to report the figures. Only nine of the 27 companies (33%) included in the engagement referenced this KPI in 2015, and globally across sectors only 12% of companies report this measure. That said, as the examples above demonstrate a number of retailers across regions and sub-sectors report their employee turnover. In fact 52% of the over 2,200 GRI reporting companies report even more specific information including their total number and rate of employee turnover by age group, gender, and region.[16] Some companies in the engagement continued to report their turnover rates despite decreases in performance. Investors should commend those companies and encourage other companies to report this information.

A number of companies pointed out the need to account for regional differences rather than having a global target, which is easily solved by breaking down turnover rates by country.

Lastly, retail business models are highly variable, and a single company may use different business models for different markets. For example, business models based on employing young people usually go together with a higher turnover rate, which companies do not necessarily perceive to be a negative. Where a global turnover rate of 30% or even 20% is not possible or desirable for a company or in a particular market, companies should nevertheless be able to demonstrate that they track employee retention, and explain what their desired turnover is and why.

How can retailers achieve desired turnover rates?

Companies used outcomes of employee surveys to determine their strategy of how to reduce or maintain their turnover rates. Companies reported on a number of different strategies, including satisfactory working hours and wages as well as benefits that are relevant to employees, such as free healthcare or access to leisure facilities like gyms. A positive company culture also came up repeatedly in investor-company dialogues. To improve corporate culture, companies have taken steps such as increasing levels of transparency and collaboration. Active talent retention, including training and offering career opportunities within a company, were also cited repeatedly as measures used to decrease turnover, as were, to a lesser extent, linking employee retention to the pay or benefits of both shop floor managers and the most senior level executives.

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12 Metro Group (2014) – "Annual report 2013/14".

13 Whole Foods Market (2015) – "2014 Annual report".

14 Truworths International (2014) – "Integrated Report 2015".

15 Falabella (2015) – "2014 annual report".

16 NAPF discussion paper (2015) – "Where is the workforce in corporate reporting?".

2.2.2 EMPLOYEE TRAINING

Training is key to ensuring that employees are equipped with the right skills and in turn are able to improve customer satisfaction. Employees who feel that they are able to fulfil the requirements of their job also tend to be more satisfied and are more likely to stay in the job for longer. The number of companies reporting this information highlights the importance of training. This number has increased, with a particularly strong rise in reporting on training and development across the workforce (reported by 15 out of the 27 companies, up from nine).

> 'Reporting on the total training expenditure and in particular access to training and development across the workforce increased; both are now reported by more than 50% of the companies.

What is good practice?

Leading companies were able to demonstrate both a solid understanding of the current and future skill sets that will be required of their employees as well as how they account for this through relevant training across different parts of the workforce. This may include increasing IT skills to enable employees to deal with an increase in online sales. Total employee training may be expressed in hours of training or currency spent. Investors would further like to ensure the training is of good quality and achieves the intended purpose – however companies are still in the beginning of measuring the effectiveness of the training they provide.

Which retailers are already disclosing their training efforts?

The Portuguese food retailer Jeronimo Martins[17] provides comprehensive reporting on training expenditure (in spend), with breakdowns both by year and region. The company has also created a Global Learning area, which aims to define a global employee training and development model. In addition, the company gives details of training programmes and partnerships with teaching establishments. Further examples of global retailers disclosing their training expenditure (in hours or currency spent) include the Mexican hypermarket Walmart Mexico[18], the UK apparel retailer Sports Direct[19] and the Brazilian department store Lojas Renner[20].

What were key challenges in the engagement dialogues?

Different types of training, such as online and classroom-based, independently and locally organised training, and in particular 'soft' and on-the-job training are very important, but difficult and costly to track. Some companies are experimenting with tracking this information and are encouraged to do so to demonstrate leadership and help advance the sector. In the meantime, companies are encouraged to provide qualitative reporting around their training efforts to demonstrate the rationale and extent of the informal training that they have in place. Where training expenditure is regarded as being too sensitive, companies may wish to report on the number of training hours.

Very few companies track the return on investment in training, denoting an area that should be improved further.

Dialogues about year-on-year training expenditure and future training spend were challenging, with very few companies reporting on those aspects. Dialogue on employee training should therefore focus on training expenditure and training across the workforce, both of which are reported by more than half of the companies and provide a good indication on how extensive and systematic a company's training efforts are.

How can retailers deliver effective training?

A number of companies highlighted the importance and effectiveness of peer-to-peer training. Particularly in markets where companies struggle to find the right employees, wider employee development activities like apprenticeships offered a valuable means of training and recruitment.

17 Jerónimo Martins (2015) – "Annual Report 2014".
18 Walmart de México y Centroamérica (2015) - Associate development. Accessed 4 Nov 2015.
19 Sport Direct (2015) – "2015 annual report".
20 Lojas Renner S.A. (2015) – "Annual report 2014".

2.2.3 EMPLOYEE ENGAGEMENT AND AHOLD CASE STUDY

Companies with engaged employees tend to have lower levels of employee absenteeism and turnover, and higher levels of safety, customer satisfaction, productivity and profitability.[21] Examples of companies where employee satisfaction strongly contributes to profitability include the privately owned US supermarket chain Wegman's[22] and the UK department store Marks & Spencer, which identified a direct link between employee engagement and store sales[23]. Retailers are increasingly aware of this link; employee engagement was one of the most improved areas of reporting, with 17 out of the 27 companies reporting in this area, up from 10 in 2013.

> In 2015 over half of the retailers in the engagement reported on employee training and engagement compared to only just over a third in 2013.

What is good practice?

Leading companies were able to explain how they identify the needs and engagement levels of their employees on a regular basis. They report on the findings, and how these are used and feed into the company's strategy. Those companies also have a clear strategy in place to ensure that their workforce is motivated and enabled to contribute to the success of the business.

Which retailers are already disclosing their employee engagement efforts?

In its integrated report, the Brazilian retailer Pao Acuca-Pref[24] provides comprehensive qualitative and quantitative reporting on employee engagement. Quantitatively, employee engagement levels are reported year-on-year as a percentage figure. The company also reports on the participation rate in its annual engagement survey and focuses on particular areas of engagement, including diversity and inclusion. Qualitatively, the company gives details of how it seeks to increase engagement levels, such as through new starter training and integration sessions. Further examples of global retailers reporting a specific figure on their employee engagement include the Dutch food retailer Ahold[25], the UK department store Marks & Spencer[26] and the North American hypermarket Walmart[27].

What were key challenges in the engagement dialogues?

Overall companies that engaged in dialogue had a clear idea of the relevance of employee engagement. Some companies preferred local rather than global surveys to account for local differences. Some companies voiced concerns that employee survey rates may be compared between different companies. It is therefore important to point out that investors are looking for evidence that a company's employee engagement is measured and reported regularly, which allows for trends to be tracked in its performance over time.

How can retailers improve employee engagement?

Employee engagement can take different forms, from local activities or forums to the more commonly found online forums. To measure employee engagement, companies typically undertook an annual survey, which should be available in all relevant local languages and include free text questions.

Once a survey is in place, it is important that the company demonstrates that it measures and acts upon the survey's results. In engagement dialogues companies cited examples of improvements made, such as introducing flexible working hours or decreasing management hierarchy. The leadership style and corporate culture are key factors regarding employee engagement. As one company put it, the right leaders lead to the right strategy, which in turn leads to the right culture. Further examples that companies cited as means of enhancing employee engagement included being clear about what is expected from employees and providing training as well as job rotation.

Some companies looked at themselves as a 'brand' for current and prospective employees and measured this with questions such as "are you proud of working for the company?" or "how likely would you be to recommend working at the company to a friend?". External sources such as Glassdoor, a website fed with ratings from current and former employees, can further help companies identify how they rate in the eyes of their employees.

21 James Harter et. al. (2013) – "The Relationship Between Engagement at Work and Organizational Outcomes. 2012 Q12 Meta-Analysis". Gallup Inc.
22 The Atlantic: David Rohde (2012) – The Anti-Walmart: The Secret Sauce of Wegmans Is People. Accessed 4 Nov 2015.
23 Engage for Success (2105) – Evidence case study: Marks and Spencer group plc. Accessed 4 Nov 2015.
24 GPA (2015) - "Annual and sustainability report 2014".
25 Ahold (2015) – "Annual report 2014". For further information see case study below.
26 Marks & Spencer (2015) – "Annual report and financial statements 2015".
27 Walmart (2014) – "2014 Annual report".

MEASURING EMPLOYEE ENGAGEMENT AT AHOLD – CHALLENGES AND OPPORTUNITIES

Ahold is an international food retailing group with more than 220,000 employees, operating in the Netherlands, Belgium, the Czech Republic, Germany and the United States.

Ahold conducts an annual survey among all employees in all operating countries. The survey's aim is to measure employee engagement against Ahold's core business aspects, its 'better every day' promises, and to understand how to improve engagement on those. Ahold seeks to receive feedback and score the satisfaction of its employees in areas such as:

- Customer value proposition
- Working conditions and fair treatment
- Job satisfaction and engagement
- Corporate responsibility
- Company strategy

The survey also includes open text boxes for suggestions.

A third party conducts the survey and results are tracked per department, business and at group level. Ahold publicly reports a group level engagement score on an annual basis in its CSR report. In 2015 88% of the total workforce responded to the survey, compared to 81% in 2014 and the overall engagement score was 68%, which is equal compared to 2014.

Ahold has experienced several challenges with its survey.

Ensuring that the questionnaire is aligned for the whole of the business so that answers are comparable
Over time Ahold has aligned the questions and today has an identical survey for all businesses in place.

Having computers available for all associates working in its stores and distribution centres to complete the online survey
Ahold granted its employees time to fill in the survey on the central store computer.

Motivating employees to complete the survey
Ahold reiterated the importance of the survey to its employees, but more importantly demonstrated that it takes the responses seriously by implementing and communicating improvement programmes and outcomes.

The survey also offered a number of opportunities to Ahold. The company recently established a human resources analytics team with capabilities in the fields of industrial psychology, organisational behaviour, finance, statistics and computer science, which helps the company to:

- Strengthen the company's overall human resources strategy.
- Provide store-level advice on human resources topics and on how to improve employee engagement.
- Support company decision making by combining data from the employee engagement survey with other data sources, e.g. customer or performance data.

Data combinations that the team analysed include engagement levels and leadership attributes; engagement levels and store performance indicators (such as absenteeism or sales); and insights from the open text boxes and store characteristics.

3. RECOMMENDATIONS FOR FUTURE ENGAGEMENT

Although 22 of the 27 companies (81%) engaged improved their reporting, there remains significant scope for further improvement in both reporting and performance. The following are recommendations on focus areas for engaging retailers on employee relations.

1. Investors should encourage retailers to integrate and report on employees as part of their business strategy, rather than merely as a cost

Retailers are slow in recognising employees as an asset rather than merely a cost. This particularly applies to low-skilled positions, such as shop floor staff and staff working in warehouses or logistics. Even companies that speak about their employees as assets often do not reflect this in their reporting, e.g. by providing evidence of how employees contribute to the growth of the business.

Retailers should be able to demonstrate that employee relations are taken seriously at board and senior management level. Where a retailer lacks this awareness at the most senior level, this is an indication to investors that the company may underestimate the impact that employees can have on the success of the business. Retailers should therefore be able to explain how their employee related strategy links to the overall business strategy and how employees contribute to the growth of the business.

2. Investors should encourage retailers to report on employee turnover, training and engagement, or explain why they don't do so

Given the limited reporting in the sector, investors were encouraged that retailers typically measure much more than they disclose. This confirmed investors' belief that there is a business case and need for quantitative data on employee relations. Over the course of the engagement, most companies that the investor group engaged with confirmed the relevance of the elements identified as most material by the research,[28] in particular employee turnover, employee training, and employee engagement. There can be challenges and differences in how to measure and report on these, but it is clear that there is broad agreement, from both academic research and the engagement dialogues, that these are important KPIs to measure and manage. Section 2.2 provides guidance on how to engage on each of these KPIs by highlighting key challenges, good practice, and global examples across sub-sectors.

Employee absence was also accepted as one of the standard KPIs, but following the dialogues both investors and companies considered this to be of less relevance when compared to the other three metrics: while employee absence can indicate a dissatisfied and unengaged workforce, an increase in employee turnover is an even better indicator. Improvements in employee training and employee engagement tend to have a positive effect on other metrics; for example, improvements in training can lead to improvements in employee engagement, and in turn decrease absence and turnover rates.

Reporting in the retail sector remains low on all of these metrics. Less than half of the companies engaged reported their employee turnover, and although reporting on training and employee engagement has improved, there is still considerable room for progress. For example, while 17 companies referenced employee engagement in reporting, only 11 of these provided figures, and just nine provided evidence of an annual employee survey. Three of these were able to demonstrate credible evidence of a year-on-year increase in performance.

3. Investors should encourage retailers to take a proactive stance on emerging regulation and report on material employee-related issues

Companies face a range of upcoming regulatory developments. From 2016, the EU Directive on disclosure of non-financial and diversity information will require EU companies with more than 500 employees to report on policies, outcomes and risks related to employee-related matters.[29] Since 2013, listed UK companies have been required to publish a strategic report as part of their annual report, which must include reporting regarding employees where it is material.[30] In view of this regulation, where retailers have limited reporting, investors could ask how they determined that employee-related information was not material.

On pay, the recent SEC rule will require public US companies to report their CEO to median employee pay ratio from 2017[31] and in the UK consultations are under way to introduce legislation in 2016, which will require large companies to report their gender pay gap.[32]

Investors may ask retailers how they are preparing for these regulatory developments, and what information they consider material and plan to disclose.

28 Please note the limitations of this paper: Given the 30 studies identified in the beginning, and the subsequent KPIs identified based on those, the investor group focused on specific employee relations metrics. It is possible that another selection of studies would have favoured other indicators or that other indicators tend to be less researched. This paper recognises the importance of those employee-related issues that are not mentioned, such as gender diversity or mental health.

29 European Commission (2015) – "Non financial reporting". Accessed 28 Sep 2015.

30 Financial Reporting Council (2014) – "Guidance on the Strategic Report"

31 SEC press release (Aug 2015) - SEC Adopts Rule for Pay Ratio Disclosure. Accessed 28 Oct 2015.

32 PwC (2015) - Gender pay gap reporting to be mandatory. Accessed 28 Oct 2015.

APPENDIX 1: OUTCOMES OF THE PRI-COORDINATED ENGAGEMENT ON EMPLOYEE RELATIONS

Summarised below are the outcomes of the 2014/15 PRI-coordinated engagement on employee relations in the retail sector, against each of its four objectives:

Objective 1: Identify and assess existing company practice

- In 2013, the PRI developed an assessment methodology (see table below) and assessed 80 companies on their employee-related performance and disclosure.
- In 2015, it assessed the 27 target companies on their employee-related performance and disclosure.

Objective 2: Encourage improved company practice

- Three of the 27 companies improved their performance.
- The most improved company increased its performance score from 0 to 4 (out of a total of 11 performance points); on average, improving companies increased their performance score by 50%.

Objective 3: Encourage enhanced company assessment and reporting

- 22 out of 27 companies improved their reporting.
- The most improved companies increased their disclosure score by 26%; on average, improving companies increased their disclosure score by 11%.
- The most notable improvements in reporting by KPI were:
    - Seven more companies reported on employee engagement,
    - Six more companies reported on training and development across the workforce, the full-time/part-time split of the workforce, and the ratio of median employee pay to CEO pay respectively.

Objective 4: Heighten board and senior management attention to the issue

- With 11 out of the 27 companies investors were able to have dialogue with members of the senior management team or the board, or at a minimum, the board or senior management were briefed about the dialogue with the investors.
- In one case, the chair responded to the investors, acknowledging the importance of the issue, while in other cases the chair or CFO joined meetings with representatives of the investor group.
- In cases where the board or senior level staff had been included in the dialogue with investors, investor relations and human resources representatives also showed more willingness to engage with investors.

The table below outlines the methodology used to evaluate the reporting and performance of the 27 retail companies in 2013, and again in 2015. The scorecard encouraged reporting by awarding companies' points, irrespective of their performance. More specifically, companies were usually awarded one reporting point for referencing a KPI, and an additional reporting point for providing a specific figure.

Companies confirmed the relevance of the key KPIs in the engagement dialogues, but qualitative information is needed to fully assess how a company manages employee relations.

33 Further details on this engagement can be found in section 1.2 and further details on the assessment methodology in appendix 1.

KEY KPIS

KPI CATEGORY	KPI	REPORTING SCORING	PERFORMANCE SCORING[34]
Employee turnover	Annual rate	**1 point:** reference to this KPI but no specific figure **2 points:** a specific figure is provided for this KPI	**1 point:** below 30% but equal to or above 20% **2 points:** below 20%
	Length of service across workforce	**1 point:** reference to this KPI but no specific figure **2 points:** a specific figure is provided for this KPI	**1 point:** any specific figure for the average length of service or for the number of employees serving more than a certain number of years **2 points:** evidence that the employee retention rate is above the average for the sector or equal to or above three years
Employee absence	Spot rate	**1 point:** reference to this KPI but no specific figure **2 points:** a specific figure is provided for this KPI	**1 point:** below 5% but equal to or above 3% **2 points:** below 3%
Training expenditure	Total training expenditure	**1 point:** reference to this KPI demonstrating formal training programmes of a significant magnitude **1 point:** a specific figure is provided for this KPI (in spend, hours or days) NOTE: companies may be awarded up to 2 points for performance on this KPI	**1 point:** evidence that the amount of training is recorded for the entire workforce
	Total training expenditure: year-on-year trend	**1 point:** a specific year-on-year trend figure is provided for this KPI	**1 point:** detailed year-on-year disclosure of spend or hours for the entire workforce, which shows an increase in spend or hours
	Total training expenditure: future spend	**1 point:** a specific future spend figure is provided for this KPI	**1 point:** an indication of future spend for the entire workforce, which would be an increase on the current year
	Across the workforce	**1 point:** evidence that training is given to each group of employees (in particular shop floor staff) **1 point:** detailed year-on-year disclosure of spend or hours for each group of employees or shop floor staff in particular **1 point:** an indication of future spend for each group of employees or shop floor staff in particular NOTE: companies may be awarded up to **3 points** for performance on this KPI	
Employee engagement	Employee satisfaction/ attitude scores	**1 point:** reference to this KPI but no specific figure **2 points:** a specific figure is provided for this KPI	**1 point:** evidence of an employee survey having been conducted year-on-year **2 points:** credible evidence of a year-on-year increase in performance
MAXIMUM SCORE		**15 POINTS**	**11 POINTS**

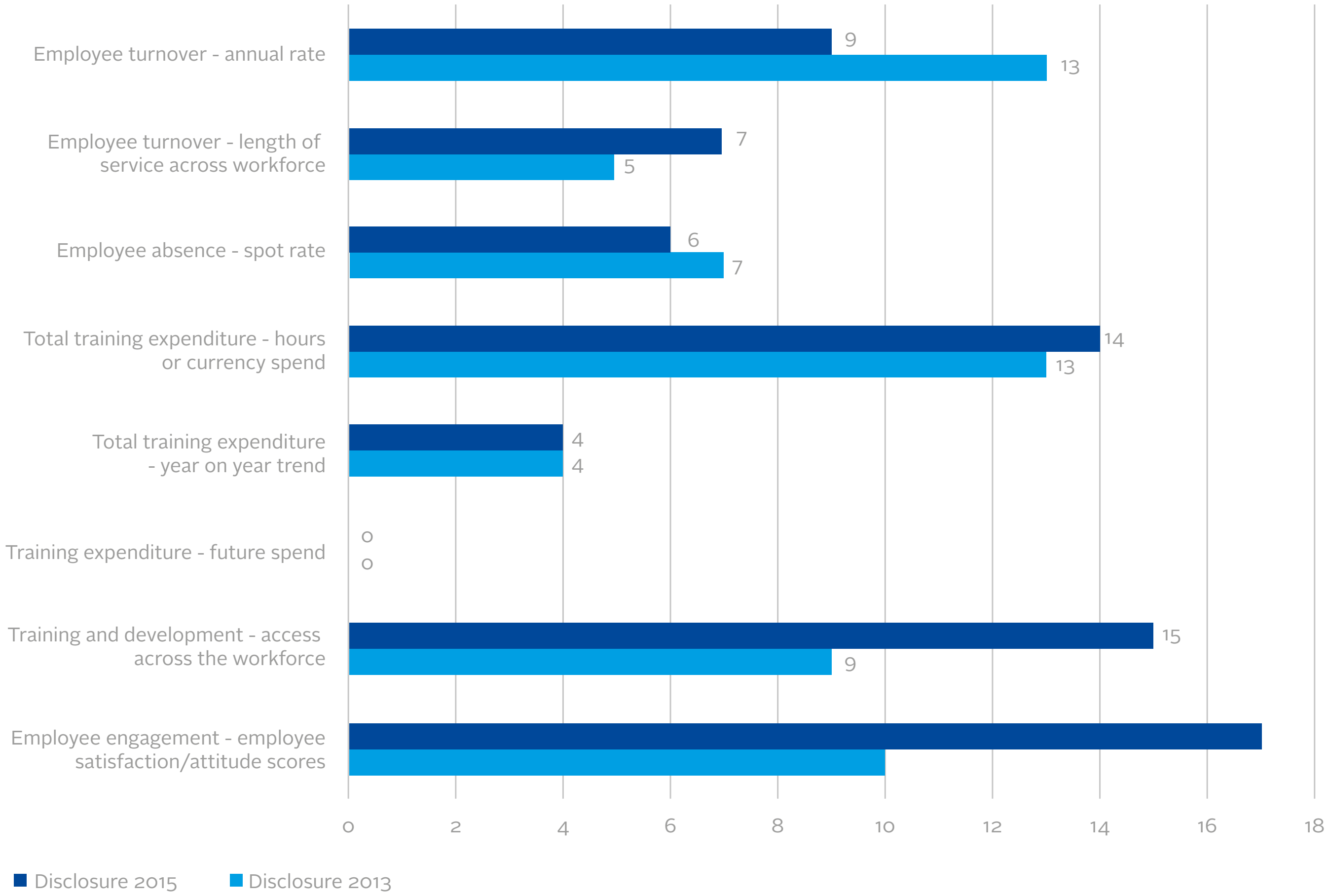
34 Note the evaluation of the company's performance was based on the company reporting those elements. This means that if a company scores zero on disclosure, the disclosure on performance is automatically zero too. On the other hand, increased disclosure does not necessarily lead to an increase in the performance score (only if the company fulfils the conditions of the performance scores).

ADDITIONAL KPIS

KPI CATEGORY	KPI	REPORTING SCORING
Pay	Total board and CEO remuneration	**1 point:** reference to this KPI but no specific figure **2 points:** a specific figure is provided for this KPI
	Ratio of median employee pay to CEO pay	**1 point:** disclose total executive compensation and total payroll costs **2 points:** a specific figure is provided for this KPI
	Pay distribution by gender	**1 point:** reference to this KPI but no specific figure **2 points:** a specific figure is provided for this KPI
Labour rights	Freedom of association Right to organise Collective bargaining	**1 point:** reference to this KPI but no specific figure **2 points:** a specific figure is provided for this KPI
Working practices	Full-time/part-time split OR Average hours worked	**1 point:** reference to this KPI but no specific figure **2 points:** a specific figure is provided for this KPI
	Statutory H&S reporting OR Lost time incidents	**1 point:** reference to this KPI but no specific figure **2 points:** a specific figure is provided for this KPI
MAXIMUM SCORE		**12 POINTS**

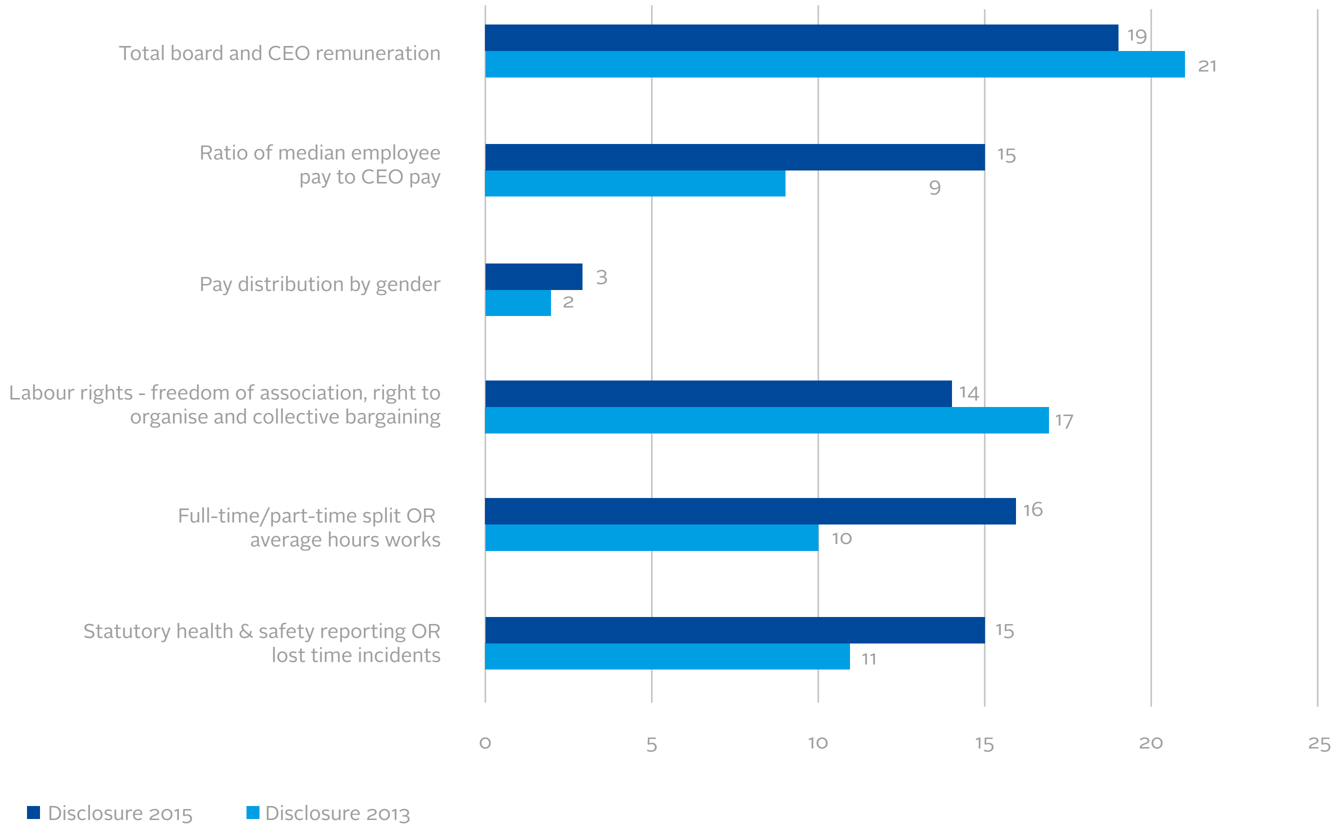
One of the main objectives of the engagement was to increase reporting, which improved at 22 out of the 27 companies (81%). Looking at the companies reporting by key KPI, increases in the reporting on training and development across the workforce and employee engagement were particularly noteworthy; both are now reported by more than 50% of the companies. While reporting on total training expenditure remains high, in 2015 employee engagement replaced it as the most reported KPI among the key KPIs assessed.

Number of companies out of a total of 27 companies reporting some information on key KPIs, 2015 vs 2013



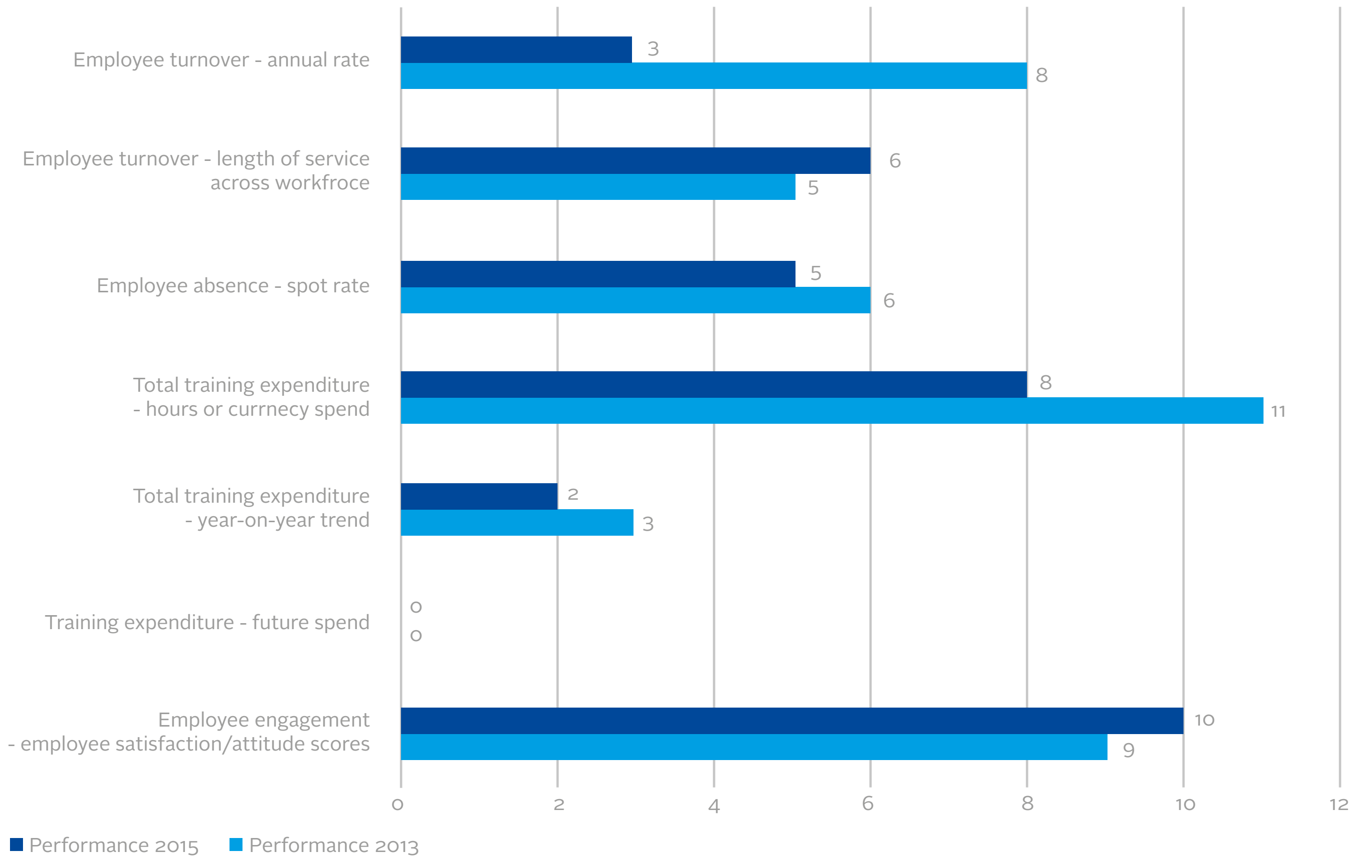
Employee turnover, absence, training and engagement constituted the main focus of the engagement, but investors also aimed to increase corporate reporting in some additional areas. Companies' reporting on these additional KPIs overall improved during the engagement, with six more companies reporting the ratio of the median employee pay to CEO pay and their full-time/part-time split, and four more companies reporting statutory health and safety information or lost time incidents. Further details can be found in appendix 3.

Number of companies out of a total of 27 companies with at least minimum levels of disclosure on additional KPIs, 2015 vs 2013



Looking instead at companies' performance on the KPIs, only a few companies improved - mostly in the areas of length of service across the workforce and employee engagement - and some companies decreased in their performance scores: Five fewer companies reported a turnover rate between 20-30% and six fewer companies reported a turnover rate under 20%. This partially reflected a decrease in performance, but was also due to a decrease in companies reporting their turnover rates. It is likely a result of companies avoiding reporting challenges and KPIs where their performance had deteriorated.

Number of companies out of a total of 27 scoring above zero on performance on key KPIs, 2015 vs 2013



This difference between the improvement seen in reporting versus the lack of improvement to underlying performance likely reflects the greater length of time needed to implement performance improvements, given that the period of the engagement was limited to 16 months.

The sample size was too small to draw firm conclusions by sub-sector, but the relative performance of different retail sub-sectors did not change over the period of the engagement. In both 2013 and 2015, companies in the department stores' sub-sector had the highest performance and reporting scores, followed by hypermarkets and food retail, with apparel remaining the sub-sector with the lowest performance and reporting scores, despite improvements in this sub-sector.

Although the company sample was too small to demonstrate geographical conclusions, the fact that the three most-improved companies – a North American department store, a South American department store and a European supermarket – are from three different regions, highlights that improvements could be seen and also expected in future from companies globally.

APPENDIX 2: OBSERVATIONS ON ADDITIONAL ASPECTS OF EMPLOYEE RELATIONS

In addition to the key focus areas outlined in the body of the paper, the following topics were also assessed in the research and were covered in some of the engagement dialogues.

A 2.1 LABOUR RIGHTS, HEALTH AND SAFETY, FULL-TIME/PART-TIME SPLIT

Labour rights - Less information reported on rate of unionisation:
In 2015, 14 out of 27 of companies (52%) reported information on freedom of association, right to organise and collective bargaining, compared to 17 companies (63%) in 2013. We have however seen a decrease both in the number of companies disclosing any information and the depth of information provided, with fewer companies disclosing specific figures on unionisation in 2015.

> One company has an internal employee representative body, and was able to provide examples of how it influenced corporate decisions, which in turn positively impacted on employee engagement levels.

Reporting ranged from merely stating that some employees are unionised, to highlighting the material damage that could result from union-organised work stoppages, to companies actively stating their support for the right to collective bargaining. Some companies provided specific figures for the rate of unionisation both on a global level as well as for significant operations, along with a narrative around those figures and their relationships with unions. In dialogues with investors, one retailer noted that their willingness to work with unions differed from country to country, while other companies explained they preferred direct relationships with employees.

More companies reporting on health and safety:
The number of companies reporting on this indicator increased from 11 to 15, and the level of reporting also increased. In 2015, seven companies provided specific figures, such as the number or rate of injuries, accidents, lethal incidents or lost days (rather than just referencing this KPI), up from two in 2013. As different types of injuries can be covered under the injury rate, companies should explain whether they include for example, minor injuries and accidents on the way to work, because this can help explain a high injury rate.

Strong increase in disclosing specific numbers of full-time/part-time split:
In 2015, the full-time/part-time split was the third most reported KPI. It was particularly encouraging to see the number of companies providing specific figures (as opposed to merely referencing this KPI) increase from two to twelve. Where companies provided specific figures these were always a breakdown of full-time and part-time employees, as opposed to average hours worked, and sometimes also broken down by country.

During the dialogues, some companies made clear that they recognise the value of full-time employees because it helps reduce the need for training and minimises the loss of knowledge. That said, a number of companies highlighted that all of their part-time work is voluntary, i.e. all employees have the opportunity to work full-time, but some choose to work part-time (e.g. to accommodate family obligations).

> One retailer included in the engagement decided to both offer all employees a full-time permanent contract and invest in retention of its employees because it sees retaining good employees as essential to the success of its business.

Looking beyond full-time versus part-time employees, a number of investor-company dialogues also addressed benefits. In the US for example, benefits do not have to be offered to employees working below a certain threshold of hours per week, which can be a driver for companies to employ more part-time staff. In the UK, much of the discussion centres around ensuring that not only full-time staff, but also part-time staff receive benefits. Investors and companies also discussed how flexible part-time work is managed. A 'just-in-time' approach where employees need to be on call, and don't know their number of working hours or working times in advance, does not allow employees to fulfil family obligations or take on a second job.

A 2.2 PAY: EXECUTIVE COMPENSATION, CEO TO WORKER PAY RATIO, PAY BY GENDER

Pay distribution by gender – progress is slow, despite increasing regulation:
One additional company reported on their gender pay gap in 2015, and one of the companies launched a gender equality certification process, which looks at the company's initiatives on gender equality, issues related to life balance as well as salary. The three companies reporting figures on this metric said that pay gaps were between 0% and 1%.

During the engagement dialogues, some companies explained that they have equal pay policies in place and are confident that they do not have a gender pay gap. One of the companies that measured this, explained during the dialogue that it was very surprised to find a 9% pay gap between men and women; a clear indication that this is important to measure and that the size or even existence of a gender pay gap tends to be underestimated. Another good reason to measure remuneration by gender is to respond to increasing regulation. In Australia, reporting on remuneration by gender is already mandatory, and for the retail sector a gender pay gap of 13% with regards to base remuneration, and 16% with regards to total remuneration was seen.[35] In the UK, mandatory reporting on remuneration by gender will be introduced for companies with 250 or more employees in 2016.[36]

CEO to employee pay ratio – reporting on total executive and employee pay increased significantly:
A total of 15 companies reported some information in 2015, up from nine in 2013. None of the companies however, reported their actual pay ratio. Instead companies reported the total executive compensation and total payroll costs separately, which allowed report readers to calculate the ratio. This is likely to continue to increase due to increasing regulation, such as the SEC rule for pay ratio disclosure in the US.[37]

Total board and CEO remuneration remains the most reported KPI:
Board and CEO remuneration was the most reported KPI out of the KPIs assessed, with 19 of the 27 companies (70%) disclosing this information. This is unsurprising given board and CEO remuneration is a widely used indicator globally, and a number of countries require disclosure,[38] but it is worth noting that the level of reporting increased: in 2013, only six companies reported specific figures, a number that in 2015 more than doubled to 14 companies. Non-reporting companies were mainly from North and South America, and notably most US companies reported some information in 2013, but no longer did so in 2015.

Over the course of 2015, there have been significant developments on employee pay, with a number of large US retailers including Target and Walmart announcing wage increases for their lowest-paid employees, and growing pressure from society and policy makers in the UK to pay employees a living wage, which might help focus company attention more broadly on employee-related matters.

35 According to the Workplace Gender Equality Act 2012, Australian companies with 100 or more employees need to report gender-related data, including remuneration by gender. A summary of the gender data reported in 2013-14 can be found in: Workplace Gender Equality Agency (2014) – "Australia's gender equality scorecard".

36 PWC (2015) – "Gender pay gap reporting to be mandatory". Accessed 27 Sep 2015.

37 SEC press release (Aug 2015) - SEC Adopts Rule for Pay Ratio Disclosure. Accessed 28 Oct 2015.

38 Practical Law, a Thomson Reuters Practical Solution (Status: 1 Nov 2014) - Executive remuneration: international comparison of required approvals and disclosure and SEC (modified 21 Oct 2014) – Fast answers. Executive compensation. Accessed 28 Oct 2015.

APPENDIX 3: FURTHER RESOURCES FOR ENGAGEMENT

Please find below a selection of further resources to support investor engagement on employee relations in the retail sector.

THE BUSINESS CASE FOR MANAGING EMPLOYEES WELL

- Alex Edmans, Lucius Li and Chendi Zhang (2015) – "Employee Satisfaction, Labor Market Flexibility, and Stock Returns Around the World"
- Didas Research (2014) - "A framework for employee management" (see abstract here; focus on the role of employee relations in investment returns; analysis of 1,400 global stocks on four dimensions, namely workforce demographics, investment in employees, employee satisfaction and health & safety; the resulting employee management scores correlate with employee productivity.)
- Gordon Clark, Andreas Feiner, Michael Viehs (Mar 2015 - updated version) - "From the stockholder to the shareholder. How sustainability can drive financial performance" (the section "Operational Performance and the 'S' Dimension", p. 32 focuses on the importance of stakeholder relations, especially employee relations; the section "Stock Prices and the 'S' Dimension", p. 39f. focuses on employee wellbeing and satisfaction)
- Aaron Bernstein and Larry Beeferman (2015) – "The Materiality of Human Capital to Corporate Financial Performance"
- SASB – SASB materiality map (human capital management is one of five sustainability issues; looks at financial drivers impacted and forward looking impact). Accessed 1 Nov 2015.
- Zeynep Ton (2012) – "Why good jobs are good for retailers". Harvard Business Review Jan-Feb, pp. 125-131.

ASSESSING RETAILERS' EMPLOYEE-RELATED PERFORMANCE

- Glassdoor and Indeed: employees review and rate their employers
- Zeynep Ton (2015) - Good Jobs Score 2015 for Public U.S. Food Retailers (the 2015 score of 10 large US food retailers is made up of sub-scores on customer satisfaction, employee satisfaction and productivity; the aim is to refine the scorecard and scale it out to other industries) Accessed 1 Nov 2015.

REPORTING FRAMEWORKS, METRICS AND QUESTIONS FOR ENGAGEMENT

- Business in the Community (2015) – "BITC Wellbeing Public Reporting Benchmark" (benchmark allowing FTSE 100 companies to measure their reporting on employee wellbeing and engagement against BITC's best practice framework)
- CIPD et al (2014) – "Managing the value of your talent: a new framework for human capital management reporting" (framework for measuring and reporting on employee relations; focus on four primary metrics: employee costs, recruitment costs, training and development costs, employee engagement)
- GRI distinguishes management approaches of social, economic and environmental factors, and employee relations form a vital part of the social factors. See "G4 Sustainability Reporting Guidelines". Accessed 1 Nov 2015.
- Human Capital Management Coalition (Nov 2014) – Questions (a group of 24 funds with more than $2.3 trillion in combined assets that focuses on how US companies develop policies on safety, diversity, and fair labour practices.)
- Integrated reporting: The International <IR> Framework distinguishes between six capitals, one of which is human capital, which contribute to value creation. These capitals can be increased, decreased or transformed. For example, training can increase the quality of a company's human capital. Accessed 1 Nov 2015.
- LAPFF (2012) – "Trustee Guide: People & Investment Value" (set of guiding questions for trustees to understand how well investee companies manage their employees, and in turn corporate performance)
- NAPF discussion paper (2015) – "Where is the workforce in corporate reporting?" (paper suggests four areas including related data points where better reporting is required: composition, stability, skills and capabilities, and motivation and engagement of the workforce)
- PRI (2013) – "PRI-coordinated engagement on employee relations", p. 5-6. (introduces employee-related KPIs that impact retailers' bottom line)
- PRI (2015) – "Quick reference guide: Engaging retailers on employee relations"
- Sustainability Accounting Standards Board (Sep 2015 – Provisional standard) – "Food retailers & distributors. Sustainability Accounting Standard" (focus on wages, collective bargaining, work stoppages, legal and regulatory fines related to labour law and discrimination)
- Sustainability Accounting Standards Board (Sep 2015 – Provisional standard) – "Multiline and specialty retailers & distributors. Sustainability Accounting Standard" (focus on diversity, legal and regulatory fines related to labour law and discrimination, wages and turnover rate)

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The Principles for Responsible Investment (PRI) Initiative

The PRI Initiative is a UN-supported international network of investors working together to put the six Principles for Responsible Investment into practice. Its goal is to understand the implications of sustainability for investors and support signatories to incorporate these issues into their investment decision making and ownership practices. In implementing the Principles, signatories contribute to the development of a more sustainable global financial system.

The Principles are voluntary and aspirational. They offer a menu of possible actions for incorporating ESG issues into investment practices across asset classes. Responsible investment is a process that must be tailored to fit each organisation's investment strategy, approach and resources. The Principles are designed to be compatible with the investment styles of large, diversified, institutional investors that operate within a traditional fiduciary framework.

The PRI Initiative has quickly become the leading global network for investors to publicly demonstrate their commitment to responsible investment, to collaborate and learn with their peers about the financial and investment implications of ESG issues, and to incorporate these factors into their investment decision making and ownership practices.

More information: www.unpri.org

PRI Principles for Responsible Investment

The PRI is an investor initiative in partnership with UNEP Finance Initiative and the UN Global Compact.

United Nations Environment Programme Finance Initiative (UNEP FI)

UNEP FI is a unique partnership between the United Nations Environment Programme (UNEP) and the global financial sector. UNEP FI works closely with over 200 financial institutions that are signatories to the UNEP FI Statement on Sustainable Development, and a range of partner organisations, to develop and promote linkages between sustainability and financial performance. Through peer-to-peer networks, research and training, UNEP FI carries out its mission to identify, promote, and realise the adoption of best environmental and sustainability practice at all levels of financial institution operations.

More information: www.unepfi.org

UNEP FINANCE INITIATIVE

UN Global Compact

Launched in 2000, the United Nations Global Compact is both a policy platform and practical framework for companies that are committed to sustainability and responsible business practices. As a multi-stakeholder leadership initiative, it seeks to align business operations and strategies with ten universally accepted principles in the areas of human rights, labour, environment and anti-corruption, and to catalyse actions in support of broader UN goals. With 7,000 corporate signatories in 135 countries, it is the world's largest voluntary corporate sustainability initiative.

More information: www.unglobalcompact.org

United Nations Global Compact