Good Jobs, Good Investments

Moderator:


Presenters:

Cambria Allen, Corporate Governance Director, UAW Retiree Medical Benefits Trust
Mariela M. Vargova, Ph.D., Senior Sustainability Analyst, Rockefeller Asset Management
Richard Clayton, Research Director, CtW Investment Group
Agenda

• Opening Remarks
  

• Presentation: The Human Capital Management Coalition
  
  Cambria Allen, Corporate Governance Director, UAW Retiree Medical Benefits Trust

• Presentation: Human Capital Management as Investment Perspective
  
  Mariela M. Vargova, Senior Sustainability Analyst, Rockefeller Asset Management

• Presentation: How a Good Jobs Strategy Can Work for McDonald’s and WalMart Shareholders
  
  Richard Clayton, Research Director, Change to Win Investment Group

• Questions and Comments

• Resources

• Conclusion
Why “Human Capital”?

Branko Milanovic, a leading scholar on income inequality, argued recently that we should “Junk the Phrase ‘Human Capital’” because “it obfuscates the crucial difference between labor and capital”.

Economist Thomas Piketty, in “Capital in the Twenty-First Century”, excludes from his analysis the kind of capital that “consists of an individual’s labor power, skills, training and abilities”.

“When retailers view labor not as a cost to be minimized but as a driver of sales and profits, they create a virtuous cycle. Investment in employees allows for excellent operational execution, which boosts sales and profits, which allows for a larger labor budget, which results in even more investment in store employees.”

OECD secretary-general, Angel Gurría has stated recently that “addressing high and growing inequality is critical to promote strong and sustained growth” and that “Implementing reforms that raise the job opportunities and earnings potential of low-skilled workers, help young people get a step on the job ladder and improve the labour market opportunities of women will unlock growth potential in our economies and ensure that it is shared by all.”
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Resources

You can find these resources, and others, on the Trustee Leadership Forum’s website: hausercenter.org/iri/about/tlf

From the Human Capital Management Coalition’s Toolkit and Questions

Principles for Responsible Investment Report “Coordinated Engagement on Employee Relations” (which includes Key Performance Indicators for Human Capital Management)

Other resources on topics including fiduciary duty, diversity and inclusion, and fees are also available on the TLF website.

Stay connected with the TLF through twitter @IRInvest to learn about upcoming webinars, events and resources.
Human Capital Management and Shareholder Engagement for the Long-Term

Presented By: Cambria Allen
Corporate Governance Director

Harvard Trustee Leadership Forum for Retirement Security
May 7, 2015
Who We Are

The Trust is the largest non-governmental purchaser of retiree health care benefits in the United States.

- Independent VEBA launched in 2010 to absorb health care liabilities from GM, Ford, and Chrysler (now FCA US LLC)
- Serves over 750,000 UAW retirees and their dependents
- 11-member board
Who We Are: Investor

- $54bn USD AUM*
- Fiduciary duty to beneficiaries
- Assets must last ≈80 years
- Long-term outlook

* As of the calendar year ending December 31, 2013.
## ESG in Guiding Documents

### Investment Policy Statement (IPS)
- Acknowledges that ESG-related risk factors can impact investment performance across asset classes
- ESG factors incorporated into manager selection and evaluation processes

### Proxy Voting Policies
- Guides voting decisions on behalf of Trust
- Trust uses customized proxy voting policies

### Corporate Governance Principles
- Authorizes activities of corporate governance unit
Human Capital Management Creates Value

• IRRCi & Harvard study (2015) links HCM and material improvements in financial performance

• Wharton (2006): $1 increase in payroll = increase in same-store sales of $4 - $28

• Ton (2014): increasing payroll spend = higher profit margins
Forms of Capital

Physical Capital (Infrastructure)

Human Capital (Workforce)

Financial Capital (Shareholders)

Human Capital is a fundamental **asset**.
What Is Human Capital Management?

**Human Capital Management** (HCM) includes a broad range of corporate practices related to the management of employees, including (but not limited to):

- Hiring and retention
- Employee engagement
- Training, compensation
- Fair labor practices
- Health and safety
- Responsible contracting
- Ethics
- Desired company culture
- Diversity
Human Capital Management: The Long-Term Investor Case

• Long-Term Outlook = Time
  – Benefit: Allows time to develop business
  – Challenge: Requires sustained performance

• Capital Efficiency → Long-Term Performance
Benefits from Good Human Capital Management

• Attract & retain employees
• Give employees tools to be more effective
• Create positive working environment & culture
• Build customer loyalty
• Increase revenue through reduced long-term costs
Risks of Poor Human Capital Management

- **Operational risks** = *Increased Costs*
  - Increased turnover
  - Reduced customer satisfaction

- **Legal risks** = *Increased Costs*
  - Lawsuits (investors; employees)
  - Federal & State inquiries
  - Int’l labor laws/standards

- **Regulatory risks** = *Increased Costs*
  - SEC; DOL; NLRB
  - Legislation

- **Reputational Risks** = *Increased Costs*
Poor Human Capital Management =

POOR CAPITAL EFFICIENCY
Human Capital Management (HCM) Coalition

OBJECTIVE:

Elevate Human Capital Management as critical to sustaining operational & overall performance over the long-term.

1. Focus key market participants on HCM as a long-term value driver
2. ID, assess & encourage strong HCM practices & performance
3. Encourage enhanced disclosure of HCM practices and KPIs
HCM Coalition: Who We Are

- 24 institutional investors
- $2.3+ trillion in assets
- Global coalition
  - U.S. State pension funds (CalPERS; CT Treasurer)
  - Taft-Hartley funds (UFCW; AFL-CIO; LiUNA)
  - Foundations (Nathan Cummings Foundation)
  - International funds (Legal & General Inv Mgmt)
HCM Coalition: Methods

- Retail
- Fast Food
- Healthcare

Identify Company

Send Engagement Questions
- Board Oversight: Philosophy, Culture, Approach
- Long-Term Performance & Operational Integration
- Data Collection, Risk Mgmt & Accountability
- Investor Engagement & Disclosure
- Incentives & Comp Structure

Initial Dialogue
- Tailored to Company
- Based on Initial Engagement Qs

Engagement Outcomes
- Improve Disclosure of HCM Metrics
- Enhance Board Oversight of HCM
- Develop Employee Engagement Efforts (education & training)
How a Good-Jobs Strategy Benefits Long-Term Shareholders

CtW Investment Group
Harvard Trustee Leadership Forum May 7, 2015
How a Good Jobs Strategy Can Help Fix What’s Broken at Wal-Mart and McDonald’s

• Why a low wage economy is producing low, volatile shareholder returns
• Long-term performance problems at MCD and WMT
• Why is Performance Dragging?
  – New Competition
  – Declining Customer Satisfaction
  – Declining Employee Satisfaction
• How a Good Jobs Strategy Helps
  – Restructuring Operations to achieve real efficiencies
  – Improve customer service & quality
  – Address long-standing reputational issues
• What Shareholders Can Do This Year
  – Pay Related Resolutions
  – Proxy Access
Wal-Mart Stores Inc. Underperformance

WMT trails its S&P Sector Index by 30% over the past 5 years
McDonald’s Corp. Underperformance

MCD has underperformed its S&P Sector Index by 100% over the past 5 years.
Wal-Mart’s Profitability Declining

Wal-Mart ROIC FY2009-FY2014

The chart shows a downward trend in Wal-Mart's Return on Invested Capital (ROIC) from FY2009 to FY2014, indicating a decline in profitability.
MCD’s Long-Term Return on Capital Declining
Wal-Mart Same Store Sales Declining

Wal Mart Same Store Sales

-2.00% -1.00% 0.00% 1.00% 2.00% 3.00% 4.00% 5.00% 6.00%
MCD Same Store Sales Performance Deteriorating

MCD Same Store Sales

Wal-Mart Customer Satisfaction Increasingly Below Average
MCD Customer Satisfaction Below Average And Declining
WMT: Reasons for Declining Customer Satisfaction

New York Times:
“Walmart, the nation’s largest retailer and employer, has cut so many employees that it no longer has enough workers to stock its shelves properly, according to some employees and industry analysts.”

Bloomberg:
“Earlier this year, Bloomberg News reported that Wal-Mart had trouble keeping its stores stocked as it cut back on workers per store. That has cost sales and driven away frustrated shoppers.”

Cleveland Research:
“Additionally, we believe one of the key issues leading to heavy inventory is the lack of labor in the stores to get the inventory out of the back rooms and onto the sales floor.”

8th & Walton:
“Walmart suppliers are also expressing some frustration with out of stocks and in-store execution”
MCD: Reasons for Declining Customer Satisfaction

YouGov:
“Documented problems include falling out of favor with millennials, complaints about customer service, as well as highly-publicized protests over labor conditions and wages.”

Morgan Stanley:
“29% of the respondents in the U.S. say they don’t trust the quality of McDonald’s food; 35% consider there are too many artificial ingredients on McDonald’s menu.”

The Wall Street Journal:
“much of McDonald’s most potent competition today comes from an array of smaller, more focused chains, ... [that] ‘basically do a few things well’” and that McDonald’s menu grew from 85 in 2007 to 121 in 2014.

QSR Magazine:
In 2013 that McDonald’s drive-through times were the slowest in the 15 years the magazine has reported the data (189.9 seconds vs. MCD’s 90 second goal).
Employee Satisfaction at Wal-Mart

Wal-Mart Glassdoor Rating

- Cost-Co
- Wegmans
- Publix
- Whole Foods
- Trader Joes
- Kohls
- Target
- Macy's
- Wal-Mart

The chart shows the Glassdoor rating of various retail companies, with Wal-Mart having the lowest rating among the listed companies.
Employee Satisfaction at MCD

Figure 2: McDonald's overall employee satisfaction ratings since 2010 (scale of 1-5), highlight particular challenges beginning 1Q13 as ratings declined significantly and the delta between MCD and the industry has widened...

A widening overall employee satisfaction gap to QSR peers since 2013 has coincided w/ benefits/comp ratings declines and operating results weakness.

Note: Represents 90-day rolling averages; Industry represents limited service restaurants
Source: Glassdoor, UBS Evidence Lab
Optimal Labor Allocation for Good Jobs Strategy

• Retail and fast food managers typically see labor as a cost, not sales, driver
• Incentives focus on cost-cutting and short-term profit targets
• Analysis of 250+ stores over four years shows 1 σ increase in labor leads to 10% increase in profit margin

$L^*$ = optimal amount of labor
The Bad Jobs Strategy: A Viscous Cycle

- Low Labor Budget
- Disengaged Workers
- Poor Customer Satisfaction
- Operation Problems
- Low Sales & Profits
The Good Jobs Strategy: A Virtuous Circle

- Optimal Labor Budget
- Engaged Workers
- Truly Efficient Operations
- High Customer Satisfaction
- High Sales & Profits
Good Jobs Employers

**Retail**

**Cost-Co**
- Pays ~40% more than WMT
- Turnover <10%
- High sales/ sq. ft.

**Trader Joes**
- Starting pay $40k-$60k
- Turnover ~10%
- Sales/sq. ft. 3x industry

**Quik Trip**
- Top 100 Company to Work for 7+ years
- Sales/sq. ft. 50% above industry

**Fast Food**

**In-N-Out Burger**
- Top 100 Employer
- Highest wages in industry
- Rapid expansion in California

**Shake Shack**
- Wages above industry average
- Rapid sales growth

**Starbucks**
- Health & retirement benefits
- Eliminating just-in-time scheduling
- Support for College
What’s Stopping WMT?

• Management has moved to raise wages and prioritize staffing
• However, substantial backlog of compliance issues:
  – $1.8B paid in wage & hour violations since 2008
  – NLRB finds labor law violations
  – New NLRB complaint over store closings.
• Executive pay emphasizes short-term profit targets
• Unclear if board will support significant operational changes
• Walton family controls ~50% of shares, and has two seats

Proxy Access is Solution (Item #6 on proxy)
What’s Stopping MCD?

• Activist shareholders, such as Glenview, lobby for short-term strategies such as sales of company owned stores and real estate, that do not address long-term human capital management strategy.

• Board is heavily entrenched, with 9 of 13 directors with tenure over 10 years, including 5 with over 15 years.

• Incumbent directors appear to recruit new candidates overwhelmingly from Chicago-area social circles; multiple overlaps in charitable and corporate board memberships among current directors.

• *Proxy Access is Solution (Item #6)*
Bibliography

Popsop Staff, “McDonald’s is desperate to attract customers with “24 hours of joy” or Big Mac-printed pants, Mar 27, 2015.


McDonalds Form 10K filed with the SEC 2004-2015.

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