

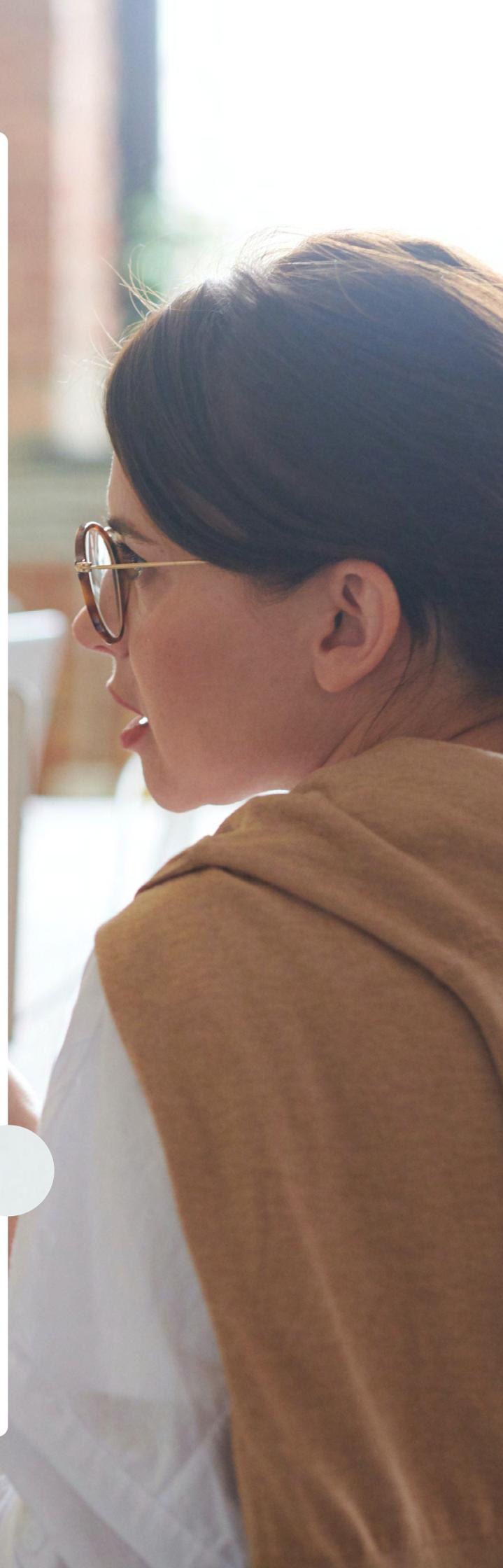
Human Capital in Small and Mid-Sized Firms

Active Engagement



JANUARY 2022

Marketing communication



The topic.

The highly-competitive operating environments and typically rapid growth of Small- and Mid-cap firms (SMID¹) can strain their employees. Competing in the same employment and talent market as larger firms, and facing the same disclosure expectations as larger firms, these smaller companies can be more exposed to Human Capital risks.



It is critical for investors to understand the ability of these issuers to adapt Human Resources practices to their entrepreneurial ambitions and to their specific business challenges. This includes gaining an understanding of how small and medium companies track the efficiency of HR measures in place, as well as sharing best practices.

Human Capital Management (HCM) can be both a key a strategic issue as well as a key Sustainability issue for the companies in our European Small & Mid Cap Equities investment universe. HCM has long been an issue for investors and for investor engagement with larger firms through efforts such as the collaborative Workforce Disclosure Initiative (WDI). Yet even among large-cap firms, few are transparent and informative. The lack of HCM information is even more acute among the smaller firms.

Candriam's Environmental, Social, and Governance (ESG) approach is to encourage long-term support, rather than exclusion. Active Engagement is an integral part of our Responsible Investing. Based on our long history of both direct and collaborative Engagement, we are developing a program of direct engagement specifically tailored to our SMID investee companies. Hand-in-hand with the Fundamental Equities Team, we work with these companies to improve their HCM data disclosure and to better understand their issues, their supervision, and how better management of human capital may improve their business performance. Our initial goal is to encourage at least the disclosure of basic but meaningful HCM Key Performance Indicators (KPIs), and to encourage further steps. The choice and rationale of KPIs is central to their success as a management tool, as well as to their usefulness for investors.

¹ - We define SMIDs as companies with market capitalization up to EUR 16 billion, reviewed annually, and with practical alignment with MSCI.

The story thus far

We embarked on our SMID workforce engagement program in September 2020, planned for two main stages.

- Stage 1: Collect indicators for preliminary analysis and determine priority topics and priority target companies.
- Stage 2: Construct qualitative questions and establish dialogues with priority companies, based on the results of the questionnaires.

Designing the initial questionnaire. The first challenge was to survey a group of companies using a relevant set of HCM-related KPIs. Along with others in the Workforce Disclosure Initiative, we have discovered that proper workforce-related reporting can be challenging even for large companies with extensive reporting systems. Our objective was to design a limited set of relevant HCM KPIs so that these smaller companies would not be intimidated by the project.

We surveyed firms on 13 KPIs related to seven themes -- *Workforce Demographics, Work Organization and Structure, Workforce Stability, Employee Recruitment and Development, Employee Engagement Practices, and Management of the Covid 19 crisis.*

The response rate was gratifying. During the first stage, between November 2020 and August 2021, we reached out to more than 60 companies, with a response rate of 72%. Our first finding was that despite their more limited resources available to respond to investor queries, the Small- and Mid-cap companies were very responsive. They seemed to understand the importance of human capital, and showed genuine willingness to improve disclosure.



The Small- and Mid-cap companies... understand the importance of human capital, and show genuine willingness to improve disclosure.

Transparency varied sharply by topic. Diving into the responses, we discovered is a strong divergence in disclosure levels among KPIs. For example, the topic of workforce demographics generated the most complete responses, while data for workforce stability, recruitment, and developing was more challenging to gather.

Workforce size ranged widely, from fewer 100 employees to tens of thousands. Considering the Covid-19 crisis, the 28% average growth of workforce over three years was strong.

Workforce contract, in the sense of temporary versus permanent or full-time versus part-time, varied widely, as expected given the range of sectors. While extreme figures are not necessarily problematic, the rationale is important, suggesting topics for qualitative dialogue in Stage 2. The proportion of permanent employees, relative to the sector and individual company situations, shapes our qualitative approach to analysing statistics on ability to Attract and Retain workers, Workload, and Health & Safety in a tight labour market. A high proportion of part-time workers permits more staffing flexibility for employers and usually indicates a more inclusive company with a wider variety of workers such as parents and seniors. However, part time is not always the choice of the workers. Associated organisational concerns, such as split scheduling, should be carefully addressed. Again, outliers are a topic for understanding the firm's business and reason for the figure in Stage 2.

The voluntary turnover rate averaged 7.6%, while the WDI survey of larger companies reported 11.3% turnover on a comparable period. As an important indicator of the ability to retain workers, this is quite a good sign for the SMID sample which benefits from the attachment of employees to these human-sized structures, with a higher level of involvement and sense of belonging.

Employees covered by annual evaluation is considered a good proxy of the *Recruitment and Development* process. For example, lack of an annual evaluation program, when combined with significant workforce growth, or low level of training, or low internal mobility should be flagged for discussion. Indeed, it raises the fundamental question of how career development strategy is driven.

Internal mobility can be a true competitive advantage, especially when workforce growth is high, as it is for many of the surveyed SMIDs. It is also a strong indication of the ability of a company to develop expertise and management skills of its own employees. A reasonable level of internal mobility is a way of improving flow between teams and sharing common values. Of course, raw data must be analysed relative to other indicators such as turnover, global workforce evolution, the age pyramid, seniority, etc.

Training hours must also be analysed in relation to other aspects, such as the sector, staff turnover, fundamental business changes, etc. and in conjunction with clear identification of competences and skills required. Although the figure can be skewed upwards in sectors with mandatory compliance training such as financial firms, hours of training can sometimes be a relevant proxy for talent development. Our survey identified several companies with declines in training over the past three years, and some strong discrepancies within the same sector. We also identified companies with low or even no training even through the business was growing rapidly. Obviously, these draw attention to topics for discussion during Stage 2.

Collective bargaining agreements are an indication of employee organisation and the balance of power. Effective representation may promote efficient negotiations, and ensure a certain level of benefits and working conditions. While collective bargaining agreements are more prevalent in some countries than others, even in countries with poor labour regulations, total absence of collective bargaining can actually indicate a higher risk exposure level.

Stage 1 shows a clear disparity in terms of disclosure, size of workforce, Human Capital risks and opportunities. It also demonstrated that the Small & Mid Cap companies we surveyed treat Human Capital as a priority. Significant scope for improvement remains, but **this constructive outcome sets a strong base for the second stage.**

Figure 1: Selected Survey Results - Three-year Average

	Minimum	Maximum	Average
Workforce Headcount	43	114,700	8,559
Percentage Temporary Workers	0%	38%	9%
Percentage Part-Time Workers	0.5%	39%	7%
Voluntary Turnover	3%	11%	8%

Source: Candriam

Next steps?

We are now prepared for an integrated Engagement program of qualitative questions and extensive exchanges with companies. We are completing our internal consultation and coordination with teams such as ESG Analysts, Fundamental Equity, Stewardship, and our own Human Resources Department in order to define and agree on our engagement priorities.

Determination of our engagement priorities includes not only the results of the first stage, but also factors including our overall internal ESG rating of the company or the weight the issuer represents if held in the portfolio.

This integration across functions, going beyond the ESG analysts and involving all relevant internal stakeholders, is critical to the relevance and continuity of our Engagement efforts. This is a demonstration of how integration of ESG factors across the functions within an asset management firm can benefit both investment and stewardship activities. With 25 years of experience in ESG investing, Candriam strives to remain at the forefront Responsible Investment.




€150 B
AUM as of
30 June 2021


570
Experienced and
committed professionals


25 years
Leading the way in
sustainable investing

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