

Executive Summary

Aviva Investors is leading the way in corporate governance with the release of a third policy paper – Human Capital – linking culture and people to organisational performance. The essence of the Human Capital Policy Paper is incorporated in Aviva Investors' company valuation process.

Aviva Investors is of the opinion that the existence of a company culture based on ethics and integrity not only leads to the positive and ethical treatment of staff, but also can enhance company performance. We believe that a thorough review of a company's people management practices is the optimal method by which to measure the integrity and ethics of a company's culture and people management practices. In summary, it is our view that there is a direct link between a company's culture and values, people management practices, and company profitability and long term performance.

With an increasing amount of external pressure placed on companies (e.g. compliance legislation, a push for good corporate governance, and economic pressures of tight margins and competition) companies must become more effective and efficient in their quest to reach their bottom line goals. In order to do this, and gain competitive advantage, we believe a company's approach to positive and strategic people management is not only the best, but perhaps the only way in which to achieve these goals.

To validate our views, Aviva Investors recently undertook a literature review to investigate the link between a corporate culture based on ethics and integrity and company performance. Recent research indicates a significant correlation between ethical corporate conduct, people management activities and company performance. A British research project found that employee attitudes and organisational commitment can impact company profitability by up to 5%, and productivity by up to 16%. This research indicated that human resources management practices can contribute to a 19% variation between companies in terms of profitability, and up to 18% variation in productivity.

The British research also compared the impact of people management practices against other management strategies such as business strategy, emphasis on quality, use of technology and investment into research and development. The findings were surprising; strategy, emphasis on quality, and technology accounted for between 1 and 2% variation in profitability and productivity, whilst research and development accounted for up to 8% variation in profitability (the impact on productivity was not considered to be statistically significant). Compared with the impact of human resource management practices (18% variation in productivity and 19% variation in profitability), it is clear which is a more powerful predictor of company performance.

Furthermore, a recent US-based study found conclusive empirical evidence that the presence of an 'ethical tone' set by senior management tended to permeate all levels of an organisation leading to superior company performance and enhanced corporate reputation.

A key outcome of our research has been the development of a 'human capital survey'. It is our aim to collect and analyse information that will then help provide insights into a company's long term performance. Company responses will be assessed against an index and an overall rating will be applied. Companies that complete the Human Capital survey will, upon request, receive guidance as to the types of measures and people management practices that can improve corporate governance and their long-term bottom line returns. To our knowledge, we believe that Australian fund managers have not considered a formal review of human capital like this in their company research process.

It is our opinion that this initiative will result in a win-win situation for all stakeholders concerned: Aviva Investors will be better equipped to accurately evaluate the risk component of a company valuation; Companies will have access to up to date information on best practice in terms of corporate culture and people management practices; employees of participating companies will benefit from improved people management practices; and shareholders of those companies should realise better returns in the long term.

This paper offers several ideas for responding to a call for improved social reporting practices. The Human Capital survey could provide a checklist for CEOs, MDs, and HR executives when considering a more strategic approach to corporate culture and people management. However, before culture and people management can become more effective, and strategic, CEOs and other senior executives and management at all levels must be committed to the view that all staff are valuable, and that the values of ethics and integrity are paramount to business success.