

Human Capital Management and Diversity: A Company's Most Important Assets

Why are Human Capital Management and Diversity Important?

- Human Capital Management and diversity are both critical components of a company's DNA and have been shown to positively contribute to corporate sustainability, increased performance and long-term value creation.
- Diversity is at the core of CalSTRS as an organization and who we represent: more than 914,000 California educators, each with different ideas, strengths, interests, cultural backgrounds, etc.
- In today's global economy, it is vital that boards and companies include diversity of thoughts and perspectives to avoid being affected by "group think."
- Proven research by McKinsey & Company confirms that companies with diversity in their management staff and on their corporate boards deliver better financial results on average than companies that do not. Gender-diverse companies and ethnically diverse companies are 15 percent and 35 percent more likely to outperform their industry (see below chart).
- Recent empirical research demonstrating the correlation between strong HCM and shareholder returns supports this approach. A company that subverts the law or widely adopted international standards for HCM is exposed to operational, legal, regulatory, and reputational risks that may create roadblocks for both its existing operations as well as efforts to expand to other markets.

How diversity correlates with better financial performance

Likelihood of financial performance above industry median, by diversity quartile

15%

*more likely
to outperform*

Gender-diverse companies

35%

*more likely
to outperform*

Ethnically diverse companies

Source: 2015 "Why Diversity Matters" by McKinsey & Company, www.mckinsey.com

Affinity Group Overview and Engagement Results:

- **Human Capital Management Coalition:**
This group of 27 institutional investors, representing over \$2.6 trillion in assets, engages capital market participants and other stakeholders on the importance of investing in human capital as a driver of long-term performance to increase shareholder value through risk-adjusted sustainable returns.
 - > The HCM Coalition views human capital management as encompassing a broad range of corporate practices related to the development and management of a diverse workforce, employee engagement, training, compensation and a desired company culture of both diversity and inclusion.
- **Enhanced Diversity Initiative:**
CalSTRS' "Enhanced Diversity Initiative" engages a select number of companies to understand their diversity programs and efforts to diversify executive staff and increase the pipeline of diverse board candidates.
 - > In December 2016, staff engaged with 10 financial and technology portfolio companies to encourage organizational diversity. These companies were identified due to historical trends within these industry sectors for ethnic and gender diverse individuals to be underrepresented in executive positions.

Affinity Group Overview and Engagement Results (continued from page 1):

- **Thirty Percent Coalition:**

CalSTRS and 20 large institutional investors are currently engaging 81 companies to foster greater board diversity by strengthening nominating and corporate governance policies and charters by embedding a commitment to diversity inclusive of gender, race, ethnicity and more; committing to include women and underrepresented minority candidates in every pool from which board nominees are chosen; expanding board director searches to include nominees from both corporate positions beyond the executive suite and nontraditional environments, including government, academia and non-profit organizations; and reporting on progress and any challenges experienced along the way.

- > As a result of the coalition's work in 2016, 18 companies did one or more of the following: appointed one or more women to their board; amended the company's corporate governance policies or charter to commit to diversity of gender, race and ethnicity; and expanded search and nominating processes to include women and underrepresented minority candidates.

- **California Initiative:**

The California Initiative began after the Graduate School of Management at the University of California, Davis, in partnership with Watermark, published its 11th annual study: *California Women Business Leaders: A Census of Women Directors and Highest-Paid Executives*. CalSTRS, in conjunction with CalPERS, continues to use this study to engage California companies with no women directors.

- > In mid-2016, 87 companies were engaged, resulting in 12 doing one or more of the following:
 - Appointed one or more women to their board;
 - Amended the company's corporate governance policies or charter to commit to diversity of gender, race & ethnicity; and/or
 - Expanded their search and nominating processes to include women and underrepresented minority candidates.

- **Coalition of Four:**

In November 2016, CalSTRS, along with two international institutional investors and a U.S.-based pension fund, collectively representing assets under management of more than \$2.5 trillion, wrote letters to 61 S&P 500 companies to gain a better understanding of their various practices to ensure maximum board effectiveness and promote diversity. These companies either had no women on their board or only one woman, while also having a significant proportion of their directors serving on the board for lengthy periods of time. The companies with no women on their boards are outliers in the S&P 500, where more women are being appointed to boards on a regular basis.

- > Staff is currently receiving responses and plans to engage these companies, not only on board diversity, but to learn how they promote diversity at senior management levels and throughout their organization. It is imperative that companies invest today to develop a diverse pipeline of talent.

- **Diverse Director DataSource – 3D:**

Developed in 2011 by CalSTRS and CalPERS, the Diverse Director DataSource, known as 3D, offers shareholders, companies and other organizations a resource to locate and recruit diverse individuals whose experience, skills and knowledge qualify them to be a candidate for a director's seat.

- > Recently, CalSTRS and CalPERS announced that 3D will now be available through the Equilar Diversity Network. Launching 3D on Equilar's Diversity Network showcases the depth and availability of qualified, diverse directors. The Diversity Network is designed to connect candidates from various diversity organizations with corporate boards. Moving 3D to Equilar comes as CalPERS and CalSTRS continue to make strides in exercising their shareholder positions to strongly reinforce corporate board diversity. Sourcing candidates from multiple Equilar databases, including 3D, should further expand outreach and consideration of diverse candidates.

Regulatory Engagement:

- Regulatory engagement is an ongoing focus with continuous engagement with the SEC regarding a rulemaking petition to require board member disclosures in a company's proxy to evaluate the nominees' gender, racial and ethnic diversity, and skillsets to oversee the company's long-term business strategy.