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Call for evidence on the non-financial reporting review Acas response

16 August 2023

This is the Acas Executive response to the government's call for evidence on the smarter regulation non-financial reporting review.

Cover letter

Acas and the CIPD welcome the opportunity to respond to the government's non-financial reporting call for evidence. Together we commend to the government the critical value of social factors within environmental social and governance (ESG) to a pro-growth agenda and hence to value creation and risk mitigation.

The social aspect of environmental social and governance is less well developed or consistently reported upon than governance and environmental reporting. While we recognise the economic imperatives and global climate emergencies that require attention we also argue that matters of human and social capital also need to be prioritised by company boards. This was very much in evidence during the recent covid-19 (coronavirus) pandemic. Health and safety, labour and skill availability and job design and culture were all demonstrated as being material to company performance and therefore important and significant in their own right.

Our ask of government is that you support a more strategic approach to social non-financial reporting over the medium to long term. While some investors are focused on a narrow set of ethical and diversity dimensions of 'good corporate social responsibility (CSR)' there is robust evidence pointing to a need for Boards to identify a broader set of material 'Social' dimensions to help businesses thrive and manage risks during uncertain challenging times and ultimately to drive value over the longer term.

Acas and the CIPD have started to marshal the evidence on the evolving definitions of the 'Social' dimensions. We are also reviewing the non-financial social metrics in UK and international frameworks to understand areas of commonality and gaps. We would be happy to share the evidence and emerging models with the government in the autumn.

Our response to the Department for Business and Trade (DBT) call for evidence recommends:

- when considering changes to current legal requirements for companies to prepare non-financial information, that the government be cognisant of the importance of 'Social' factors to growth – there is a current gap in the way these are understood and used by stakeholders and investors, which is a risk to progress
- the government to invite Acas and the CIPD to present their findings based on the large body of evidence demonstrating the positive link between material 'Social' dimensions and long term value-creation and risk mitigation – also on the implications for consistent reporting and benchmarking
- that the government acknowledges, and makes greater use of, the large body of management information available from Acas and the CIPD on the causes of and solutions to workplace conflict and what measurable practices create and build healthy, productive workforces
- using the shared convening powers of Acas and the CIPD – there is a process of investor and corporate engagement planned over Q3 to Q4, and the government's involvement would be welcomed

Acas and the CIPD have each separately submitted detailed responses to the call for evidence, drawing on our rich research and insight on the workplace.

We would welcome further ongoing conversations to advance the UK's competitive advantage by engaging in a pro-growth conversation about the 'Social' in environmental social and governance.

Full response

What changes, if any, would you like the UK government to make to the current legal requirements for companies to prepare non-financial information, and why?

Key summary

Global investors need a consistent set of workforce metrics to understand and make evidence-based decisions on what adds material value and mitigates risk. Acas wishes to contribute to a longer conversation with the UK government, using emerging evidence, to inform a future definition of the 'Social' in environmental, social and governance, which captures both workforce factors and the wider 'Social' domains.

Our insight suggests that a focus on the material non-financial information has potential to support financial return – to companies, investors and to the wider UK economy – and that this is currently undermined by a lack of understanding of social factors. Better reporting focused on the social metrics that matter, should mean that Boards are better able to deliver your aim of 'meaningful engagement with the information … driving strategic decision making by companies' and fulfil Directors' responsibilities to have regard to the interests of the company's employees.

We recommend:

- When considering changes to current legal requirements for companies to prepare non-financial information, that the government be cognisant of the importance of 'Social' factors, particularly those which link to an engaged workforce, to a growth agenda. There is a current gap in the way these are understood and used by stakeholders and investors, which is a risk to progress.
- The UK government notes the large body of evidence demonstrating the positive link between value-creation, productivity, growth and a range of workforce factors, including: management practice; dimensions of 'good' work (for example, adequate pay and benefits, ensuring employees' health, safety and wellbeing); employee engagement; and skills. We recommend the government works further with Acas to distil the findings from the evidence and develop a model definition of Social, covering both workforce factors and wider 'Social' domains.
- Noting the low engagement in non-mandated reporting, we would welcome the opportunity to work with the government to raise understanding and awareness of the evidential basis on the links between workforce practices, metrics and growth, to build demand for and consistency in reporting.
- The UK government works with Acas to develop a comprehensive understanding of the domestic and international frameworks and standards, to scope the commonalities and gaps; and make recommendations on clear domains of Social reporting based on both appetite and impact.
- Using our convening powers, Acas has a programme of investor and corporate engagement planned over Q3 to Q4. We would welcome the government's involvement in that, and to build in complementarity with your own engagement programme.

Introduction

Acas (the Advisory, Conciliation and Arbitration Service) welcomes the opportunity to respond to the government's non-financial reporting review call for evidence.

Acas is an independent and impartial non-departmental public body with a statutory duty to promote the improvement of industrial relations in Great Britain. In carrying out this duty, Acas offers conciliation in both individual and collective disputes, good practice advisory services for employers, and a website and national helpline which assists millions of employers and employees each year.

Our work gives us unique insight into what is and is not conducive to good industrial relations and, in turn, what has potential to drive productivity, value and growth. It also makes Acas the evidential authority on the risks generated by poor workplace relations. We have examples from Tata Steel, to Phoenix Group to the NHS and railways which offer investors insight into how Board assurance and decisions which can either generate value, or create risks to success.

We recognise and are cognisant of the evidence on the broader 'social' domains, which are material to investment decisions. However, this response to the Department for Business and Trade's call for evidence focuses on Acas's unique expertise and evidence on the causes of workplace success and the costs of workplace dispute. It is offered as strategic evidence in considering how non-financial reporting can drive a pro-growth agenda; and mitigate risk to reputation and engagement.

Acas evidence demonstrates the considerable costs associated with workplace conflict (see below); and data on why organisations come to Acas for help shows the key areas which businesses struggle most with, and which lead to conflict. We recommend the government seeks further analysis of this data, which will provide sharp focus on what should be measured and reported on, as it reflects both material benefit and cost.

The UK is an attractive place to do business, with competitive advantages, including 'flexibility in the way that people engage with the labour market'. Acas acknowledges this while noting the implications for employee engagement, management quality, conflict, employee voice. Addressing these implications would enable the UK to further build on its relative strength in this area.

These factors are integral to the 'Social' in environmental, social and governance. The UK would therefore benefit from a definition and investor focus that incorporates these factors. Indeed, according to the 2022 Labour Rights Index, the UK scores highly, and its index score (88) – denoting that the UK is 'approaching decent work' – has increased since 2020 (the index covers 135 economies and is structured around the working lifespan of a worker, based on 46 questions or evaluation criteria scored across 10 indicators). The UK's overall score compares favourably to other major Western economies including the US (63.5), and Canada (76) and is similar to Germany (89), Norway (88) and Spain (90). (It also registers maximum scores for: ‘family responsibilities’ (which includes laws requiring parental leave, paternity pay, flexible working for family responsibilities); 'maternity at work' (paid maternity, minimum thresholds, protection from discrimination); 'safe work'; 'social security' (pension, unemployment benefit); 'fair treatment'; 'child and forced labour'; and 'trade union' recognition.)

Next steps

Acas is working with a range of partners to explore the 'Social' in environmental, social and governance – what evidence exists around different aspects of 'Social' reporting to generate value creation, where the commonalities of approach exist between international frameworks, and what these tell us about what investors, shareholders and corporates value. This insight will be shared with the government over autumn and winter 2023 to 2024. It is our intent to open a broader conversation on the S to help the investment and corporate governance community recognise the value of the Social and its materiality to their interests.

Benefits of non-financial reporting

We support the policy proposition of Smarter Regulation to Drive the Economy that 'the productivity of British businesses is the fundamental driver of our economic performance, and in turn the prosperity of every household'. And we recognise the Department for Business and Trade's analysis in Smarter regulation non-financial reporting review: call for evidence that 'the demand for the provision of non-financial information has grown, as investors and other stakeholders seek information to support more sophisticated decision making that is not just narrowly focused on financial return'. The existing Companies Act 2006 makes explicit that, in promoting the success of a company, the director must 'have regard' to – amongst other things – 'the interests of the company's employees'.

In summary: Annex A sets out the evidence base, which shows that there is a correlation between effective corporate social reporting and value creation or risk mitigation. Ensuring investors and shareholders have what they need to make effective decisions is key to avoiding unclear, inconsistent reporting measurements. We have commissioned a deeper dive into the available evidence, and invite further discussions with the Government on which ‘domains’ of social reporting have greatest impact.

Current weaknesses in non-financial reporting

Environmental, social and governance reporting is becoming more common, however, there is lack of clarity on the definition and scope of 'Social'. Acas is currently undertaking a review of the non-financial social metrics in use across different UK and International frameworks, including commonalities and gaps. While there are consistencies around key human rights issues, for example, forced labour, child labour and modern slavery, our initial findings suggest significant gaps around workplace factors including productivity, flexible work and skills. This overlooks the potential of workplace factors in terms of value creation and risk mitigation. Full analysis can be shared with the Department for Business and Trade later in 2023 to 2024.

The absence of agreed standards and metrics results in an ad-hoc approach from organisations. Our preliminary conversations suggest that material stakeholders also have different definitions of 'Social'. For example, some focus on equality diversity and inclusion issues; some on health and safety elements; and some (the majority) on the current legislative frameworks on gender pay and modern slavery. This lack of consistency poses a challenge in terms of benchmarking (this is seen in the role of ratings agencies, where OUP's Public Finance found in November 2022 that 'ESG rating divergence decreases companies' incentives to improve their ESG performance. Companies receive mixed signals from rating agencies about which actions are expected and will be valued by the market').

While it does not sit within Acas's core areas of expertise, we also note there are also evidence gaps in wider reporting of the 'Social', for example around community impacts and ethical products. Many of these wider 'Social' factors may be determined by the reporting entity, depending on what is material to their business. However, we believe the workforce elements are of universal value.

In summary: Social reporting is not as advanced as either governance reporting or environmental reporting. While there are a number of models available – they do not achieve consistent traction or high levels of engagement (beyond mandated requirements in different jurisdictions). We recommend a full review of the evidence as it relates to different elements of social reporting, with a view to development of a model setting out what possible reporting domains have material benefit and can address risk. We would be happy to share our emerging research findings with the government by the end of 2023.

The case for a focus on workforce factors: the link to productivity

Acas has a long-standing interest – and proven track-record – on helping UK organisations close the 'productivity gap' through a focus on workforce dimensions including, for example, skilled managers, employee voice, fairness, and well-designed work. This is evidenced by the Acas Productivity Tool, one of several outputs designed to help organisations identify their strengths and weaknesses, and, in turn, find solutions to productivity problems through a series of simple practical steps. Indeed, this tool builds and draws on the substantial body of evidence that shows the positive relationship between broader social factors and value-creation, productivity and growth. These factors are material to directors, investors and other stakeholders in the fulfilment of their duty to ensure the success of a company and pay regard to future strategy, opportunities and risk.

This submission focuses on Acas's evidence and experience. Acas is the evidential authority on what works – and what does not – in a workplace. Evidence on a number of workforce factors relevant to value-creation is outlined below (please note, our full definition and model of the most impactful reporting domains will be shared later this year).

Management practice

There is evidence to suggest that productivity problems can, at least in part, be attributed to relatively poorer management practices. Bloom and Van Reenan's World Management Survey (WMS) has, since 2003, mapped management practices across more than

20,000 businesses, hospitals and schools in 35 countries. It finds that firms ranked amongst the top fifth for 'management quality' are more than 3 times as profitable as the bottom fifth.

'Good work'

There is also evidence that good work can help deliver productivity gains. The 2017 Taylor Review defined good work as 'working practices that benefit employees through good reward schemes and terms and conditions, having a secure position, better training and development, good communication and ways of working that support task discretion and involve employees in securing business improvements'. Indeed, academic research from 2005, based on an analysis of European data from 1995 to 2000, suggests that countries with higher job quality have higher levels of labour productivity and vice versa.

More recent 2020 research from the Warwick Institute for Employment Research found evidence of a link between good work and productivity. Their research comprised a literature review of the grey and academic literature examining seven dimensions of 'good work' and productivity measures, identified by the Carnegie UK Trust-RSA Working Group on Measuring Job Quality (PDF, 2MB).

The Warwick Institute reports a positive correlation between four of the seven dimensions of good work (for which evidence exists) and productivity: particularly pay and benefits; health, safety and psychological wellbeing; job design and the nature of work; and voice and representation.

Employee engagement

Research has shown that employee engagement can have a positive impact on organisational performance. The Institute for Employment Studies, a British centre of research and consultancy on human resources and employment, has published a large body of research on this topic, and points to an 'increasing awareness that employee engagement is pivotal to successful commercial and business performance', describing engaged employees as 'the backbone of good working environments'.

Further evidence is found in a 2020 meta-analysis from Gallup (PDF, 616KB) on the relationship between engagement at work and organisational outcomes. Performance outcomes included: customer loyalty and engagement, profitability, productivity, turnover, safety incidents, absenteeism, shrinkage, patient safety incidents, quality (defects), wellbeing and organisational citizenship. It found that employee engagement is related to each of the 11 performance outcomes studied. Results indicated high 'generalisability' – the correlations were consistent across different organisations.

In addition to the above, analysis of the 2017 Skills and Employment Survey (PDF, 2MB) – a survey of over 3,000 workers across Britain – found strong evidence for the links between employee engagement and innovation at work.

Finally, evidence from the 2011 Workplace Employment Relations Survey (WERS) shows a positive relationship between employee trust and firm performance. The Workplace Employment Relations Survey – co-sponsored by a range of organisations including Acas – was last carried out in 2011, comprising a sample of 22,000 employees. A 2013 paper (PDF, 400KB) from the University of Sheffield's Institute for Economic Analysis of Decision-making analysed data from the 2004 and 2011 Workplace Employment Relations Survey, finding that – in both the pre and post (2008) recessionary period – there is a positive relationship between three measures of workplace performance (financial performance, labour productivity and product or service quality) and employee trust.

Skills

Education and skills are important drivers of productivity. Various econometric studies have confirmed the importance of skills and education for productivity growth. For example, a 2013 BIS research paper (PDF, 622KB) found that a 1% rise in the share of the workforce with a university education raises the level of productivity by 0.2 to 0.5% in the long run. Research from the US suggests that skills play a key role in the effective use of information technology and there is evidence – based on analysis of linked-employer-employee data – that innovation at firm level is enhanced by a combination of skills and research and development (R&D) investments. Recent papers from the Productivity Insights Network and the OECD reached a similar conclusion.

A [2009 paper (PDF, 1MB)]() from the Warwick Institute for Employment Research found similar evidence. It examined data from a number of sources, including the Labour Force Survey (LFS), the National Employers Skills Survey (NESS), ONS Regional Accounts, Global Entrepreneurship Monitor (GEM) and BERR 'Business Start-ups and Closures: VAT registrations and deregistrations in 2007'. It concluded that, in general, the evidence suggests that skills levels are related to productivity, that is more highly skilled people produce more high value goods and services more efficiently.

In summary: there is a substantial body of evidence that shows the positive relationship between value-creation, productivity, growth and a range of workforce factors within the 'Social' in environmental, social and governance, including: management practice; dimensions of 'good' work (for example, adequate pay and benefits, ensuring employees' health, safety and wellbeing); employee engagement; and skills. A focus on these factors is beneficial to business and in turn UK plc. We are currently developing a framework model of these domains, which we would be happy to share with the government by the end of 2023.

The case for a focus on workforce factors – the link to risk

There is scope for non-financial social reporting to help companies identify and address broader risks or threats to their productivity and growth and empower investors in both investment decisions and their ongoing approach to risk and sustainability.

2021 Acas-commissioned research mapped the incidence of conflict across UK workplaces, showing the impact on individuals and their employers. This found that the cost of conflict to UK organisations was £28.5 billion, the equivalent of more than £1,000 for each employee. Close to 10 million people experienced conflict at work. Of these, over half suffer stress, anxiety or depression as a result; just under 900,000 took time off work; nearly half a million resigned, and more than 300,000 employees were dismissed.

The vast majority of those who suffer from stress, anxiety or depression due to conflict continue to work. This 'presenteeism' has a negative impact on productivity with an annual cost estimated between £590 million and £2.3 billion.

The same study showed that conflict leading to dispute triggers further costs and risks. It calculates that the total cost of management time spent dealing with potential and actual litigation is estimated at £282 million each year with a further £264 million spent on legal fees. In addition, we calculate that £225 million in compensation is awarded against employers per year.

More broadly, insufficient focus on workforce factors, reporting and deep understanding can lead to damage to reputation and therefore profits. Several recent cases have been in the media where poor management practices and insufficient focus at Board level to respond effectively to risks have led to reduced influence and drop in profit.

Employers and employees come to Acas for help – from our helpline and website – to get things right, or to respond to challenges. They come to us when things go wrong, and the workplace relationship has broken down. They come to us to identify the root cause of a problem, and to find ways to resolve it – this in-depth, often in-house advisory work, is commonly about culture and behaviour change. They also come to us to stay informed and updated on salient and topical issues relevant to workplace relations.

To provide a pattern and avoid the aberration in management data caused by covid, the stats below compare the last reporting year (2022 to 2023) with 2019 to 2020.

Advice

- In 2022 to 2023, we received 649,000 helpline calls (799,000 in 2019 to 2020). Of these, the most common topic was around discipline, dismissal and grievance (39% compared to 36% in 2019 to 2020). Followed by contracts, then wages or pay (in 2022 2023, 18% and 15% respectively; in 2019 2020, 16% and 14%).
- In 2022 to 2023, there were 10.5 million website visits for help and advice. Main topics were resignation letter templates, disciplinary and grievance, redundancy, dismissals and national living wage. On 22 February 2020, we published our first set of covid advice and had 2 million sessions on this page in 6 weeks, which skewed our wider data.

Disputes

- The top 3 issues which come to Acas for early conciliation (EC) are: Wages Act (31% of cases, 26% in 2019 to 2020); Unfair Dismissal (21%; 23% in 2019 to 2020) and Disability Discrimination (13%, 11% in 2019 to 2020).
- Of the 105,000 early conciliation notifications received last year; only 32,000 went on to become employment tribunal (ET) claims (91,000 in 2019 to 2020; of which 31,000 went onto employment tribunal).
- The top three issues which came to Acas for conciliation at the employment tribunal stage were: Unfair Dismissal (45%; 42% in 2019 to 2020); Wages Act claims (40%; 35% in 2019 to 2020) and Breach of Contract (26%; 28% in 2019 to 2020), with a close fourth of Working Time (Annual Leave) (25%; 25% in 2019 to 2020). Disability discrimination increased in proportion from 13% of cases at early conciliation stage to 23% of cases at employment tribunal stage.
- In 2022 to 2023, we dealt with 621 formal collective disputes (and many more before formal talks commenced). Of these, 40% were about pay; and a further 25% were about 'Other Pay or Conditions of Employment' (510 disputes; 25% and 33% in 2019 to 2020). In-depth business support.
- In 2022 to 2023, we conducted 23 in-depth advisory projects within organisations. A large majority of these were on conflict, mediation and change management (2019 to 2020; 56 projects).
- In 2022 to 2023, we conducted 330 in-depth advisory meetings face to face, with a further 2,100 by phone (866; 2,994 in 2019 to 2020). The most common issues in face to face meetings were about conflict, mediation and change management and managing people; and by phone about discipline and grievance and conflict, mediation and change management.
- In 2022 to 2023, we ran over 1,000 in-workplace training courses, with the most popular events being on managing people (34%) and discipline and grievance (24%). This 11 compares to 1,700 in 2019 2020; managing people (27%) and discipline and grievance (20%).
- We ran 831 'open access' training events in 2022 to 2023 (1,320 in 2019 to 2020); with the most popular being on managing people (42%) and discipline and grievance (19%) (25% and 19% respectively in 2019 to 2020).

All the above illustrates the critical issues which employers and employees need help with, what is causing conflict, and what is creating cost and risk (and reducing workplace productivity).

In summary: workplace conflict represents a significant cost to individual firms and the UK economy as a whole. A lack of focus on non-financial reporting to enable board assurance also creates risks to reputation and market value. Expanding the scope of non-financial reporting to include key workforce factors would empower investors to identify and address the risk that workplace conflict poses to firm performance, ultimately benefiting business and UK plc.

We would be keen to work with the government on what causes these issues, how to ameliorate or prevent them, and to link that to value creation. We are part of an international disputes agencies network (along with USA, Canada, South Africa, Northern Ireland and the Republic of Ireland, Australia and New Zealand); and offer to work in partnership with this network to understand any similarities or differences between jurisdictions to help inform the UK response to the global International Sustainability Standards Board measures.

How should the standards being prepared by the International Sustainability Standards Board (ISSB) be incorporated into the UK's non-financial reporting framework?

Alignment with the International Sustainability Standards Board

The consultation notes that the UK also needs to be able to respond to international developments, including the International Sustainability Standards Board global reporting standards.

We welcome the International Sustainability Standards Board's mission to issue ISSB Standards that address 'climate first, but not climate only' and their focus on research topics that will ensure entities meet the information needs of investors on sustainability topics beyond climate.

The programme does not yet include key social issues, in particular regarding those that have a clear correlation with productivity, as outlined earlier in this submission, namely around skills, job design, employee voice and representation, and good management practices. It would appear to be a risk to the UK pro-growth skills-focused approach to adopt a strategy that does not explore these areas.

These gaps in the International Sustainability Standards Board's proposed research areas are consistent with the gaps seen across the range of global standards and frameworks, which we are in the process of analysing. This could be considered an oversight because it is fundamental to being able to model the impact of social value. It would therefore appear to be a risk not to have an explicit focus on productivity.

In summary: the International Sustainability Standards Board's definition of 'Social' within their forward research programme misses key factors that could be critical to UK growth and are important but not yet well enough understood factors of material interest to the investment community. We recommend the government considers whether there is an opportunity as part of its long-term strategic thinking to encourage the International Sustainability Standards Board to explore these factors to inform and support investors. We will be writing in response to the International Sustainability Standards Board consultation separately.

Annex A: Benefits of non-financial reporting – the evidence base

There is a vast body of research showing a positive correlation between good environmental, social and governance practices, including social reporting, and financial performance. 2016 research from Harvard Business School (PDF, 784KB) provides empirical evidence that companies focusing on addressing material sustainability issues report better financial performance, as measured by return on assets and return on equity. Similar findings have been reported by 2 meta-analyses (that is the statistical combination of results from 2 or more separate studies). Based on the findings of more than 200 academic studies, corporate reports, and books, Clark, Feiner and Viehs (2015) found that around 90% of them showed a positive correlation between environmental, social and governance factors and financial performance; they argued that companies can – and should – 'do well while doing good'. Earlier 2012 research from Deutsche Bank (PDF, 959KB) paints a similar picture. It examined 'more than 2,000 academic studies published since 1970', finding that almost two thirds (62.6%) showed a positive correlation between environmental, social and governance strategies and strong financial performance – and that this correlation has remained relatively stable since the mid-1990s.

2019 research from McKinsey (PDF, 718KB) highlights the importance of social reporting to investors, pointing to 'investors and executives who realise that a strong ESG proposition can safeguard a company's long-term success', and that 'the magnitude of investment flow suggests that ESG is much more than a fad or a feel-good exercise'. A 2022 paper from Pérez et al. shows the compelling evidence for this: 'inflows into sustainable funds, for example, rose from $5 billion in 2018 to more than $50 billion in 2020 – and then to nearly $70 billion in 2021'. George Serafeim, writing in 2020 for the Harvard Business Review goes further, arguing that 'companies don’t win over investors just by issuing sustainability reports and engaging in other standard ESG practices', instead they must be integrated into an organisation's 'strategy and operations' – this is because, he says, 'investors are becoming sophisticated enough to tell the difference between greenwashing and value creation'.

More specifically, there is 'growing evidence' – according to Bhattacharya, Sen and Korschun (2008) – that a company's corporate social responsibility activities comprise a legitimate, compelling and increasingly important way to attract and retain good employees.

A 2022 McKinsey paper argues that social reporting is conducive to gaining consumers' trust. It argues that organisations must 'take adequate account of social licence – that is, the perception by stakeholders that a business or industry is acting in a way that is fair, appropriate, and deserving of trust'. A 2021 poll from PwC involving over 5,000 consumers found that 83% think companies should be actively shaping environmental, social and governance best practices, with 76% agreeing with the following statement: 'I will discontinue my relationship with companies that treat the environment, employees, or the community in which they operate poorly'.