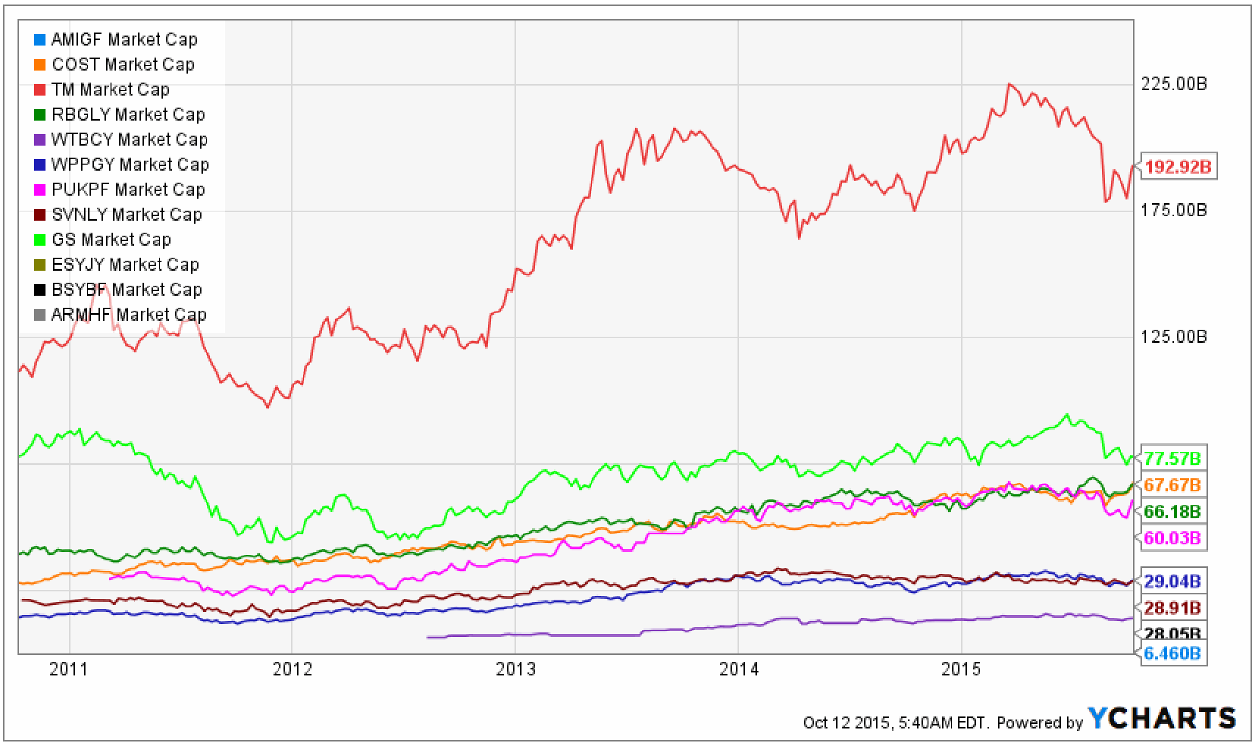
The Materiality of Human Capital Management:
Value & risk indicators

Gross value potential
Human capital management ratings analysis for our Global OMI (www.omservices.org) has identified that FTSE corporations are currently only able to realize barely 50% of the potential value from their human capital. This represents a colossal shortfall in value being lost by shareholders, customers, employees and society at large. The top 150 quoted UK companies currently have a combined market value of over £2 trillion: every 1% improvement is worth c£20 billion. Our analysis suggests that an improvement of at least 10% is achievable through understanding human governance and by adopting more effective human capital management practice.

Company Market Value
15 companies are currently OMI rated as BBB or higher (See Appendix). As ratings increase, each company with a higher rating has an increasingly differentiated approach to human governance and managing human capital. Historical market values show a distinctive, significant upward trend for these higher rated firms – see graph below for 5-year view for 12 companies within this grouping:



Our OMI highlights how more effective HCM is linked to greater sustained value creation and is a significant, material factor in explaining market value and competitive differentiation. Toyota (OMI rated A+) is a prime example as its market value is c4x that of GM, despite both producing similar volume. Key areas where HCM manifests with tangible evidence are outlined below.

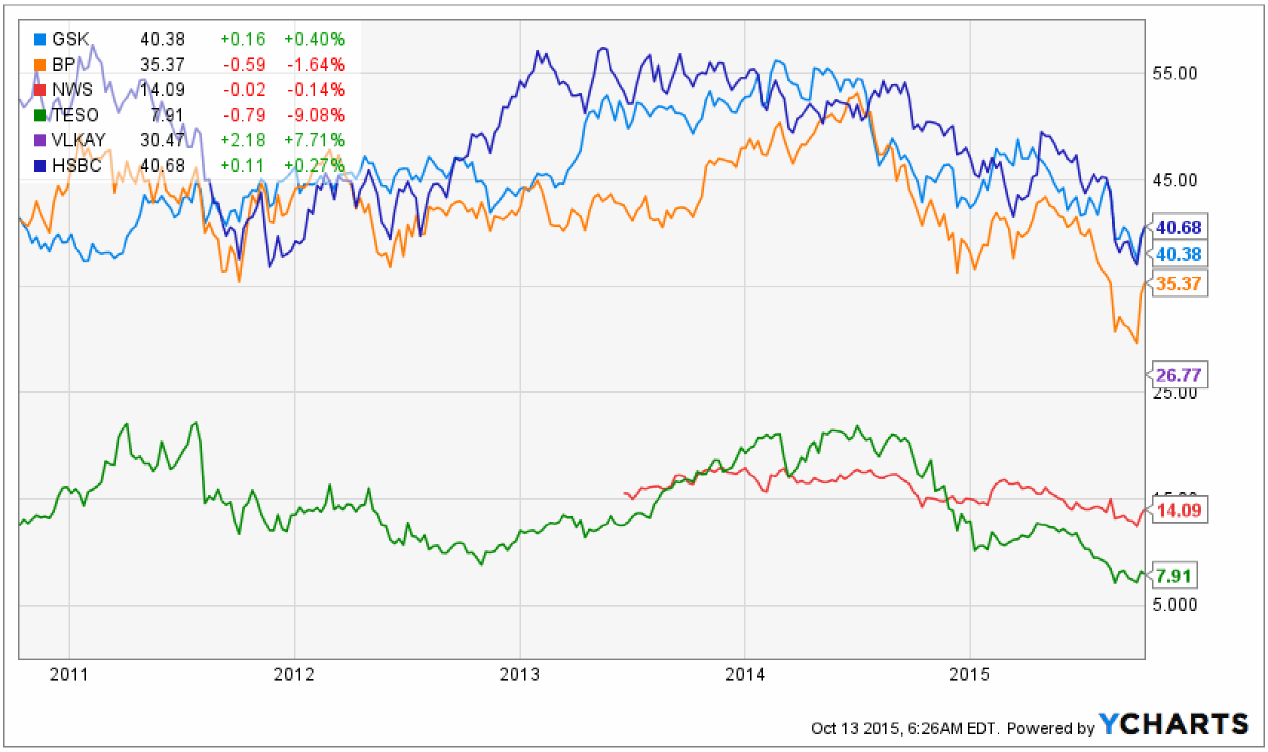
Business risk

Myriad examples of corporate problems and management failures appear to be mounting on a daily basis. The causes are endemic in most large organizations and are invariably rooted in immature management practice. The subsequent significant losses in value are the direct consequence of an absence of human governance and inadequate human capital management systems. Recent and highly publicized examples include:

1. VW – emissions cheating (20% stock value loss in immediate aftermath and unknown long term damage to business)
2. Tesco – accounting and supplier scandal (significant financial and share price impact; long term reputation/quality damage)
3. GSK – bribery scandal (£300m fine; revenue loss and reputational damage)
4. BP – cost driven quality failures (US$20-30bn settlement and associated costs from Gulf of Mexico crisis)
5. HSBC – Swiss tax evasion and Mexican money laundering
6. Banking sector - conduct costs (US$300bn[1])
7. News International – UK phone hacking scandal

Share price performance for these firms over 5 years and our Global OMI ratings for four of these companies are shown below:

Tesco B
HSBC BB-
GSK BB-
BP BB+



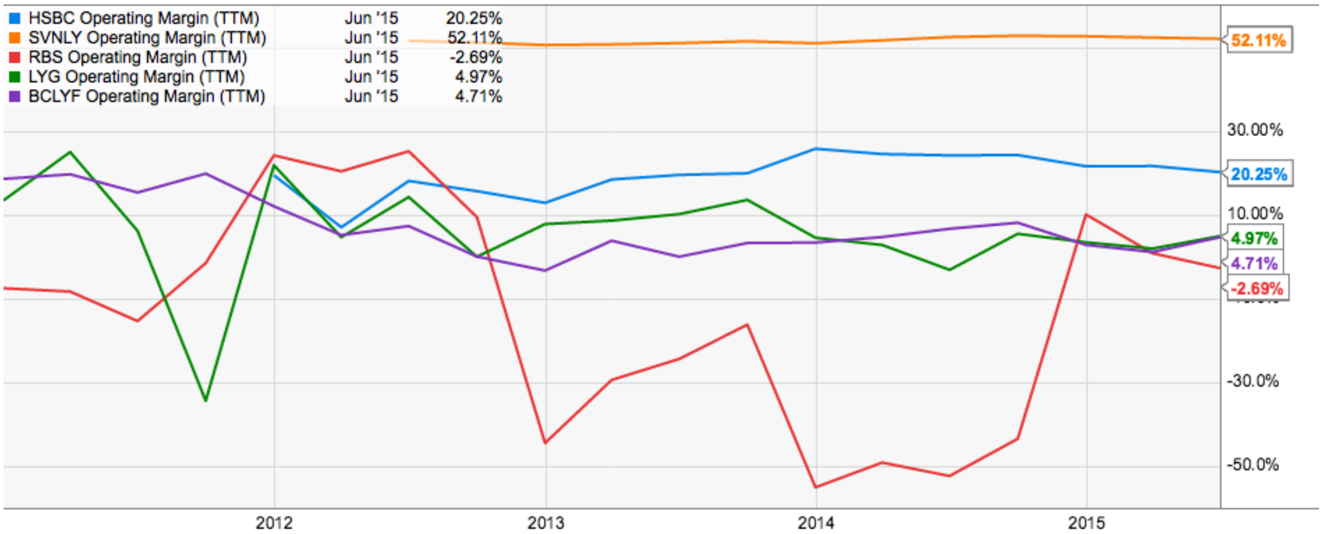
1 http://www.ft.com/cms/s/0/c6d01d9a-47dc-11e5-af2f-4d6e0e5eda22.html#axzz3ngDkIBH8)

Operating margin
We view effective human capital management as most directly visible in financial terms through operating margin. Highly rated firms tend to outperform peers in terms of operating margin metrics[2]: This can be explained because these firms' ensure that their human capital is *proactively and systemically engaged* in constantly driving superior revenue generation and cost efficiency.

OMI rated BBB or higher	Operating Margin comparison (%)							
Toyota	**10.11**	VW	6.07	GM	4.52	Ford	2.97
Goldman Sachs	**40.24**	MS	28.47	JP Morgan	36.69	Deutsche Bank	22.58
Handelsbanken	**52.12**	Barclays	24.82	Lloyd's	8.44	RBS	21.51
Reckitt Benckiser	**25.39**	Unilever	16.38	Beiersdorf AG	14.04	L'Oreal	17.18
Admiral	**40.46**	Aviva	5.69	RSA	6.73	Direct Line	20.87
Whitbread	**18.29**	Accor Group	11.67	Starbucks	17.61	Greene King	19.33
Costco	**3.12**	Sainsburys	2.85	Tesco	-0.5	Morrison	0.81

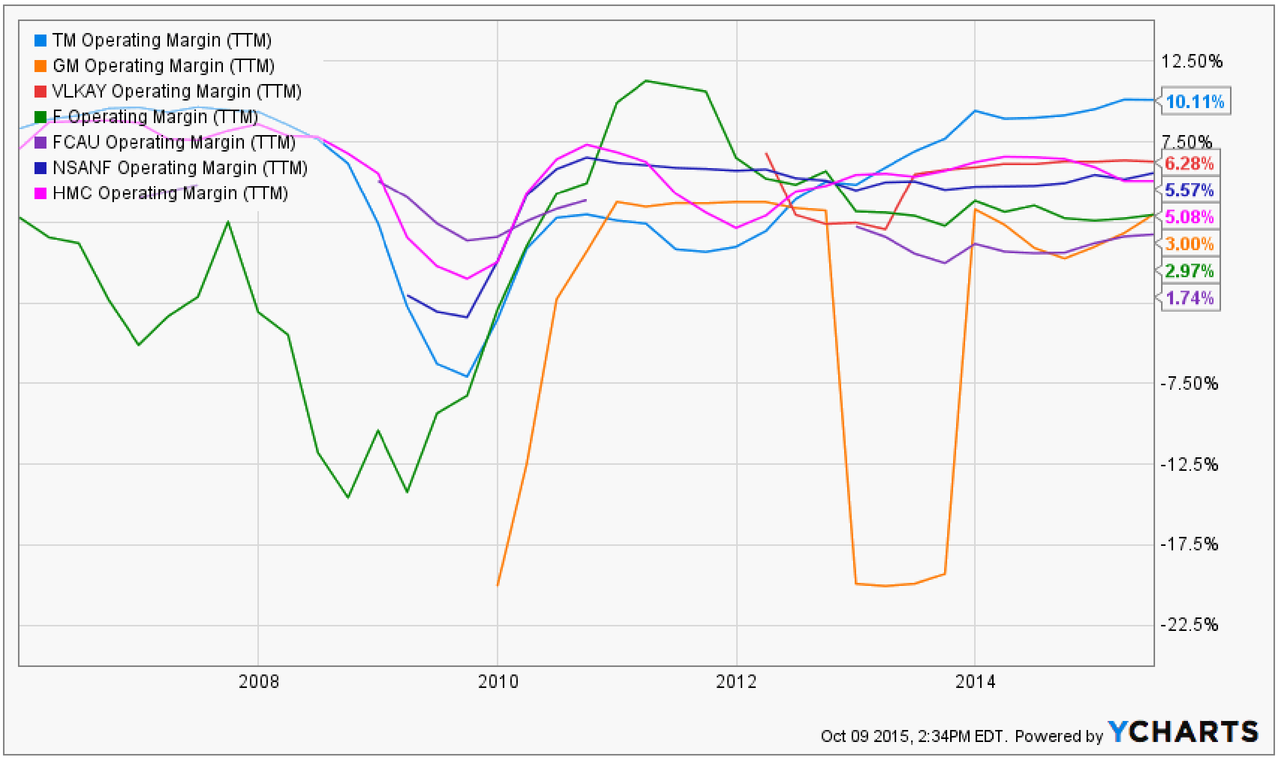
The tables below also show peer group operating margin over a 5-year view, highlighting how margin differentials have played out over a recent medium term timeframe:

Banking (Handelsbanken, HSBC, Barclays, RBS, Lloyds):



[2] Data taken from Yahoo Finance as at 8 October 2015

Major car manufacturers (Toyota, GM, VW, Nissan, Ford, Fiat Chrysler):



Innovation

Companies that understand how to effectively utilize knowledge through their human systems obtain significant advantages through strategic, product and operational innovation. Few companies systemically manage and measure this:

- Toyota (OMI rated A+) operates at an annual innovation rate of c500%+ (1 value adding innovation per employee/total employees x %)
- Pfizer's (OMI rated BB) equivalent innovation rate is 0.35%[3]
- Reckitt Benckiser (OMI rated BBB+) changes product formulae every 8 hours[4] and seeks and sources innovation from all its human capital.

A leading indicator for OMI ratings is the extent to which an organization understands and embeds learning though its human capital as a key source of ongoing value generation.

[3] See 2014 Annual Report (280 employee innovations based on headcount of 78,000)
[4] https://www.rb.com/innovators/the-innovation-story-at-rb

Appendix

OMI Explained

After over 10 years in development, Organizational Maturity Rating (OMR) is a highly sophisticated, analytical methodology that gets under the organizational 'skin' and offers an analytical perspective to complement conventional financial and investment analysis. It is designed specifically for the purpose of assessing ***the extent to which an organization has the human capital management (HCM) capability to achieve the most sustainable competitive advantage and market value***.

OMRs follow the same type of rating scale as the credit rating industry. This ranges from AAA to D with 22 gradations. The default rating for an organization with a conventional approach to people management (so called "HR") is 'B'. The Global Index is simply a list of all the companies currently rated.

OMS LLP is approved by the Maturity Institute (www.maturityinstitute.com) to carry out Organizational Maturity Ratings (OMR) and analysis. OMR analysis views the value potential of a corporation from two distinct perspectives:

- **Market value:** both step change, through innovation, and incremental improvements measured by way of specific reference to baseline improvements in the **four key variables of O*utput (O), Costs (C), Revenue (R) and Quality (Q)*** *of product and/or service*.

- **Operational Risk:** the probability of significant business risk attributable to ineffective HCM.

A company may be producing relatively high financial returns based on conventional criteria (EBITDA, ROCE, RONA etc.). OMR identifies additional value creation that arises from greater integration of effective HCM, business strategy and operational planning. An OMR captures a whole system view of the organization with discernible links to value creation and business risk.

The methodology that underpins OMR covers the key criteria for determining the quality of leadership and management capability with respect to Human Governance and HCM. Markets will change, economic cycles will come and go and business models may have a natural life cycle but organizational maturity analysis identifies underlying fundamentals for sustainable value generation. Where these are in place the organization will gain competitive advantage through adaptability and agility. Where effective HCM is absent the organization will be susceptible to instability, risk and long-term value erosion. The OMR approach is therefore designed as a reliable and predictive indicator of relative competitive advantage and future performance.

OMI 'BBB' and above rated companies:

OMI – GLOBAL HUMAN CAPITAL MANAGEMENT INDEX

The Global OMI is a perpetually updating index of companies rated by OMS LLP. More companies will be added regularly. If you want to know how your company compares please contact us.

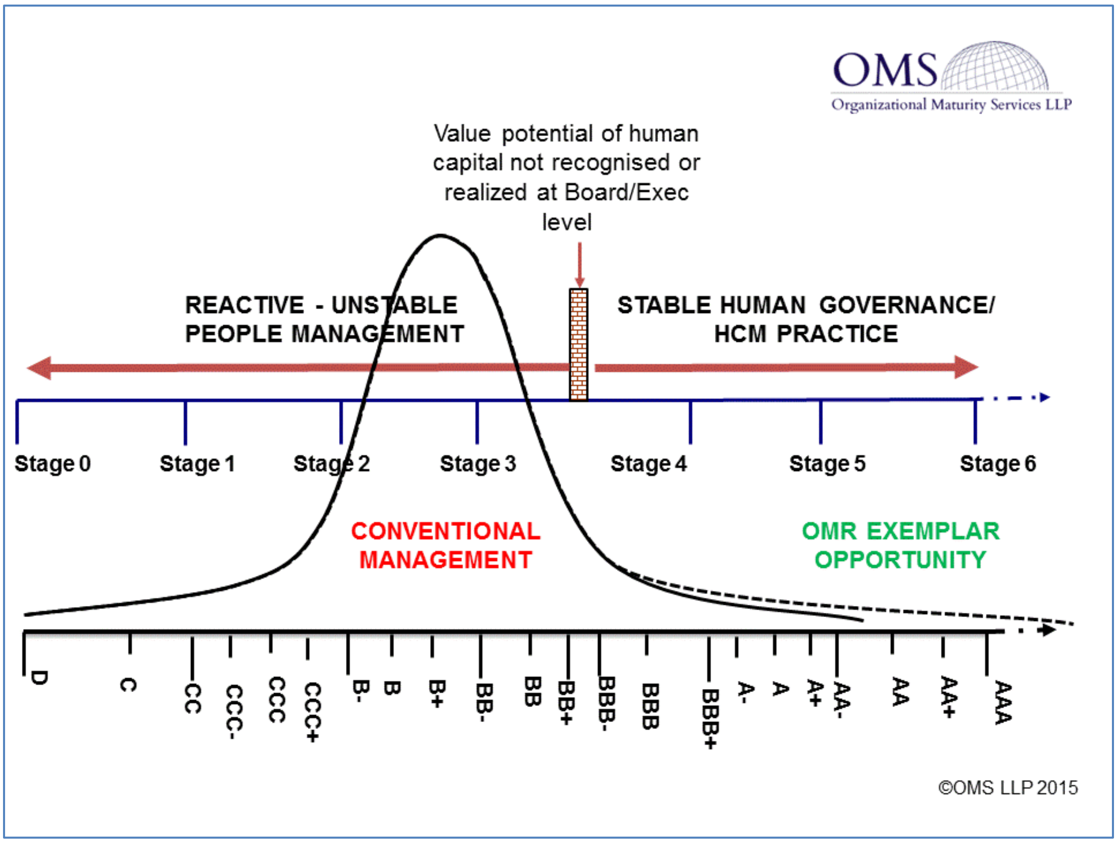
Table shown is in order of rating from highest to lowest (scale AAA to D).

Show 20 entries Search:

LOGO	COMPANY	OMR
	Goldman Sachs	AA-
	Toyota	A+
	Admiral Group	A+
	Costco	A
	Handelsbanken	A

OMR "AAA" Ratings scale

The graphic below illustrates the OMR "AAA" ratings scale together with the distribution curve for companies rated on the Global OMI to date. The illustration highlights that most organizations still do not understand the nature of their own human capital and its link to value – indeed, most firms continue to treat people primarily as a cost, consider people management as an "HR" remit and forego significant value and create higher business risk consequent to this.



www.omservices.org
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