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TRANSCRIPT

Labor Ignores and La Nina Threatens

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Mike Disabato: What's up, everyone? And welcome to the weekly edition of ESG Now, where we cover how the environment, our society, and corporate governance affects and are affected by our economy. I'm your host, Mike Disabato. And this week, we have two stories for you. First, we discuss why the social pillar, the S in ESG has all of a sudden regained some of its correlated powers for company performance. Hint, it's because workers aren't returning to jobs that they left. And then, we discuss what a third La Nina in a row could do to the global food supply chain. Thanks, as always, for joining us. Stay tuned.

The Great Resignation was on the minds of every company manager in the US during the peak of the pandemic. That was because in 2021, according to the US Bureau of Labor Statistics, over 47 million Americans voluntarily quit their jobs. That is an unprecedented mass exit in the US. People seem to be fed up with the working conditions they were under, the stagnant wages, the health risks that they now face due to the pandemic. Labor exhaustion became an almost palpable miasma that moved through towns and cities in the US. And everyone seemed to be talking about it. Even Beyonce has a song in her new album called Break My Soul, that is supposedly an ode to the Great Resignation. But the Great Resignation didn't start with the pandemic. As Joseph Fuller and William Kerr of the Harvard Business Review wrote in March 23rd of this year. From 2009 to 2019, the average monthly quit rate increased by .10 percentage points each year.

Then in 2020, because of the uncertainty brought by the COVID-19 pandemic, the resignation rate slowed as workers held onto their jobs in greater numbers. That pause was short-lived. In 2021, as stimulus checks were sent out and some of the uncertainty abated, a record number of workers quit their jobs, creating the so-called Great Resignation. What is interesting is stimulus checks... These are my words now, are no longer going out. And uncertainty has definitely abated somewhat, even if the pandemic hasn't really. Yet as my colleague, Liz Houston, who covers the retail and luxury good sectors for us told me, "Some industries are still unable to attract workers." And I should note real quick that this issue is a global one. But due to data availability, we are going to focus on the US for this episode. Just want to let you know. Anyway, here's Liz.

Liz Houston: Resignations or the quit rate is only one way of looking at the labor market. If you look at it from the company's point of view, the employer's point of view, we look at vacancies. So these are the number of job openings compared to the overall size of the workforce. And these really are elevated. So the Great Resignation, maybe, maybe not, but the great lack of workers for the job openings that you're listing, that is genuine phenomenon. And that is still pretty extreme.

Mike Disabato: Catch your name aside, elevated vacancies are seen throughout the US economy, but they are especially elevated for the leisure industries like travel, and restaurants, and also for the retail industry. Those jobs that didn't allow for hybrid work environments and were especially disrupted by the necessary pandemic protocols to try to stem the flow.

Liz Houston: If we look at job openings for retail, these are currently running above 6% relative to the workforce. Prior to the pandemic, this was more 2, 3, 4. And if you look at accommodation and food service, they're looking at vacancies of around one in 10. So just shy of that right now. It's been above that in recent months. And that's well, well above where we were pre-pandemic. So they were looking at around kind of four, 5% vacancies before then. And now, it's just shot right up. And that is not explainable by the Great Resignation. That seems to be a severe lack of workers for those industries.

Mike Disabato: All right. So let's investigate this a bit more. There's the obvious part, the structure of employment for these industries.

Liz Houston: Well, if you think about the typical business model for companies in these industries, they are relying on large workforces. Generally, it's a low revenue per employee model. They are classified as low skilled. That's an economist's definition and not a reflection of reality. And they're relatively low paid. And lots of them are working part-time, so they don't qualify for benefits packages. So they get a raw deal in many senses. And this possibly explains why they're not flocking back to those industries in their droves.

Mike Disabato: Right. Low pay, no benefits. You often have to deal with people who can launch vitriolic attacks on you if their food is cold. We've all seen the videos. Those factors are the obvious structural issues of the job. The systemic risk of the industry, let's call it. But those structural issues have beset the industry for some time. So it's likely that there was a combination of reluctance by workers to maybe die while working the retail industry during the early days of COVID. Or workers just not wanting to put up with the stresses of that industry anymore. Now, some companies in the restaurant industry did see the writing on the wall and acted.

In 2021, McDonald's increased their hourly wages for current employees by an average of 10%, raised entry level wages between $11 and 17 US dollars an hour. And McDonald's gave a better package to their employees, including paid time off, emergency childcare, and tuition reimbursement. This allowed McDonald's to end 2021 with higher staffing levels and at the beginning of the year, which if you look at their competitors, is actually quite impressive. And so, McDonald's paid attention to their labor management processes, and they were rewarded for it.

It is the kind of thing that we look at in the social pillar when we do social analysis or the S of ESG. The S is often the pushed aside member of the acronym's trio. Social factors can be hard to measure. Sure. But in general, research including ours has found that compared to the E and G, the environmental and governance factors, social factors have historically had a less, let's say, useful power in looking at company stock movements. That is until recently when we and others have found the S pillar was much more useful in understanding company performance since 2021 when times got much, much more stressful.

Liz Houston: Maybe when everything is fine, the S factor has less of an impact. But when times get tough or even in times of crisis, that S factor is really important. So sure, there's a short term dislocation in labor markets that companies are struggling to deal with, but maybe companies should be looking at this with greater impetus for the long-term. And when we look globally at those industries that I'm talking about, retail, accommodation, and food service. Less than 40% of them are even monitoring employee satisfaction. That's a question that I think boards should be reassessing at this point.

Mike Disabato: Employee satisfaction surveys allow for good communication between labor and management. Or at least better than the alternative, which is nothing. You understand with these things that maybe your employees are scared to come into work because people are coming in without masks and yelling at them, or that they need more benefits to take care of their ailing family member, who is now sick with COVID. When you take care of your workers, you breed more loyalty and, in part, create more employee satisfaction. And employee satisfaction isn't just what the S pillar is about, by the way. We also look at things like product safety and quality, stakeholder opposition, supply chain, labor standards, stuff like that. But labor management is part of it.

And what is interesting is that if you isolate factors that predict employee satisfaction, you could see some rather useful benefits when it comes to stock returns. Or as Hamid Boustanifar and Young Dae Kang found in a report published in a CFA financial journal this year, that from 1984 to 2020 in an equal weighted portfolio of companies that treat their employees best, it will earn an excess return of 2% to 2.7% per year. For their research, these two looked at a satisfaction list that is determined by anonymous surveys of employees and is America's largest ongoing annual workforce study that represents more than four point million employees in the most recent year. And it's a list that not only considered pay and benefit programs, but also employees trust in their organization and workplace opportunities to reach their full human potential irrespective of rank and position.

What it shows is that humans are more willing to help company survive when times are tough if that company spreads the benefits around. And employees aren't going to help that much when they feel undervalued. It's a dynamic that we see playing out in dramatic fashion for another job that, to be honest, is a bit more exciting than retail, airline pilots. If you are privileged enough to have traveled in 2022, you might know what I'm talking about. There were 793,018 flights canceled in the US in the first 23 weeks of 2022. That's a 21% increase over 2019 numbers. This is all according to flight tracker data, AOG. Now, a lot of those are due to labor shortages. Not all of them are due to pilot strikes, but some were. It's a broader issue that the industry is facing that my colleague, Umar Ashfaq, who covers the airline industry for us has been watching closely.

Umar Ashfaq: One of the ones that we saw, which was highly publicized recently was the Scandinavian Airlines' pilot union who ended the 15-day strike after a collective bargaining agreement was signed. Now, this is not due to, in my understanding, a shift in the labor market, because the strike was essentially a protest to the pay cuts, and the restructuring plans, and the decision of the company's management to not rehire pilots who were laid off during the pandemic. On the other side, we also see Lufthansa's pilots, who also voted in favor of labor action that could ultimately result in a strike. And on the other side of the pond, we see Alaskan Airlines pilots who are also voting on strike authorization. And Delta Airlines, something similar we've seen as well. And they have been protesting over excessive scheduling, as well as fatigue.

Mike Disabato: It is interesting that airline companies miss these possible disruptions since most noted in their earnings calls that travel would return to a high level after restrictions were lifted. And it isn't like you could just quickly replace airline workers who require extensive background checks. Pilots are especially tough. They require years of training. They need to be in peak physical condition relative to most jobs. And they're constantly tested on their mental alertness.

And most airline companies knew via employee surveys that are publicly available no less, that many airline pilots felt stressed and undervalued by management. So there was record high demand for flight crews globally because post-pandemic travel or post-restriction travel increased at such a high level, airline companies weren't prepared for this. They didn't have good labor management practices in place it seems. I'm going by pilot surveys here. And so, workers in the industry saw this and decided to agitate for better treatment.

Umar Ashfaq: If you look at prior cases or looking at the controversies' database that we have for airlines, a bunch of them had previously, even before the pandemic been involved in negotiations or work stoppages due to workers demanding better pay. It's just that now, a squeezed labor market just makes it better time for the workers to leverage their position.

Mike Disabato: So Great Resignation, Great Reshuffling, great lack of workers for the job openings you're listing, whatever you want to call it. The thing is, the S in ESG is becoming more important than ever. And it seems ESG is becoming an indicator of problems with fragile systems or networks like retail, air travel, and coming up next, the food system.

So this winter, we may see a triple dip situation where we have three La Nina oceanic and atmospheric phenomenons in a row. Now, you may think I made up that word, triple dip, but that is the actual word that climate experts use when talking about three instances of one of the atmospheric or oceanic phenomenons called either El Nino and La Nina. Now, I'm going to explain what that is in a second. Well, not me. My colleague, Cole Martin, who covers the food industry for us and is knowledgeable on all things food, because this is big news, if another La Nina happens. And it's going to really disrupt the food industry. And so, Cole is now going to tell you why that's going to be the case.

Cole Martin: One of the potential impacts of a third consecutive La Nina is dry weather in the America's region, which is a very important crop growing region worldwide, particularly when it comes to grain exports. So during a La Nina phase, what essentially happens is the ocean temperatures in the Pacific are cooler than average. And what that essentially leads to is less evaporation of water, and therefore, potentially less precipitation over the America's region, as I said. Now, what that could mean for grain production is, obviously, if you have less rain and potentially higher temperatures, that could mean that yields in these regions could be lower.

Mike Disabato: Now, there are variations to what may happen as with all weather and climate discussions, but let's say that yields do fall. And this is where we can tie this to our earlier segment on the problem of labor management and social situations in our current society, because of how it's going to impact consumers, i.e., a world's workforce.

Cole Martin: Obviously for consumers, an increase in grain prices could be problematic. If you look at consumer surveys now, particularly in developed economies. What's the number one thing that consumers are most concerned about? And that is inflation. And that's in a context, by the way, where benchmark grain prices, at least right now have been falling considerably over the last few months. Consumers are seeing prices going up. They are seeing prices for things like food and for basic goods going up. And a third consecutive La Nina, if it led to a significant decline in the harvest, in the America's region that could pile further misery onto consumers, especially in advanced markets.

Mike Disabato: Right. Grain prices are low and food prices are still high at the moment. It is a problem that we are seeing across the world. It is a problem that companies are going to have to

deal with because wages need to increase to keep up with inflation, so people can actually survive. Now, La Nina is one of the major drivers of the Earth's climate system. It's going to be around regardless if there's climate change or not.

But the impacts of La Nina and all naturally occurring climate events now take place in the context of human induced climate change. And La Nina's effects, if it does happen this winter, will be exacerbated by climate change. So I asked Cole, if whether he's seeing food companies make a lot of efforts to try to stem climate change or at least adapt to these harsher environments that they're going to have to operate in.

Cole Martin: Most of the food companies now are obviously aware of potential implications for climate change. And many of them have been updating their emission reduction pledges. The thing about the El Nino oscillation cycle, as I mentioned, and the variations in ocean temperatures is that, scientists are really only starting to grapple with now what the long-term implications could be for the oscillation cycle in the context of rising ocean temperatures, rising ocean levels, and a hotter planet generally. What the NOAA, as a government agency in the US, basically what scientists there essentially concluded was that, we don't know for sure what the impact on rising planetary temperatures will do for the cycle.

But what they've said is that, the cycle could be more unpredictable and more volatile over time. And so in that case, that could be ultimately more detrimental for prices in a given year, because harvests are more uncertain. And that may, if there are enough uncertain harvests over a period of time, that could introduce potentially a permanent premium onto grain prices and could see them trade on a secular basis much higher than they are right now.

Mike Disabato: This is where the two stories that we talked about today connect. In the beginning, we talked about the social implications of not understanding what your employees need as a company. And in this section, we talked about the problems that may arise for everyday individuals due to the change in climate, change in weather patterns, and possibly permanent increased grain prices. So really it seems as climate change, as the E in ESG becomes more important, so too will follow the S, the social pillar, as people are having to adapt to a changing world and a changing environment.

And that's it for the week. I wanted to thank Liz, and Umar, and Cole for talking to me about the news with an ESG twist. I wanted to thank you so much for listening. I really appreciate it. If you like what you heard, don't forget to rate and review us. That helps out in podcast lists, and pushing us higher up, and people can find us. And if you want to hear me every week, don't forget to subscribe to wherever you get your podcasts. Thanks again. And talk to you soon.

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