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Avoiding the Compliance Trap

An Initial Guide to Disability Affirmative Action Regulation in the United States

FIFTH QUADRANT ANALYTICS

The Return on Disability® Company

Rich Donovan
(718) 395-7877
rich@returnondisability.com

A Catalyst to Create Shareholder Value

Representing a population of 1.3 billion globally, people with disabilities (PWD) are an emerging market the size of China. The US Government has enacted new rules aimed to improve employment rates amongst PWD. These rules mandate that all federal contractors employ 7% of their workforce as someone with a self-disclosed disability. Disability is now on par with race and gender under affirmative action. Unto itself, this mandate will not lead to large-scale hiring, as Canadian and European experience shows. It does cause firms to focus on a market most know nothing about, providing opportunity to build both 'social' and shareholder value.

Build a Strategy, Not a Checklist

As firms react to the new affirmative action rules, they have an opportunity to create value for shareholders. To do this, the firm must go beyond compliance to act in ways that generate new revenue and leverage disability to reduce cost. Senior management must decide if its scarce budget will be spent on legal fees and narrow checklists or on robust strategies that address the demands and talents of customers and employees.

Fifth Quadrant Analytics (FQA) published research demonstrating firms that engage the disability market as valued customers and employees outperform their peers in creating shareholder value. FQA recommends transforming this government mandate into an opportunity to serve shareholders and grow profits.

Measure Action to Create Value

For firms where the US Government is a key revenue source – your customer has spoken. For every other company, this law has signaled a change in societal norms. The new rule carries a requirement to measure action and progress towards 'targets'. It is the responsibility of senior management to act to maximize shareholder value not to merely comply with the law. By following a metrics system that is based in value creation – yet encompasses compliance – firms ensure they serve their shareholders, customers, employees and regulators.

For more information on 'how', please visit Fifth Quadrant Analytics.

What Happened and How Should Our Firm React?

On August 27, 2013 the US Department of Labor published a public notice of final rules to codify enforceable standards and targets that ‘largely’ equate disability with race/gender under **Federal Affirmative Action Laws (Executive Order 11246).** There are two elements of this rule – one pertaining to Veterans (VERRA) and one pertaining to PWD as defined under ADAA (Section 503). The new rules affect the recruiting/hiring process, disclosure, record-keeping and set specific ‘targets’ for the number of PWD employees. The rules become effective 180 days from publishing in the Federal Register, likely to occur in September 2013. FQA has included excerpts from Department of Labor’s final rule below for clarity sake:

Stated Objective of the Mandate

Strengthening the implementing regulations of section 503, whose stated purpose “requires Government contractors and subcontractors to take affirmative action to employ and advance in employment qualified individuals with disabilities,” is an important means by which the Government can contribute to reducing the employment disparity between those with and without disabilities. **The objective of these regulations is to ensure that employers doing business with the Federal Government do not discriminate and that they take affirmative action to recruit, hire, promote and retain individuals with disabilities.**

Percentage of Workforce Goals
The Final Rule establishes a nationwide **7% utilization goal for qualified PWDs**. Contractors will apply the goal to each of their job groups, or to their entire workforce if the contractor has 100 or fewer employees. Contractors must conduct **an annual utilization analysis and assessment of problem areas, and establish specific action-oriented programs to address any identified problems**.

Recruiting/Disclosure
Require contractors to invite applicants to **voluntarily self-identify as an individual with a disability** at the pre-offer stage of the hiring process, in addition to the existing requirement that contractors invite applicants to voluntarily self-identify after receiving a job offer. The purpose of this data collection is to provide contractors with useful information about the extent to which their outreach and recruitment efforts are effectively reaching people with disabilities.

Record Keeping
Require contractors to maintain several **quantitative measurements and comparisons for the number of individuals with disabilities who apply for jobs and the number of individuals with disabilities they hire in order to create greater accountability for employment decisions and practices.** Having this data will enable contractors and OFCCP to evaluate the effectiveness of contractors’ outreach and recruitment efforts, and examine hiring and selection processes related to individuals with disabilities.

FQA Analysis
The intent of the Department of Labor is to place disability on par with race and gender under affirmative action. This policy is directly supported by the top two Presidential appointments at Labor, both of whom have strong resumes in disability and employment law. **Business must take these regulations seriously. The tone of Labor officials has been co-operative, signaling that they understand the iterative process ahead for businesses adapting to these rules.**

While legal advice must be a part of the process, FQA advises stepping back from the details of the law to assess how the spirit of the law positively impacts the value of the enterprise. Engaging a lawyer, developing process/policy and meeting ‘requirements’ will only result in increased legal fees and administrative costs. **FQA encourages firms to develop firm-wide strategy that address new revenue and reduced costs that are derived from serving disability as an emerging market and talent source. The rules mandate analysis, innovative and shareholder-focused firms will leverage the new budget for compliance to analyze impacts on revenue and costs driven by disability.**

Firms that engage disability via **business strategy with an eye to value creation** will better serve their shareholders than firms that merely comply. **The market can tell the difference, and rewards those firms acting to create value.**

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Global Experience with Disability Hiring Mandates

Quotas/targets have not led to large scale hiring
Governments in Canada and Europe have mandated hiring targets for PWD for more than 20 years. Results have been mixed, with firms allocating millions of dollars of resources, with cross-industry results in the 1% - 3% range on average. The most 'successful' examples are the Canadian banks, who have been 'covered' by these mandates since the late 1980s. **These firms spent the first 20+ years working with governments and non-profit agencies to bring PWD in the door, with numbers hovering in the 1% - 2% range over this initial period.** In the last 4 years, the banks have changed their approach, focusing on the business drivers that attract talent to any firm. **Recruiting language changed, as did the owners of the process, moving from legal/charity departments to recruiting teams with senior business champions.** Numbers have crept up in recent years, to the 2% - 5% range, averaging 3.6% amongst Canadian Financial Institutions.

The challenge for US firms covered by this law is to avoid repeating the first 20 years of poor results – and the costs that were incurred – to focus on the business drivers behind disability from day one. **Compliance will not drive results.**

The 7% 'Target' is unprecedented globally
While described as a 'target', the US Government has set an objective to hold firms accountable. The language used is intentional, so that those tasked with enforcing the rules are not boxed in, and can have flexibility to assist and educate firms that are not PWD savvy. The 7% 'target' is aggressive, but statistically attainable. **To paraphrase what the government has said "this is the ultimate goal, and we understand it is difficult to achieve. As long good faith effort is there to achieve this over time, we will be your partner".** European, Japanese and Canadian targets/quotas range from 1.6% - 6% depending on the nation.

FQA views the 7% 'target' as a10-year goal, and this assumes that firms actively learn from the experience of others abroad. To achieve these goals requires a laser focus on business drivers first, with 'social' factors in the background.

Disclosure is Complex – New Hires versus Existing Employees
There are two components to the 7% 'target' – **new hires that disclose and current employees that disclose.** Business must pay close attention to both of these groups, focusing on existing employees in the first three years of enactment. **Disclosure is incredibly complex, as it deals with the most intimate part of an individual's identity – both inside and outside the workplace.** Experience shows that that approximately **60% of PWD will not disclose, especially if they do not feel valued by their employer**. Compliance efforts being highlighted suppress disclosure rates because talent views the firm saying **"we have to do this by law".** Care must be taken to **manage a firm's actual value for disability and the message projected, both internally and externally.**

FQA observes that **firms that project a business-focused message (and act in support of this message) consistently enjoy higher disclosures rates. This rate increases initially from the existing employee base, then plateaus, and can grow over time through new hires**. FQA recommends focusing on getting the message right first, then projecting that message internally to encourage internal disclosure. While focusing internally, the firm must build its recruiting assets. The best firms in PWD outreach today are hiring **30 – 40 full time equivalent employees a year into a base of 80,000 employees. Recruiting must start now, but results take many years to become material to both compliance efforts and business results.**

The Measurement Mandate – Firms must engage in analysis of efforts
Business does not exist to hire people. Percentages of PWD hired is not the ultimate metric for shareholders. **Firms must be able to translate these efforts to employees and investors in terms of business value.** The measurement of 'effective outreach' must be **a subset of a broader assessment of how disability impacts the value of the business.**

FQA recommends that **firms step back from these rules, making compliance a result of how they act in the disability market**. By focusing on disability as an emerging market, opportunities to increase revenue and decrease costs become clear. Firms are going to budget for reaction to these new rules – **FQA advises spending those dollars on broad business metrics focused on value creation rather than a narrow (costly) compliance checklist.**

Build Firm-wide Strategy → Act → Measure → Repeat

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MEASURE CORPORATE ACTIONS THAT MAXIMIZE SHAREHOLDER VALUE

The Return on Disability® (RoD) Rating Explained

The RoD Rating is a proprietary fundamental rating system that measures a company's activity in the disability space as it relates to the creation of shareholder value.

Drawn from a universe of 302 business drivers – focused on customers, employees and productivity – RoD measures 20 publicly observable data points. The data points are subsequently weighted to reflect the relative importance in value creation for each company.

The result is one number – The RoD Rating.

The economic rationale is strikingly simple.

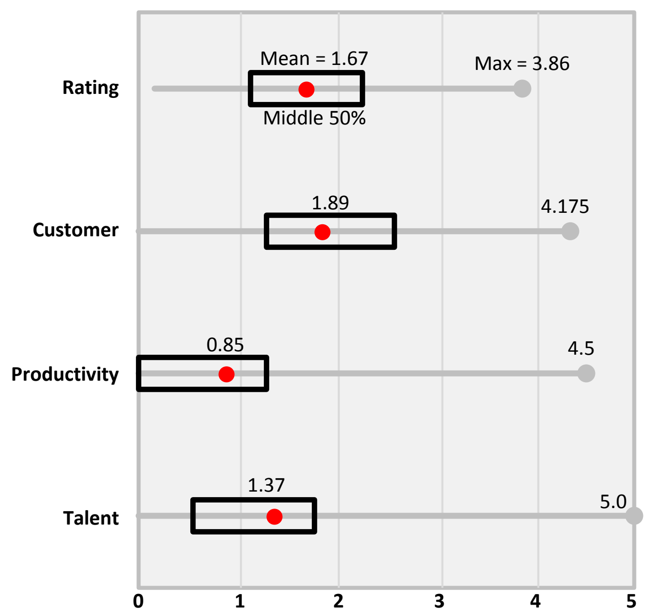
We have found that companies that perform well in disability are highly responsive to their customers, and thus outperform peers in revenue growth.

Disability is an inspiration for lean process, breakthrough innovation and a new source of diverse talent – driving productivity.

Our research shows that companies that score well on RoD, consistently grow shareholder value as measured by long-term stock price appreciation.

Fifth Quadrant Analytics includes Section 503 compliance as a component of our analysis package.

TABLE 1. SUMMARY RoD RATINGS ANALYSIS



- The RoD Rating has 3 main categories:
  - Customer
  - Talent
  - Productivity
- The average Rating for the top 100 firms in US LargeCap is 1.67 (0 = low, 5 = high)
- The average Rating of the Top 25 firms in US LargeCap is 2.65. The top Rating is 3.86.
- 69% of the firms in US LargeCap do not register a rating.