Workers' capital and corporate social responsibility

Retirement savings are just one of the many types of asset owned by workers. How they choose to invest these assets, and how they act as owners of company shares in particular, will have implications for corporate social responsibility.

Jon Robinson
Coordinator
Programme on workers' capital
Global Unions*

The bulk of the world's equities (company shares) are owned by the big institutional investors – insurance companies, mutual investment funds and pension funds – and not by individuals, at least not directly. Unfortunately, these institutional investors have not always been an ally of trade unions or trade unionists, as the institutions' short-term approach to investment often encourages companies to embark on activities that damage workers' interests. Company executives, whose remuneration is often linked to share price over the short term, will seek to keep their company share price as high as possible. These short-term attitudes from investors and executives have all too often resulted in company behaviour such as downsizing, outsourcing, cuts in research, training and safety costs and questionable mergers and acquisitions that clearly damage the interests of workers and union members.

Furthermore, those who manage pension fund investments on behalf of workers often look for quick returns to guarantee the continuation of their fund management mandate. This in turn can lead to further pressure on companies to downsize, outsource or look for mergers or acquisitions. In fact, these investments are not only deployed against the interests of workers around the world but sometimes against the interests of the very same workers for whom the investments are being managed in the first place (see box on the case of Morgan Stanley).

The large institutional investors are, however, one of the few groups who can positively promote corporate social responsibility and, indirectly, much of the capital they invest belongs to the workers themselves as the beneficial owners of these investments.[1]

The extent of workers' capital today

It is estimated that the total workers' capital[2] comprising the various pension funds worldwide is in the region of US$11 trillion today (down from a peak of US$13.5 trillion a few years ago).[3] In the past, these retirement funds increasingly invested their assets in company shares or "equities" – a long-term trend despite some understandable aversion to equities today, due to recent corporate scandals and the falling stock markets. Of course trends in asset allocation will differ from country to country, with each having its own distinct investment culture, but according to recent

* The Global Unions group is an international trade union alliance formed by the International Confederation of Free Trade Unions (ICFTU), the Global Union Federations (GUFs, formerly known as International Trade Secretariats) and the Trade Union Advisory Committee (TUAC) to the Organisation for Economic Co-operation and Development (OECD).

research, they have converged somewhat over time, with between 50 and 60 per cent of their total assets allocated to equities.[4]

In countries like Canada, the Netherlands, South Africa and Switzerland, which already have collective pension funds, regulators are lifting restrictions, not just on how much those pension funds can invest in equities but how much can be invested in overseas equities. As a result, the cross-border nature of these pension funds' investments is growing. In some cases, like the Netherlands, where pension funds are large and the capital markets relatively small, the pension funds' overseas share holdings have already outgrown their domestic holdings.

With few exceptions, therefore, all equity markets are to some degree foreign-owned. In 1999, for example, foreign investors owned 22 per cent of the United States equity market, 24 per cent in the United Kingdom, 22 per cent in Germany and 42 per cent in France.[5] Many of these foreign owners will be overseas pension funds. In fact, it has been estimated that in total, pension fund holdings already account for about one-third of the world's total share capital – and significantly more in some countries like the United Kingdom and the United States.

The sheer size and international nature of these pension funds make workers' capital one of the most important forces amongst the "global investors" of today. Collectively, these funds have the potential to influence companies and corporate behaviour on a global scale.

Pension fund investments

The cross-border nature of the capital markets means that the trustees who have overall responsibility for managing the funds must decide not only whether to include international investments in their portfolio, but also how to evaluate and monitor those international holdings if they do. Even if funds have little or no international investment, today's pension fund trustees should still take account of international issues, because other companies in the fund portfolio may well own substantial overseas assets, hire foreign workers, make foreign sales or subcontract from third parties based overseas.

In practice, most fund managers should already take social, environmental and ethical matters into consideration in the running of their fund. They will, for example, base decisions on their perception of the opportunity for added value, damage to reputation, potential risk of litigation, brand value and the impact of corporate behaviour and social and environmental factors on their investments. This should mean ensuring that companies, wherever they are based, are well run, respect internationally recognized labour standards and provide adequate disclosure to shareholders. In other words, ensuring that companies practice good corporate governance and apply positive social policies across all their operations.

Just as the trade union movement seeks to address the power and influence of multinational enterprises as part of its

The case of Morgan Stanley

One of the more bizarre examples of how short-term pressures from investment managers can work against employees' interests is the negative attitude of some analysts to the liabilities they associate with unionized companies. In November 2002, Morgan Stanley issued a highly contentious analyst's report advising American investors to avoid heavily unionized industries because their stocks underperform the broader equity market in the United States.[1] Referring to pension liabilities and post-retirement health-care benefits as "plagues", Morgan Stanley's American equity strategist claimed that "investors do not want to own businesses with high fixed costs, pension funding issues and spiralling post-retirement healthcare obligations… found prominently in industries with outsized union representation". Morgan Stanley later issued a note of "clarification" in which it claimed the analyst's remarks were not a statement of Morgan Stanley policy regarding unions or union workers.

[1] Morgan Stanley Equity Research North America: *Look for the Union Label*, 14 November 2002.

response to globalization, so one of the challenges for the international labour movement is to help promote a "worker-friendly" view of capital ownership and shareholder value among pension funds and other investors.

Recognizing both the need and opportunity to develop such an initiative, union leaders from 19 countries with privately funded pension systems met in Stockholm in November 1999 under the auspices of the International Confederation of Free Trade Unions (ICFTU) and drew up a programme for cross-border action on workers' capital. The programme included:

- establishing an international trade union network on pension funds and their investments;
- developing principles, guidelines or recommendations concerning the investment of workers' capital;
- establishing a dialogue with pension funds and investment managers on international issues;
- seeking information and examples of best practice on pension fund investment policies, governance structures and education and services for trustees; and
- facilitating international trade union cooperation in all these areas.

This programme was subsequently endorsed by the Executive Board of the ICFTU and today the Global Unions' Committee for International Co-operation on Workers' Capital is working in partnership to influence corporate behaviour and promote the use of worker-friendly capital strategies by pension funds and investment managers. This will secure and enhance retirement provisions while at the same time protecting workers' broader interests.

There is a range of legitimate strategies through which organized labour might advance a more worker-friendly agenda for workers' capital. At one end of the range is the development of vehicles for "economically targeted investments" (sometimes also referred to as "social investments") which are established with the specific intention of directing capital assets to fill unwanted gaps in the capital markets or into specific socially desirable projects that create "collateral benefits" as well as simply financial returns.

At the other end of the range there is disinvestment (or the refusal to participate in undesirable investments) and there are various forms of shareholder activity in between. These not only include traditional screening of investments (by applying social criteria or "screens" in selecting the investment portfolio) but also involve pension funds voting as shareholders or sponsoring shareowner resolutions of their own at company annual meetings. Of course, shareholder rights vary from country to country, particularly in so far as they relate to the shareholder resolution process. This can be problematic even for experienced shareholder activists, and it can seem overwhelming for inexperienced pension fund trustees. However, with proper communication and cooperation between unions and, if necessary, other allies, these difficulties can be largely overcome.

Shareholder action and union cooperation

An early example of trade union cooperation in shareholder action on an international scale occurred in 2000 in what the *Wall Street Journal* called "one of the most ambitious global proxy contests ever launched". A joint campaign by unions from Australia, the United Kingdom and the United States gained substantial support for two resolutions at the London and Melbourne annual general meetings of Rio Tinto. Each put to both meetings, the two resolutions concerned the independence of certain directors and the adoption of the ILO "core" labour standards. The resolution on the first issue gained 20.3 per cent of shareholders' votes, while the one on ILO standards garnered 17.3 per cent of the votes. A similar exercise, supported

Shareholder resolutions on global labour standards

Since the mid-1990s, a wide variety of shareholders has begun filing resolutions on the subject of global labour standards. The number has more than doubled, to 49 such resolutions in 2001 and in 2002. For resolutions that have come to a vote, the average level of support for global labour standards proposals has risen from around 6 per cent in 1996 to nearly 10 per cent in 2002.[1]

A recent proposal from the LongView Collective Investment Fund, supported by the American Federation of Labor and Congress of Industrial Organizations (AFL-CIO) and members of Global Unions, raised concern over Unocal's operations in Myanmar and asked the company to implement the ILO's core labour standards. It earned 32.8 per cent of the votes cast – the highest-ever shareholder vote for a resolution on labour standards. This level of support was subsequently bettered in Canada, when 36.8 per cent supported a resolution at the Hudson's Bay Co. against sweatshops, and in a number of resolutions in the United States concerning sexual discrimination, with support as high as 58 per cent in one recent case.

[1] IRRC: *Shareholder Initiatives Against Sweatshops*, IRRC, August 2002.

by the participants at the meeting of the Committee for International Co-operation on Workers' Capital in December 2001, helped raise the vote in favour of a similar resolution on workers' rights and Unocal's operations in Myanmar from 23 per cent in 2001 to 34 per cent in the 2002 proxy season.[6]

In the United States in particular, individual labour unions have been encouraging active share ownership for at least two decades. Pension fund trustees in the United States are obliged by law to treat the voting of company shares as they would any other asset and have a fiduciary duty to use the votes in the best interests of scheme beneficiaries. In other words, trustees are required by law to treat ownership of shares, including the right to vote at company meetings, as an asset of the pension scheme to be used in the interest of scheme members. In fact, unions and union funds have become the largest single sponsors of shareholder proposals in the United States in recent years.[7] What is more, research shows that, on the whole, these labour union proposals get "as much or more support than do similar proposals made by other shareholder groups".[8] In addition, shareholders have become increasingly successful in recent years in using the proxy voting process to persuade a growing number of companies either to improve their international labour practices or to commit to third-party monitoring of them.[9]

One alternative to the more traditional forms of shareholder activism of screening, voting and sponsoring company resolutions, for which there appears to be increasing enthusiasm amongst institutional investors in parts of Europe, and the United Kingdom in particular, is the practice of "corporate engagement" by investors.[10] It involves investors, either individually or acting in unison, entering into a dialogue with a company or its Board of Directors with a view to changing company strategy or policy. Corporate engagement itself is not new – many UK and US institutional investors have a long history of engagement, particularly on the traditional "corporate governance" agenda. What is new is that this agenda has now been expanded to the wider issues of corporate responsibility and, for an increasing number of responsible investors, includes social, environmental and ethical performance.

As such, it offers a complementary as well as an alternative approach to other forms of shareholder activism and avoids at least some of the difficulties associated with proxy voting and submitting resolutions at company annual meetings. Furthermore, the process of "engagement" by shareowners entails few if any additional risk elements for the investor. There is no selling of shares at disadvantageous prices. It is also likely to enhance company performance per se, thus making an engagement strategy less contentious than one based purely on stock selection.

Workers' capital and socially responsible investment

Of course, there are both "constraints" and "drivers" that play a part in determining the potential influence of workers' capital over the financial markets – and company behaviour – in the future. A major constraint is a stubborn perception, or misconception, about the legitimacy of socially responsible investment (SRI). There are those who will advise trustees and fund managers that to invest for anything other than the highest possible financial return is not in the best interests of the fund's beneficiaries and, at worst, is a breach of the trustees' fiduciary duties. But these arguments ignore the realities of current practice and a growing body of evidence to the contrary.

Firstly, according to the United States Social Investment Forum, "a solid and growing body of empirical evidence has conclusively dispelled the myth of [SRI] underperformance". In fact there is little evidence of any systematic underperformance with a socially responsible approach to investment and numerous studies do suggest there are links between good social, environmental or ethical performance and good financial performance.[11] More specifically, there is evidence that, contrary to earlier perceptions, socially responsible investment can actually enhance portfolio performance.[12]

Secondly, the available statistics reveal growing interest by institutional investors in SRI, social accountability and corporate social responsibility more generally, which will increase levels of shareholder activism and of ethical investment in particular.

For example, according to the United States Social Investment Forum, assets in professionally managed, socially screened investment portfolios increased by 36 per cent between 1999 and 2001 – that is one-and-a-half times more than the rise in all the professionally managed investment assets in the United States.[13] According to the same source, the total of all forms of professionally managed, socially responsible investment in the US grew to $2.34 trillion in 2001, representing nearly 1 dollar in every 8 of the total under professional management in the United States.[14]

This growth in SRI is not simply an American phenomenon, although in other countries socially responsible investment represents a smaller proportion of all assets under management. In the United Kingdom, for instance, the total value of SRI assets increased from only £52 billion in 1999 to £224 billion ($360 billion) in 2001.[15]

The phenomenal growth of SRI in the United Kingdom undoubtedly owes much to the legislation introduced in July 2000, which requires pension funds to disclose within their Statements of Investment Principles whether and to what extent they use social, ethical or environmental criteria in their investment selection.[16] One survey, carried out shortly after these disclosure regulations took effect, found that 59 per cent of the biggest 500 British funds (owning three-quarters of the assets of those surveyed) incorporated some SRI principles into their investment process, while only 14 per cent took no account of social or ethical issues;[17] almost the reverse of the findings in a smaller survey carried out before the legislation came into effect.[18]

Similar provisions which will encourage both greater disclosure and further consideration of SRI have already been enacted or are being considered elsewhere in Europe – including Belgium, France, Germany and the Netherlands – and in Australia where, from March 2003, all investment providers are required to describe the extent to which environmental, social or ethical considerations, including "labour standards", are taken into account in their investment products.

Conclusions

Many pension fund beneficiaries want their retirement savings to reflect their ethical and social values and many union members want to exert more influence over corporate behaviour through their ownership of capital. Recent corporate scandals and the growing interest in SRI in particular provide both a stimulus and further rationale, if needed, for unions to promote a more active ownership agenda for their members' pension funds.

It is sometimes argued that by promoting the interests of workers' capital and advocating various forms of shareholder action, unions are seeking to elevate the interests of shareholders above those of other stakeholders including, of course, the employees themselves. However, the global unions are determined that any workers' capital policy will complement rather than conflict with other labour activities, such as the development of collective bargaining, and the strengthening and implementation of initiatives such as bilateral company codes of conduct. They are also aware that shareholder activism cannot replace – nor should it be expected to replace – the fundamental responsibility of governments to ensure the protection of the rights of all citizens and the promotion of internationally accepted standards on the social responsibilities of business, such as the ILO's Tripartite Declaration of Principles concerning Multinational Enterprises and Social Policy, its Declaration on Fundamental Principles and Rights at Work and the OECD Guidelines for multinational enterprises.

But shareholder activism and investor opinion are significant factors in the global capital markets of today. The amount of assets accumulated within the world's pension funds means that the workers who own these assets are significant investors and have real potential to influence corporate behaviour on a global scale. But the full potential of workers' capital has yet to be realized. In this respect, governments have an important role to play as catalysts of greater shareholder activism – as they have done in the United Kingdom by legitimizing the consideration of social, environmental and ethical investments through their enactments on statements of investment principles. But to enable this potential to be fulfilled will require considerable organization, effort and allocation of union resources at international, national and local level to provide more and better professional education of pension scheme members and pension fund trustees; broader and deeper worker representation on pension fund boards of governance; and the fostering of constructive relationships with the investment professionals who manage these funds.

Progress will inevitably be greatest where funded pension arrangements and the rights of shareholders are already most developed and the levels of union activity are high. Hopefully, the work of the joint ICFTU / GUF / TUAC Committee for International Co-operation on Workers' Capital will assist in ensuring that workers' capital will in future benefit rather than hurt the interests of workers, their families and communities. With sufficient effort and expertise and the right capital strategies, the owners of workers' capital have the potential to make a difference to the world in which we live, simply because they own so much of it.

Notes

[1] The beneficial owner is the person who has the ultimate right to the value of an investment, as distinct from the registered owner who may simply be a "nominee" company or investment manager.

[2] Throughout this article, "workers' capital" refers to the assets accumulated in collectively funded pension schemes in order to provide workers with financial security in their retirement.

[3] *The Watson Wyatt Global Investment Review*, 2002.

[4] ibid.

[5] The Conference Board: *Institutional Investment Report*, 1999.

[6] The "proxy season" is when most companies have their annual shareholders' meetings (usually in spring in the United States).

[7] Typically, between 200 and 300 social and environmental resolutions are filed every proxy season in the United States and by 1999, 47 per cent of all resolutions on corporate governance issues were sponsored by unions / union funds.

[8] Thomas and Martin: "Should labour be allowed to make shareholder proposals?" in *Washington Law Review*, 1998.

[9] IRRC: *Shareholder Initiatives Against Sweatshops*, IRRC, August 2002.

[10] Discussions between large shareholders and companies like Premier Oil over their continued involvement in Myanmar would be an example of “corporate engagement”.

[11] See, for example, “Social Funds in the US: Their History, Financial Performance and Social Impacts” in Fung, Hebb and Rogers: *Working Capital – the Power of Labor’s Pensions*, Cornell University Press, 2001.

[12] See, for example, the Domini 400 Social Index of 400 common stocks screened according to broad social and environmental criteria, which has outperformed the S&P 500 stock index on a total return basis since it went live on 1 May 1990 at: http://www.socialinvest.org/areas/news

[13] Social Investment Forum: *2001 Report on Socially Responsible Investing Trends in the United States.* Available online at http://www.socialinvest.org/Areas/research/trends/2001-Trends.htm

[14] The $2.34 trillion managed by major investing institutions includes pension funds, mutual fund families, foundations, religious organizations and community development financial institutions, and accounts for nearly 12 per cent of the total $19.9 trillion in investment assets under professional management in the United States (Nelson’s 2001 *Directory of Investment Managers*).

[15] Russell Sparkes: *Socially Responsible Investment: A Global Revolution,* Wiley.

[16] *The Pensions Act 1995 Occupational Pension Schemes (Investment) Regulations,* as amended by the SI 1999 No. 1849.

[17] UKSIF: *Response of UK Pension Funds to the SRI Disclosure Legislation,* October 2000.

[18] National Association of Pension Funds survey, 1999.