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Improving the quality of work in the UK's private sector: Evaluating the potential for investor-led strategies

ShareAction»

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Introduction

As of May 2016, a record number of 31.7 million people are in employment in the UK.[1] Yet more than half the people in poverty in the UK live in a household where at least one person works.[2] The Organisation for Economic Co-operation and Development (OECD) found that the long-term incidence of low pay is high in the United Kingdom at 15 per cent, as compared with other major OECD economies.[3] This growth of working poverty is a significant challenge to the proposition that work is a route out of poverty. By extension, tackling the issue of low pay and poor quality work is crucial to alleviating poverty and social exclusion in the UK.

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The growth of working poverty –particularly since the 2008-9 financial crisis – is one element of a bigger story around pressure on standards of living driven both by low pay and rising costs of essential goods, particularly housing.

This paper suggests that a strategy to reduce poverty which activates institutional investors, including pension funds, foundations and asset management firms, around the problem of low-paid, precarious and exploitative employment in the UK's private sector could have a meaningful impact on UK poverty.

The paper examines:

1. The scale and reach of publicly listed companies in the UK in order to understand the potential influence of a strategy of activating investors,
2. The composition of investors in these publicly listed companies,
3. The legal frameworks underpinning the UK corporate governance regime that enable investors to influence these firms,
4. The growing numbers of investors integrating Responsible Investment practices,
5. The attention paid by investors to issues relevant to working poverty,
6. The key barriers that have impeded investor action on working poverty in the UK in the past,
7. A case study of the potential impact of investor-led action to address in-work poverty in the example of the UK Living Wage initiative, and
8. Recommendations for how to operationalise an investor-led strategy to reduce poverty.

In conducting our research we have:

1. Analysed relevant laws and regulations governing publicly traded companies and their investors;
2. Approximated the reach and influence of publicly traded employers on the wider UK workforce;
3. Consulted a range of institutional investors directly and analysed published information on their company engagement methodologies;
4. Drawn upon research on workforce issues undertaken by industry bodies such as the Pensions and Lifetime Savings Association (PLSA)[4] and the Chartered Institute of Personnel and Development (CIPD);
5. Utilised ShareAction's own research and experience of working with institutional investors.

UK workforce subject to investor influence

In order to assess the potential of a strategy to address in-work poverty through activating institutional investors, it is important to firstly understand the scale of influence of publicly listed companies on employment practices in the UK.

Unhelpfully, no data is collected by the London Stock Exchange or FTSE on the number of UK employees of listed companies. By making a number of informed estimations, we calculate that at a minimum 2,500,000 people in the UK workforce, or about 10 per cent of the total UK working population is directly employed by a publicly listed firm.

While the number of companies that are publicly listed makes up a small proportion of all firms in the UK, these firms are worth attention within any strategy to reduce poverty due to:

1. The concentration of workers in a limited number of very large employers
2. The influence of these firms on the wider UK labour market
3. The availability of levers to influence these firms.

We explore each below.

On the London Stock Exchange, there are 2,396 listed companies with a total market value of £3,934,082,000,000.[5] The FTSE 100, or 100 largest companies listed on the London Stock Exchange by market capitalisation, employs over 5.9 million people worldwide[6] and contains a significant number of the UK's largest employers including Tesco (315,829 UK employees), Sainsbury's (161,000), and Royal Mail (160,000). As outlined in the table below, the largest 20 employers in the FTSE 100

Table 1: The 20 largest employers in the FTSE 100

Employer	Number of UK employees[7]	Sector	Prevalence of low pay
Tesco PLC	315,829	Retail	High
Sainsbury (J) PLC	161,000	Retail	High
Royal Mail Group Ltd	160,000	Industrial Transportation	Low, but with a high proportion of seasonal workers
Wm Morrison Supermarkets PLC	119,778	Retail	High
Royal Bank of Scotland Group	112,000	Banking	Low
Lloyds Banking Group PLC	88,000	Banking	Low
Marks & Spencer Group PLC	74,679	Retail	High
BT Group PLC	72,200	Telecommunica-tions	Medium because of a concentration of call centre staff
Compass Group PLC	60,000	Catering	High
Next PLC	50,018	Retail	High
HSBC Holdings PLC	48,000	Banking	Low
Whitbread PLC	45,000	Hospitality	High
International Consolidated Airlines Group	41,000	Travel	Low
G4S PLC	37,000	Support services	High
Barclays PLC	33,600	Banking	Low
Centrica PLC	28,814	Energy and utilities	Low
Aviva PLC	27,278	Insurance	Low
Dixons Carphone	27,000	Retail	High
Sports Direct International PLC	27,000	Retail	High
Kingfisher PLC	26,319	Retail	High
Total	**1,554,515**		

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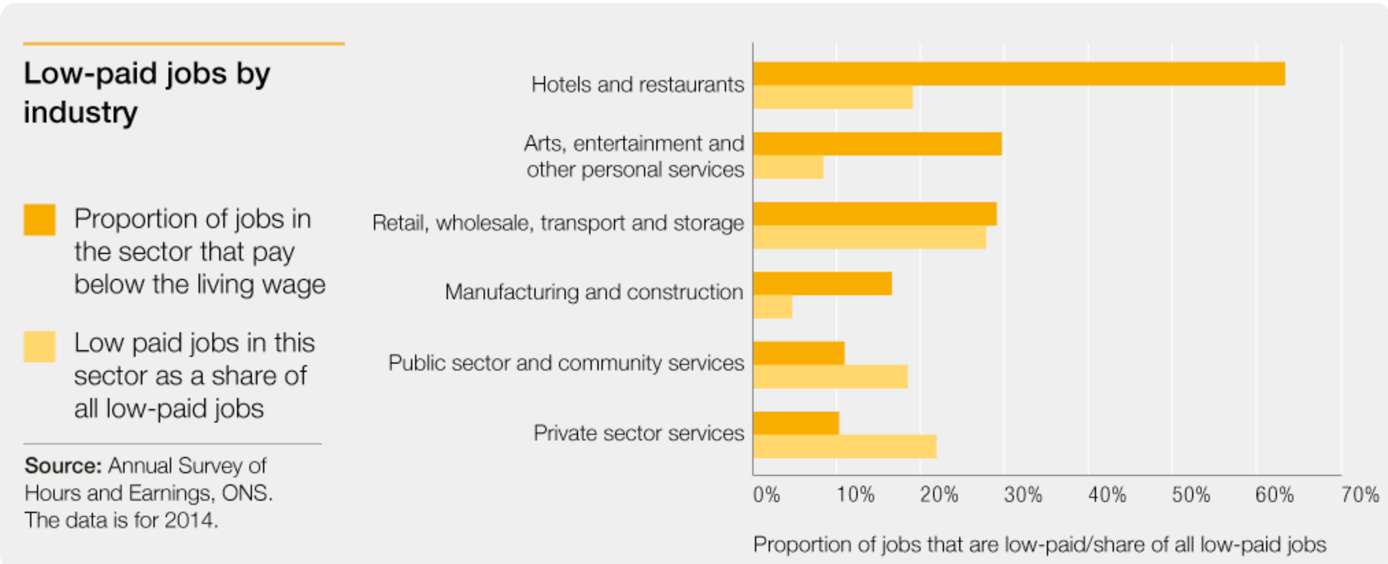
It should be noted that many other very large employers are listed on the FTSE 250 such as Mitie (70,000 employees), the Home Retail Group (47,000 employees), and Mitchells and Butlers (43,000 employees). We calculate that companies with the largest numbers of UK employees in the FTSE 250 employ approximately 590,000 people. Together with the FTSE 100's largest employers, this makes up 8.33% per cent of the total UK workforce. Adding in those employed by smaller FTSE listed employers through totalling those with data available (largely through annual reports) and estimating those with none available by comparable firms in the same sector, we find that well in excess of 10 per cent of all UK workers are employed by publicly traded companies.

It is important to note the sectoral breakdown of these firms in order to understand the prevalence of in-work poverty and poor quality of work. With the exception of banking, insurance, and other financial services firms, most of the largest UK employers in the FTSE 100 and FTSE 250 are in sectors with a high proportion of low paid staff.

From the table above, the large number of retailers is notable. The sector has a high proportion of staff living in poor households. Within the wider FTSE 250, many of the companies with the largest numbers of employees are again within the retail sector such as Debenhams and the Home Retail Group. There are also large hotel and restaurants chains in the FTSE 100 with Whitbread's Premier Inn and Costa Coffee and Intercontinental Hotels Group, and even more so in the FTSE 250, which includes chains such as Domino's, Greggs, Millennium & Copthorne Hotels Group, the Restaurant Group, and JD Wetherspoon. The third sector with a large number of low paid employees that has a significant presence in the FTSE 250 is support services. Names include Compass, G4S, Serco, Capita and Interserve.

The influence of publicly listed firms on the quality of work in the UK extends beyond their direct

Table 2: : London's Poverty Profile shows the sectors with the highest concentration of low-paying jobs[8]



employees, both through influence over third-party suppliers and in their informal role as standard-setters in the business community. The numbers of people indirectly employed by publicly listed firms is significant, with some firms having a bigger outsourced workforce than directly employed staff. Though few firms calculate this data, Sky found for instance that they indirectly employed 48,430 in contrast to their 25,049 direct employees.[9] Considering issues around the quality of work in heavily outsourced sectors such as cleaning[10] and catering, this potential influence could be significant in any strategy to reduce poverty. The impact that FTSE 100 companies can have upon their third-party suppliers is illustrated with reference to the UK Living Wage standard. Under the accreditation requirements of the Living Wage Foundation, a company must ensure that out-sourced staff working on UK sites receive at least the Living Wage rate. With more than 2600 employers now signed up to this standard, including a growing number with large and complex out-sourcing arrangements such as National Grid, the potential value of public companies driving up standards through their supply chains is clear.

FTSE 100 companies tend to have a significant media profile which widens the impact of the practices they adopt. An example of the attention paid to listed firms as a benchmark for improving wider corporate practice is around the Davies review of women on boards.[11] Mervyn Davies focussed first on increasing the number of women on boards in the FTSE 100, followed by the FTSE 250. This initiative has been a striking success, with an increase from 12.5% women on boards of FTSE 100 firms in 2011 to 26.1% as of October 2015, and no remaining all-male boards in the FTSE 100.

These big firms are also highly influential with policy makers. They dominate business forums such as the Confederation of British Industry and have regular access to ministers and senior civil servants. To the extent that FTSE listed companies improve their own labour practices voluntarily following investor engagement (as seen in the Living Wage programme described in Section 7), they are less likely to lobby against regulation designed to raise standards and they may even weigh in supportively in the interests of a ‘level playing field’.

Finally, listed companies present shareholders and other stakeholders who wish to raise the quality of work in the UK with obvious levers for influence. These levers are discussed in detail in Section 4.

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Who are the investors in UK listed companies?

Understanding the composition of investors in the UK's publicly listed companies is fundamental to understanding the potential to activate these investors to address poor quality of work and address in-work poverty.

Investors in FTSE listed companies can be separated between institutional investors and individual shareholders. Institutional investors themselves can be divided into categories including: investment managers, insurance companies, pension funds, foundations, sovereign wealth funds, and hedge funds.

In the UK in the last 50 years, the portion of public equity held by individuals has decreased from 54% to only 11%.[12,13] This decline has been accompanied by the rise of institutional investors, particularly pension funds and insurance companies, which rapidly increased their share of the equity market from the 1960s, but have recently reduced their allocation to equities.

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The shifts in the composition of investors has mixed implications for investor action to improve the quality of work. The decline of individual shareholders can create more opportunity for influence, as investors themselves can be held accountable. But as the Kay Review of UK equity markets and long-term decision making outlines, the decline of individual shareholders was accompanied by the rise of intermediation, with more and more actors in the chain between the actual asset owner and the company. This has led to more diffusion of responsibility and misaligned incentives between players in the investment chain.

Another trend is the rise in ownership of UK listed companies by foreign investors. The Kay Review notes however that "the figure for foreign 'ownership' is exaggerated since it includes holdings by asset managers whose parent company is US based, even though management is conducted from the UK and the manager may be acting on behalf of UK clients. BlackRock, a US firm, is today the largest asset manager in the UK equity market. Other US asset management firms such as Capital, Fidelity and Vanguard have substantial London offices."[14]

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The Kay Review also notes that the increased fragmentation of shareholders and geographical distancing of shareholders from their holdings has contributed to a lack of interest and control of shareholders in their investee companies. Having said that, the fragmentation of the shareholder base opens opportunities for smaller shareholders to have an influence and to exercise their voice without it being overshadowed by a dominant owner, particularly when this is undertaken through collaborative engagements between multiple shareholders.

Furthermore, overseas investors will sometimes have a greater interest in workforce issues than local investors, as was the case with Walmart where European investors were more active on challenging the company than US equivalents. (See box on page 11).

The corporate governance regime

This section outlines the corporate governance regime for publicly traded companies in the UK, which needs to be understood to estimate the potential influence of investors on publicly listed companies' employment practices. Corporate governance is defined as the "system of relations through which the corporation makes decisions and exercises its authority."[15]

On paper, minority shareholders in the UK have strong rights in the corporate governance structure, for example compared to shareholders in US firms. In practice, shareholders of UK companies have historically been reluctant to use those powers in an assertive manner, certainly in relation to the employment practices of investee companies. The essential pieces of the legal and regulatory framework that underpin the corporate governance regime as it affects investor ability to influence the quality of work in the UK are the Stewardship Code, the Corporate Governance Code, and fiduciary duties. The relevance of each of these is outlined in the following sections.

The UK Stewardship Code

The Stewardship Code articulates responsibilities and duties of investors, and aims to improve engagement and dialogue between companies and their shareholders.[16] In the investment context, stewardship is a growing global concept that embraces the idea that institutional investors ought to pay active attention to the strengths and, particularly, any weaknesses of its investee companies, seeking to positively influence those companies where risks are being run and practices are poor.

Analysis of statements of compliance with the Stewardship Code reveal that the vast majority of signatories focus solely on the governance element of the environmental, social, and governance concerns which make up 'ESG' considerations for an investor.[17]

The Stewardship Code itself, which will be subject to review in future, makes only passing reference

The levers of shareholder influence on publicly listed firms

Shareholders in UK firms may undertake the following mechanisms of influencing investee companies under UK law:

- Sell their holdings. Except when there is an express covenant or restriction, shareholders in publicly listed companies are free to sell all or part of their investment at any time assuming they can find a buyer.
- Direct engagement. Shareholders have the right and ability to request a meeting with a company's board or executives to discuss any concerns they have. They may also use shareholder meetings for this purpose, particularly the AGM. They may and often do write to investee companies to request information and to raise issues.
- Collective engagement. A group of like-minded shareholders can act collectively to have greater influence than individually.
- Voting rights. Shareholders can vote on the election of directors and the selection of auditors. In UK listed companies, shareholders can also vote on the board's remuneration report and policy.
- Issuing a formal complaint to a regulator. This is applicable if a company is suspected to have broken a law or regulation.
- Submitting a shareholder resolution. Under the Companies Act 2006, shareholders in UK firms may submit a resolution to be considered at a company's Annual General Meeting if the concerned members represent not less than 5 per cent of the total voting rights of the members entitled to vote on a resolution; or the concerned members number at least 100, holding shares on which there has been paid up an average sum per shareholder of not less than £100.
- Calling for an extraordinary meeting. This is provided for in the UK under the Companies Act 2006.
- Proxy fight. This is when a group of shareholders are persuaded to join forces and gather enough shareholder proxies to win a corporate vote, typically, on the composition of the board
- Lawsuit. This is utilised only in extreme cases as the costs are often still ultimately borne by the shareholders. Such lawsuits are very rare in the UK and rather more common in the US.

to social and environmental concerns as part of supportive guidance to Principle 4:

> *"Instances when institutional investors may want to intervene include, but are not limited to, when they have concerns about the company's strategy, performance, governance, remuneration or approach to risks, including those that may arise from social and environmental matters."*[18]

The Corporate Governance Code

The UK Corporate Governance Code (the 'Code') sets out best practice for corporate governance including the composition of the Board of Directors, executive remuneration, accountability, audits, and relations with investors.[19]

Although over 90 percent of the FTSE 350 companies report that they either comply with all, or all but one or two of the Code's provisions, the quality of this reporting is often poor, as discussed below.[20]

Since October 2013, directors have been required to produce a strategic report as part of a company's annual report.[21] The FRC's guidance states that the strategic report should include:

> *"An explanation of the main trends and factors affecting the entity; a description of its principal risks and uncertainties; an analysis of the development and performance of the business; and an analysis using key performance indicators. Disclosures about the environment, employees, social, community and human rights issues are required when material. There is also a requirement to include disclosures on gender diversity."*[22]

In concept, this reporting by publicly listed firms informs investor understanding of these issues, including workforce issues, and creates greater accessibility of information through which stakeholders can benchmark company practice. In practice, the information provided in companies' strategic reports often fails to disclose substantive information on a company's workforce, and its usefulness can be limited. Nonetheless, the regulatory framework is, by international standards, a strong one offering investors in UK listed companies clear opportunities to demand relevant data on the quality of work and workforce issues.

Fiduciary Duties

In addition to responsibilities under the Stewardship Code, institutional investors may be subject to wider fiduciary obligations, or the duties of investment intermediaries to act in the best interest of the parties whose assets they manage.

Fiduciary obligations exist to ensure that those who manage other people's money act responsibly in the interests of beneficiaries, rather than serving their own interests. The two key elements of fiduciary duties are the duty of loyalty and the duty of prudence. The duty of loyalty establishes that fiduciaries must act in good faith, avoid conflicts of interest and must only act in the interests of their beneficiaries, without making any unauthorised profit by reason of their fiduciary office.[23] The duty of prudence holds that fiduciaries must exercise "due care, skill and diligence."[24]

> "There is no impediment to trustees taking account of environmental, social or governance factors where they are, or may be, financially material.

It has been commonplace for pension fund trustees to take a narrow interpretation of the duty of prudence, which holds that fiduciaries should focus on the maximisation of short-term returns.[25] This narrow interpretation has inhibited a focus on ESG factors that may take some time to influence a firm's financial performance, including workforce management factors.

In 2014, the UK Law Commission produced a major report on the Fiduciary Duties of Investment Intermediaries. This confirmed that trustees should take into account environmental, social, and governance factors when financially material and that they may take into account wider factors, such as ethical and "quality of life" concerns, subject to a two-part test.[26] The Law Commission stated that it could "finally remove any misconceptions on this issue: there is no impediment to trustees taking account of environmental, social or governance factors where they are, or may be, financially material."[27]

This helpful clarification is still not fully understood or adopted by many UK institutional investors, but it is clearly relevant to investors in firms where the quality of work is an impediment to the long-term success of the company, or might be. Furthermore, it opens the way for pension funds to take a much closer interest in quality of work issues where these matter to beneficiaries.

Responsible Investment and quality work

Responsible Investment is defined as “an approach to investing that aims to incorporate environmental, social and governance (ESG) factors into investment decisions, to better manage risk and generate sustainable, long-term returns.”[28]

A growing number of investors are embedding Responsible Investment practices as a means of both implementing these legal duties and going beyond them to have competitive advantage in ensuring long-term returns.

The field of Responsible Investment has grown rapidly in the last ten years, notably under the auspices of the UN backed Principles for Responsible Investment (PRI), which is headquartered in the City of London. This global initiative, which marked its ten year anniversary in 2016, now has over $67trillion of assets under management signed up to a set of six principles that focus on the financial relevance to investors of identifying and managing environmental, social and corporate governance factors in their portfolios.

> “Companies listed in the ‘100 Best Companies to Work For in America’ generated between 2.3% and 3.8% higher stock returns per year than comparable companies from 1984 through 2011.”

The case for investor engagement on ESG factors is highlighted by such infamous ‘preventable surprises’ as BP’s Gulf of Mexico spill (costing the company USD 54 billion by June 2015)[29] and Volkswagen’s defeat devices scandal (so far costing the company an estimated USD 35 billion).[30]

The financial materiality of quality of work and a company’s labour practices is growing in acceptance amongst those investors that consider ESG risks to be relevant and material. There is now substantial evidence of the financial materiality of workforce management.

Research by Larry Beeferman and Aaron Bernstein with the Labor and Worklife Program at Harvard Law School assessed 92 studies on human capital management as it relates to corporate performance using the definition of materiality used by the US Securities and Exchange Commission. They found that the majority of these 92 studies found a positive correlation between companies’ training and HR policies and investment outcomes. Only one found a negative correlation. They concluded that “there is sufficient evidence of human capital materiality to financial performance to warrant inclusion in standard investment analysis.”[31] For instance, companies listed in the ‘100 Best Companies to Work For in America’ generated between 2.3% and 3.8% higher stock returns per year than comparable companies from 1984 through 2011.”[32]

The ESG rating agencies that play a key role in informing investors’ understanding of company risks weigh labour standards approximately equally to environmental risks. For instance Vigeo, a French agency which assesses companies on their practice and performance on ESG issues, weighs labour standards – including supply chain management, fundamental labour rights, non-discrimination and diversity, forced and child labour, social dialogue, employee participation, restructuring, career development, remuneration systems, health and safety, and working hours - as 30 per cent of a company’s total ranking while environmental concerns make up 31 per cent, other societal risks 21 per cent and governance 18 per cent.[33]

Institutional investors think about the quality of work in companies from two main perspectives: first, avoiding costly and embarrassing reputational damage due to violations of core labour standards and, second, improving firm-level performance and productivity through effective human capital management. For UK listed companies, the core labour standard considerations are largely concentrated around firms’ overseas supply chains, looking for evidence of violations of the relevant frameworks on forced labour, child labour, working hours, paid overtime, minimum wage, anti-discrimination, freedom of association, and health and safety.[34] The standards are based upon Conventions, Recommendations, Declarations and Directives from the UN, ILO, Global Compact, OECD, and WHO.[35] In practice, these evaluations have only a minor impact upon an investor's decision to invest or divest from a firm, but will often be a source of information to influence an investor's dialogue with a firm.

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Beyond the question of violations of core labour standards, institutional investors are increasingly viewing the quality of labour practices, both domestically and in regards to international operations and supply chains, within a framework of 'human capital management.' Human capital is defined by the OECD as "the knowledge, skills, competencies and other attributes embodied in individuals or groups of individuals acquired during their life and used to produce goods, services or ideas in market circumstances." The UK's Pensions and Lifetime Savings Association (PLSA) says, "Essentially, a company's human capital is its people – the skills and capabilities of whom are used in its value creation process."[36]

As an indicator of this growing perspective, in 2015, the PLSA published for the first time a discussion paper for its membership on corporate reporting on workforce issues, with a focus on human capital management as a driver of company productivity, stability, and better risk management for investors.[37]

The PRI has highlighted a range of different indicators of work quality that have thus far been particularly subject to attention by investors, including:[38]

- Employee absence and health and safety
- Employee turnover
- Training expenditure
- Employee satisfaction and engagement
- Expenditure on employees in pay and benefits, including access to benefits
- Employee composition in terms of permanent and contingent workforce, particularly contractual arrangements such as zero-hour contracts
- Diversity and pay equity

Employment practices that would improve company performance on each of these indicators are relevant to the UK's problems with working poverty, job security, and poor employee engagement.

Investor appetite for engagement with companies on labour issues has been demonstrated through a variety of initiatives. For instance, since 2012, the Secretariat of the PRI formed a Steering Committee of 11 global institutional investors to initiate a collaborative programme focused on employee relations at investee firms. 21 institutional investors participated in this collaborative engagement programme, which focused on retail firms across the world. The aim of the 21 investors in this network was to improve company performance on 'human capital management' and disclosure. The PRI also coordinates a specific collaborative initiative on employment conditions in agricultural supply chains, an initiative which gathered the support of 36 investors with a combined assets under management of US$ 2.2 trillion.

ShareAction's 2015 survey of asset managers found that 29 per cent of the UK's largest asset managers would be willing to attend a company annual general meeting (AGM) to engage the directors on workforce issues such as pay, safety or labour relations and 13 per cent would do so to challenge or question a board on wider social issues. This compares to 17 per cent who said they would do so for an environmental risk issue.[39]

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In the United States, the Human Capital Management (HCM) Coalition is led by the UAW Retiree Medical Benefits Trust and includes 24 institutional investors representing over $2.3 trillion in assets. Their stated objectives are to:

- Educate themselves and other stakeholders about the role of HCM in company performance
- Foster an environment of open communication between asset owners, asset managers, and other key market participants on HCM as a long-term value driver
- Identify and assess company HCM practices and performance
- Engage companies about their HCM performance
- Encourage enhanced disclosure of HCM practices and key performance indicators
- Encourage improved HCM practices and performance
- Elevate board and senior management attention to HCM

Institutional investors - both foreign and UK-based - are demonstrating a growing interest in promoting quality work amongst their investee companies. Furthermore, investors would appear to be open to developing the resources and capabilities to do this better.

Case study of investor concern over core labour standards violations: Walmart in the US

Back in 2006 when investor understanding on labour standards issues was rather less developed than it is today, Norway's Sovereign Wealth Fund, one of the largest in the world, divested its €321.7m stake in Walmart over "serious and systematic violations of human rights and labour rights" and failure to engage with investors to address these concerns. In 2013, Sweden's AP funds (1-4), worth a combined $140 billion at the time, similarly divested from Walmart over violations of labour standards. Christina Kusoffsky Hillesöy, head of sustainable investments and communications for Sweden's AP3 fund described their decision to divest as the last resort:

> *"We decided to try to engage with Walmart," she said. "We've been trying for so many years and so little is happening. There's discrimination, there's very low pay, there are employees with bad working hours who are unable to live on their wages and have to take extra jobs. When you read reports about class action lawsuits, with employees suing, it's quite alarming for an investor. We didn't see the dialogue moving forward."*[40]

The Netherlands' largest pension fund ABP and Dutch asset managers PGGM and Mn Services also divested from Walmart over these concerns in 2012. Walmart has since announced a substantive wage rise by increasing its minimum base pay to $9 an hour in 2015 with a projected increase to $10 an hour in 2016. Though this decision to raise wages cannot be said to be solely attributable to this series of significant shareholder actions, it may have contributed to Walmart's board feeling they would have support from at least a portion of their shareholder base for this decision to raise the company's cost base. Indeed, the move was publicly welcomed by Walmart shareholders, including the Interfaith Center on Corporate Responsibility (ICCR) who had continued to engage with the board on the subject of labour standards and low pay with the intention of improving Walmart's practices.

Case study of an engaged investor's approach to quality work, from Elly Irving, ESG Analyst at Schroders Asset Management

> *"As investors we seek to engage with companies on the most significant and business-relevant ESG (Environmental, Social and Governance) factors. We have identified human capital management as an issue of particular importance for various sub-sectors. Through our research we use a range of indicators to try to find evidence of the implementation and assess the effectiveness of these human capital management policies. For example we look at metrics such as employee turnover, diversity statistics, and evidence of development opportunities such as internal promotions and level of whistleblowing calls concerning human capital issues. We believe that when assessing the quality of jobs provided by an employer a number of issues should be considered. These include base pay, training and development opportunities, benefits, health & wellbeing programmes and how different contract types are used such as zero hour contracts. Reporting on human capital management continues to provide little transparency into practices, however we have a long history of engaging with companies to understand their approach. We are increasingly looking at employee productivity as an indicator of good human capital management, but disclosure across most sectors remains weak and there is an inconsistency in reporting metrics. As investors we are involved in industry level discussions about human capital reporting. We continue to engage with companies on a one-on-one basis to improve their human capital practices as we believe that human capital is a key asset for many of our investee companies."*

What are the barriers impeding investor activity?

With the growing investor acceptance that quality of work is a material issue, it is worth exploring the barriers that have limited mainstream institutional investor engagement on the topic with investee companies.

The OECD found that the limited capacity of institutional investors was the key impediment to investors undertaking engagement, particularly amongst asset owners (i.e. pension funds and foundations):

> *"It is worth noting that 76% of the asset owners [in the OECD's study] and 56% of the asset managers stated that they had five or less staff members devoted to ownership engagement with investee companies (IRRC and ISS, 2011). This number should be compared to the hundreds or perhaps thousands of companies that these institutions may hold in their portfolios and are expected to monitor. Against this background, it is not surprising that limited staff was identified to be the main impediment to ownership engagement"*[41]

The PLSA 2014 Engagement Survey provides a useful insight into the perceptions of UK pension funds, as asset owners, on their role in engaging with companies and the barriers to requesting substantial engagement by their fund managers. The survey found that 94 per cent of pension funds surveyed agree that institutional investors (including pension funds) have stewardship responsibilities that include engaging with companies and voting shares.[42] Moreover 90 per cent agree that "extra-financial factors – environmental, social and governance factors – can have a material impact on a fund's investments in the long-term."[43]

However the PLSA survey finds that only "in just over half of cases funds explicitly set out their expectations with respect to stewardship within the mandates they award to investment managers."[44]

Casting an eye to asset managers themselves, ShareAction's *Responsible Investment Performance of UK Asset Managers Survey* (2015), which analysed the 33 largest asset managers in the UK, found that 96 per cent of respondents (with an 84% response rate) state that they conduct stewardship activities because they believe it affects investment returns.[45] Moreover, 92 per cent state that they are prepared to engage directly with investee companies on ESG issues.[46]

Despite these encouraging numbers, in practice, the earlier-cited barrier of resource constraints was noted by 83 per cent of the asset managers surveyed, including a lack of budget, time or adequately skilled personnel to carry out the work of engaging with companies on ESG issues.[47] Other obstacles mentioned were the thousands of companies in which they invest, the challenges and costs in obtaining adequate corporate access, regulatory uncertainty on corporate access, lack of demand from clients, and lack of receptiveness to engagement by investee companies.[48]

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As the PLSA survey found, 30 per cent of those pension funds that do not already set out their expectations of asset managers with respect to stewardship activities are considering doing so in the future.[49] The PLSA engagement survey finds that "More than half of funds are asking more questions on stewardship matters during asset manager reviews; additionally more time is spent reviewing reporting and votes cast."[50] As another indication of increasing appetite to play a more active role in engaging with companies, only 53 per cent of pension funds surveyed by the PLSA felt that institutional investors have been active enough as stewards of investee companies over the past year.[51]

When it comes to integrating and engaging on companies' labour practices in particular, there is a significant barrier in the limited availability of quantitative and qualitative data on the workforce labour practices of publicly listed companies.

In April 2015, SSE (the utilities company) became the first FTSE listed firm in the UK to "measure the value of its 'human capital' and publish its findings."[52] According to Bloomberg data, even the total headcount of a workforce is frequently unreported.[53] Companies each use their own processes and methodologies to collect and report on employee-related data. It is therefore currently difficult for investors to make meaningful comparisons based on public information between UK companies on human capital issues.[54]

Unlike company data on carbon emissions and other environmental metrics, the availability of data on workforce practices is currently very underdeveloped.[55] Stephen Haddrill, CEO of the Financial Reporting Council, has stated: "On day one of economics A-level, you learn that there are three factors of production: land, labour and capital. Why is it we don't measure labour? There is a much greater willingness in the UK, a kind of encouragement even, to talk about what the business model is, what the risks to it are, and so on. It feels to me that you've got to talk about the value of your people when you talk about that."[56]

> "Investors are not asking the right questions because relevant information is not available, and companies are not producing the data because investors are not asking the right questions.

Positively, demand amongst investors for such data is growing, as evidenced particularly by the PLSA recommendations for further workforce reporting in its 2015 report "Where is the Workforce in Corporate Reporting?" and subsequent guidelines produced in July 2016.

Shareholders interviewed by the Valuing Your Talent Initiative asserted that without access to comparable information on labour practices it is difficult to engage with company senior management as they are, in effect, "blind to such issues."[57] It has been described by companies and investors alike as a 'chicken and egg' problem, as reported by Neil Stevenson, managing director, global implementation at the International Integrated Reporting Council (IIRC).[58] Investors are not asking the right questions because relevant information is not available, and companies are not producing the data because investors are not asking the right questions.

The Investor Responsibility Research Centre (IRRC) Institute has suggested that some of the evidence available regarding human capital issues has been overlooked by investors, due to the fact that, "most of the [academic] studies in the field have not been framed from the perspective of investment analysis."[59,60]

In 2014, less than 50 per cent of companies in the FTSE 100 disclosed levels of staff turnover; under 25 per cent reported on investments made in training and development; and less than 10 per cent provided information about the composition of their workforce.[61]

A report, commissioned by Valuing Your Talent and written by the Chartered Institute for Personnel Development, highlighted investor interest to form a fuller picture of the companies they invest in.[62] It highlighted confusion amongst investors regarding human capital management terminology and measures:

> *"There is also a gap in the capabilities of investors to appreciate human capital data and derive real value from it. While both organisations and investors note its potential, there is still some way to go before both groups benefit fully from human capital information."*[63]

Nonetheless, positive moves forward have taken place such as the uptake of integrated reporting under the Global Reporting Initiative (GRI) and International Integrated Reporting Council (IIRC). The IIRC has reported that integrated reporting, which provides information about resources and relationships used by an organisation, is becoming more popular.[64] Amongst the 2,230 global organisations reporting under guidelines produced by the GRI:

> *"71% fully disclose their total workforce by employment type, employment contract, and region; 52% fully disclose their total number and rate of employee turnover by age group, gender and region; 55% fully disclose their rates of injury, occupational diseases, lost days and absenteeism, and a number of work-related fatalities by region; 51% fully disclose the average hours of training per year per employee by employee category."*[65]

In 2016 the Valuing Your Talent initiative evaluated company progress on reporting on this area and found that company reporting on workforce related topics has been on the rise since 2013, especially in the area of human rights.[66] They conclude however, that the reporting done is still not comparable across companies and so not useful to investors to inform their decisions and actions.

> "Evidence for human capital materiality is sufficiently compelling to warrant investor requests for companies to report systematically on their training and other HR policies with clarity and depth.

Without comparability between the reporting of different organisations, it is difficult for investors to establish a benchmark on which to base their engagement with companies. The IRRC Institute has argued that,

> *"…evidence for human capital materiality is sufficiently compelling to warrant investor requests for companies to report systematically on their training and other HR policies with clarity and depth, which would enable investors to assess their alignment with company's business strategy. One avenue for further research would be to explore how investors might determine the specific corporate reporting that can help shed light on these questions."*[67]

However, the question of how to achieve this comparability with as nuanced a topic as a company's people management is not a simple one. The PLSA argues that quantitative data is not what is needed, but rather what is needed is consistent qualitative data, providing a more holistic view of the impact of a corporation's workforce on the performance of a business. This would allow investors to fully appreciate the, "…risks and opportunities present within an investment proposition. In of itself this should begin to move the discussion about people out of the 'costs' category and into the 'assets' category."[68] The PLSA asserted that,

> *"…for genuinely long-term investors such as pension funds, conversations about the people that constitute company management and the wider workforce are crucial to understanding a company's culture, how well a company is functioning and whether warning lights are beginning to flash."*

The PLSA has put forward four key areas for disclosures as a starting point: 1. the composition of the workforce; 2. the stability of the workforce; 3. the skills and capabilities of the workforce; 4. employee motivation.[69] Within these suggested areas there are many metrics that are directly relevant to the problem of in-work poverty including: part-time and contingent labour, remuneration policies and ratios, and reward packages.

From discussions with asset managers, precarious work is a theme that is of growing interest. However it is also a good example of a topic where investors lack the necessary data to engage forcefully. They lack an understanding or comparable data on the scale and usage of temporary, agency, and non-guaranteed hours contracts. Other factors, such as turnover, industrial relations issues, and employee engagement metrics would also help reveal where the broader quality of work may be poor in ways that impact investors' returns and confidence in companies. Additionally, stronger data on diversity and retention rates after parental leave would

> For genuinely long-term investors such as pension funds, conversations about the people that constitute company management and the wider workforce are crucial to understanding a company's culture, how well a company is functioning and whether warning lights are beginning to flash.

enable investor engagement on these themes as well.

Under section 78 of the Equality Act 2010, the Government will be introducing legislation in 2016 making gender pay gap reporting mandatory for private sector companies with over 250 employees, with the aim of pushing up women's wages and closing the gender pay gap. As stated by the PLSA, the publication of workforce information including, but not limited to, gender pay would, "assist investors to make more informed investment decisions and to act as better stewards of their investee companies."[70]

It is clear that quantitative and qualitative data on labour practices which is accessible to shareholders is limited. However, the examples above show that investor appetite for quality data is growing and there is evidence that the availability of such data would underpin proactive engagement of investors with companies around these themes in the future.

Investor efficacy and quality of work in the UK

A useful case study through which to understand the potential and limitations of an investor-led strategy to drive up the quality of work at UK listed companies is the programme of engagement with the FTSE 100 on Living Wages that is co-ordinated by ShareAction (authors of this report).

After the launch of an accreditation scheme by the Living Wage Foundation in 2011, ShareAction began mobilising investors to call on the boards of FTSE 100 firms to adopt the Living Wage standard. ShareAction led initial outreach to FTSE 100 CEOs through letters signed by a coalition of institutional investors. The coalition was initially formed largely of investors with ethical remits such as faith investors, trade union pension funds or socially responsible investment funds. In 2011, only two of the FTSE 100 were accredited formally as Living Wage employers. The investor letters in the first year served to put the issue of low pay firmly on the agenda of boards of directors across the FTSE 100. By 2014, investors agreeing to be signatories had £25 billion in assets under management and for the first time included mainstream asset owner signatories such as the Strathclyde Pension Fund, the largest local authority pension fund in the UK.

By 2015, this growing asset owner interest had translated into demand on asset managers to begin serious engagement on the Living Wage. This year we have seen mainstream asset managers either agreeing to sign the group letters or engaging individually. One asset manager noted that the Living Wage was the number one concern raised by their clients, who were demanding that this manager undertake direct engagement with boards of companies in support of the Living Wage. For the first time this year, the PLSA encouraged its members to ask their fund managers about the UK Living Wage at investee companies.[71]

The total assets under management of those engaging through the Living Wage investor letters jumped to £50 billion in 2015, while additional institutional investors with assets under management totalling more than £1.226 trillion have engaged individually with active support from ShareAction. Crucially in this process, ShareAction collected and provided comparable data on the positions of the firms in the FTSE 100 on the Living Wage across sectors, which enabled investors to have informed engagement and be confident to challenge firms to go further on the Living Wage.

This important case study demonstrates the effectiveness of engagement by a collective of shareholders who, between them, have less than 5% of equity capital in FTSE 100 companies. The investor-signed letters, representing shareholders with just £50 billion in assets under management, solicited dialogue and disclosure from 95 companies out of the FTSE 100.

> “One asset manager noted that the Living Wage was the number one concern raised by their clients, who were demanding that this manager undertake direct engagement with boards of companies in support of the Living Wage.

At the time of writing, 30 of the FTSE 100 firms are now accredited with the Living Wage Foundation, with a further 20 of the FTSE 100 claiming to be fully compliant though on a non-accredited basis. Thus the portion of the UK's private sector that is subject to shareholder influence and where a concerted campaign of shareholder activism has been undertaken over five years, has now achieved a level of penetration of Living Wage standards that is multiples higher than for private employers as a whole in the UK economy. ShareAction has been told by FTSE 100 HR Directors and CSR Directors how impactful the investor letters and investor engagement have been in moving their boards to support and adopt the UK Living Wage. Outside of the FTSE 100, just 2600 employers of the 5.1 million private businesses in the UK are accredited as Living Wage employers.

The potential for pension savers to drive change

Another indicator of positive potential in the long-term for investors to be promoting addressing working poverty is that pensions automatic-enrolment means that many of the UK's lowest paid employees are joining pension funds.[72] Some have and will opt-out of their employers' chosen schemes but re-enrolment happens automatically every three years. It is therefore becoming a new fact of the UK employment landscape that a vast majority of UK workers have retirement savings invested in UK public companies. This creates an interesting potential dynamic which could see rather more UK pension schemes begin to adopt stewardship policies which reflect the interests of their own scheme members in high quality labour practices in the UK labour market.

> “Asset owners, such as pension funds, in particular find it difficult to explain to their underlying beneficiaries the different development of executive and average employee remuneration and the resulting widening pay gap over the last decades.

NEST, or the National Employment Savings Trust, is the government-backed default scheme for auto-enrolment. At the time of writing, the scheme has 2.4 million members, with median earnings of £19,800.[73] NEST's shareholder voting policy includes explicit support for the UK Living Wage following engagement by ShareAction with the NEST investment team. Their progressive stance reflects the interests of many of the scheme's beneficiaries in seeing earnings growth to above this decency threshold.

In the 2016 voting season, the considerations of pension savers, as the underlying beneficiaries, on the issue of pay inequality has again come into investor attention. Hermes EOS, an engagement provider for pension schemes, suggested that quantum of executive pay should be a key consideration particularly as:

> *“Asset owners, such as pension funds, in particular find it difficult to explain to their underlying beneficiaries the different development of executive and average employee remuneration and the resulting widening pay gap over the last decades.”*[74]

Pension scheme member engagement with pension scheme trustees and executives is relatively novel, but ShareAction has seen how dialogue between members and their funds can influence pension fund stewardship practices. For instance, following a meeting of scheme members with trustees of The Pensions Trust (a large UK pension scheme for the not-for-profit sector), two of the trustees went on to attend the AGMs of FTSE 100 companies to raise questions about the Living Wage publically with company directors.

With fund member engagement strategies, the novelty adds to its effectiveness. For instance, after 30 emails from members of their pension scheme, the Leicestershire County Council Pension Fund adopted a resolution in support of engaging with companies on the Living Wage. The trustees adopted a resolution that requested that “where there is the opportunity to do so the Fund's investment managers, when they consider it to be in the best financial interest of shareholders, support the concept of the Living Wage.”[75]

Conclusion and recommendations

This paper has sought to evidence the potential efficacy of investor-led strategies to raise the quality of work in the UK's private sector.

Whilst there may be some room for influencing privately held companies using investor strategies, the focus would logically be on those companies whose shares are publicly traded. We show that in excess of 10 per cent of the UK's entire workforce is employed by a publicly traded company, and the influence of these companies goes further due to their UK supply chains and to their standing and profile within the wider UK business community and with policy makers.

Amongst large publicly traded companies we see some of the most enlightened practices in the UK's private sector (for example SSE's 2015 Human Capital Reporting Study) and some of the most notorious (for example Sports Direct's ongoing use of zero-hours contracts and other abusive labour practices).

> "The apathy of investors in relation to these issues may be changing, in part due to the growing recognition of the risk-relevance and financial materiality to investors of these factors.

Although shareholders in UK-listed companies have some of the most advanced investor rights in the world, historically institutional investors have shown little interest in engaging with companies about the quality of jobs and workforce management. We show that the apathy of investors in relation to these issues may be changing, in part due to the growing recognition of the risk-relevance and financial materiality to investors of these factors. For the first time in 2015, the PLSA produced a discussion paper for its members on the quality of workforce reporting by publicly listed companies, making a number of recommendations that would assist investors in challenging companies around their management of 'human capital'.

The work undertaken since 2011 to co-ordinate UK investors in a collaborative initiative designed to drive up compliance with Living Wage standards amongst UK listed companies demonstrates the potential both to build investor interest in the problem of poor quality work and to drive change as a result of coordinated investor pressure, from even a modest group of institutional investors. The initiative has come to enjoy the support of large, mainstream asset managers with the result that 30 FTSE 100 companies are now formally accredited with the Living Wage Foundation (up from two in 2011), and a further 20 claim to apply the standards without being accredited. This number looks set to grow, with potential to engage the same set of supportive investors in a wider examination of quality of work concerns in the UK labour market.

The roll out of pensions automatic enrolment creates a new dynamic in the UK's workforce whereby nearly all adults in employment in the UK belong to pension schemes that hold investments in publicly listed companies. Thanks to a new and more enlightened definition of investors' fiduciary duties emerging from the Law Commission's 2014 report, we could expect to see a growing number of pension schemes developing investor stewardship strategies that reflect their members' interest in better quality jobs and workforce management by UK firms. NEST's consideration of the Living Wage as earlier discussed provides evidence of this potential shift, but it remains to be seen if other auto-enrolment providers will adopt a similar approach.

Two main barriers exist to the potential efficacy of shareholder strategies to drive up the quality of work in the UK. The first is a lack of high quality, comparable workforce data being reported by firms. We suggest that the UK may need a concerted programme to bring together institutional shareholders in UK listed companies to demand greatly enhanced reporting on their workforces and workforce management.

Secondly, there is a capacity issue amongst institutional investors whose stewardship and engagement teams are typically fewer than five people with responsibility for identifying and managing environmental, social and governance risks in portfolio companies across the world. Whilst investors in UK firms would appear to be showing a growing appetite and interest in the quality of work provided by their investee companies, it is unclear whether institutional investors will self-organise to work collaboratively on engagements aimed at raising the quality of work in the UK's private sector.

The recommendations below address these specific barriers to investors playing an effective role in addressing poor quality of work, along with the underlying challenges to investor engagement on wider environmental, social, and governance factors.

Recommendations

A collaborative investor-driven programme to secure workforce reporting

To overcome the lack of comparable workforce data available to investors, ShareAction recommends pursuing a model for raising the quality of workforce reporting that is based upon the Carbon Disclosure Project (CDP), which "uses the power of measurement and information disclosure to improve the management of environmental risk."[76] CDP has been successful in securing data for use by investors on companies' environmental metrics, and in turn transforming the way investors view corporate management of environmental risks.

To date, no comparable initiative has taken place to extract high quality, comparable workforce and supply chain data from companies, despite the growing indicators of interest outlined in this paper. A programme like CDP on quality of work metrics would provide an impetus to break the chicken and egg cycle between investors and companies and provide the necessary data to drive engagement that raises the quality of work in UK firms and supply chains.

Using a methodology that brings together investors to be joint signatories on a single survey to companies would also overcome the lack of investor capacity by allowing for a pooling of the costs and resources required to coordinate the securing and analysing of better data.

Such an initiative would bring quality of work to the attention of more mainstream investors by building an evidence base and a framework for investor education and dialogue with companies about the quality of work, especially for the lowest paid.

Strong engagement programmes to secure changes in company behaviour

As demonstrated in the case study of the Living Wage initiative, a group of coordinated investors can effectively encourage change in corporate practice in working conditions, despite the current obstacles. There is significant untapped potential for engagement which improves outcomes for workers and investors alike.

Strong notable engagement initiatives are underway by investors, including collaborative engagements coordinated through bodies like the UN PRI and ShareAction, and in North America, the Interfaith Center on Corporate Responsibility (ICCR), Share and As You Sow.

Should initiatives on workforce reporting develop, ShareAction recommends engagement plans closely follow suit. Engagement would ensure that reporting is useful to companies and investors alike by informing wider dialogues which serve to improve investor understanding of company culture, and encourage best practices in company behaviour.

Policy recommendations

Within the larger landscape of the corporate governance regime, the following policy recommendations would enable, encourage, and require institutional investors to take a more long-term view that takes environmental, social, and governance factors into account. There is room for cautious optimism on some of these policy developments. At a European level, the revised IORP Directive looks set to require that pension funds take ESG risks into account. This would be a highly significant development, though still requires formal ratification by the European Parliament and transposition into UK law. There are encouraging signs that the UK would transpose this despite Brexit, although the situation is unclear.

1. As discussed in Section 4, clarifying fiduciary duties in the pension investment regulations would be an important step to ensure pension fund trustees take environmental, social, and governance factors into account. For

too long, pension trustees have interpreted their duties as requiring them to maximise financial return, often over the short-term. The Law Commission confirmed that this is incorrect: trustees do not need to chase short-term returns and there is no legal barrier to them taking account of wider factors in meeting the best interests of beneficiaries. But the Commission's guidance is still not sufficiently well known by pension funds and misconceptions about trustees' duties to savers remain widespread.

ShareAction recommends:

Clarifying in the regulations governing pension schemes that trustees' fiduciary duties do not prevent them from taking account of factors such as environmental and social risks and, in certain circumstances, savers' ethical and moral views.

Strengthening the FCA rules for non-trust based pension schemes so that savers' best interests are paramount.

2. As discussed in Section 4, the UK Stewardship Code aims to encourage high quality engagement with companies by institutional investors. Good engagement by investors can have a significant impact on how companies operate. Research conducted by ShareAction indicates that the Stewardship Code is not doing enough to encourage best practice across the market. This is supported by the FRC's decision to introduce public tiers of the signatories to the Code, stating that there is a "long tail" of the 301 signatories that do not take their responsibilities as involved investors seriously enough and that they "are really wearing the stewardship code as a badge."[77] ShareAction welcomed the FRC's proposal to scrutinise adherence to the Code. However, as the Code passes its five year anniversary, we think that there is a strong argument for looking at how it has been implemented in practice and considering its strengths and weaknesses. We believe that by making considered minor amendments to the Code, the FRC could have a significant impact on the way in which investors engage with the stewardship process.

   ShareAction recommends:

   Revising the Code so that it more explicitly promotes stewardship on environmental and social risks affecting companies.

   Educating investors on best practice by providing guidance and template policies.

   Exercising the Government's reserve powers to make voting disclosure mandatory for institutional investors.

3. Giving ordinary savers mechanisms to influence what happens to their retirement savings also has the potential to align investor interests with those who experience poor quality work, as illustrated in the example of the potential shifts in the auto-enrolment landscape. People care about the impact their money has: a recent poll found that 70% of people want to invest in things that give a good return and do not harm their future.[78] But the opaque investment system leaves people disconnected from their money. Giving savers a voice in the system could increase accountability, help to drive out bad practice, contribute to better returns for savers and help make the investment system a more positive force.

   To achieve this, ShareAction recommends:

   Including saver representatives in the governance structures of all types of pension schemes.

   Addressing the lack of diversity in pension scheme governing boards.

   Requiring schemes to formally involve savers, e.g. through saver AGMs, surveys, roadshows and using clearer communications.

   Giving savers legal rights to know, on request, where their money is invested and how the rights attached to it to influence companies are being exercised.

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