# Does Socially Responsible Investment Influence Employment Relations?

John Lewer[1], John Burgess[2] and Peter Waring[3]

**Abstract**

In this paper we investigate whether socially responsible investment - .investment seeking both financial and social returns - influences the management of employment relations within corporations. Many SRI funds use investment criteria that expressly incorporate employment relations indicia; meaning that they either look to invest in companies with good reputations for employment relations or exclude companies with poor workplace practices. A further and increasingly popular approach is to try to influence corporate policy on issues of importance to the SRI fund through engagement. Given these objectives, it is relevant to ask whether SRI actually does influence employment relations and to what degree? Drawing on an analysis of SRI funds criteria and interviews with Australian SRI funds managers and consultants, we argue that although SRI has the potential to influence the management of employment relations it has not yet reached the stage of exercising significant influence.

## Introduction

Employment relations as a field of research has historically drawn on market and institutional factors to explain much of its observed phenomena (see Waring and Bray, 2006). Independent variables such as the state and dynamics of product and labour markets along with regulatory regimes have typically featured in explanations of the development and substance of the rules of the employment relationship. More recently, a stream of literature has begun to consider how corporate governance (defined broadly as the financing and control of corporations) might impact upon employment relations.

This emerging corporate governance and employment relations literature raises many novel, interesting and as yet unexplored issues. Key contributions to this literature have so far tended to focus on the links between systems of corporate governance and employment relations within national business systems (see for example Gospel and Pendleton, 2004; Parkinson, 2003; O'Donnell, Mitchell and Ramsay, 2005; Hopner, 2005; Jackson, 2005) while there have been fewer though no less important publications that have explored the relationships between corporate governance arrangements and employment relations at the level of the firm (see Jacoby, 2005 for instance). This literature has been informed by developments in political economy, particularly the theoretical insight that there is no single, homogenous form of capitalism but rather, considerable variety, with discernible differences in corporate governance norms. In Hall and Soskice's (2001) important contribution to this field,

[1] Dr John Lewer, School of Business and Management, University of Newcastle, Australia. Email: john.lewer@newcastle.edu.au
[2] Professor John Burgess, Director of the Employment Studies Centre, University of Newcastle, Australia. Email: john.burgess@newcastle.edu.au
[3] Dr Peter Waring, Division of Business and Humanities, UNSW Asia, Singapore. Email: p.waring@unswasia.edu.sg

developed economies are divided into two broad types labelled as 'Liberal Market Economies' (LMEs) and 'Coordinated Market Economies' (CMEs). The exemplars of the former are the economies of the United States and the United Kingdom with their market-outsider governance systems while examples of the latter type include Germany and Japan with their insider-relational governance systems. This simple typology has been criticised as masking considerable variety across international business systems and within national systems themselves (Jacoby, 2005; Crouch, 2005) but does appear to capture the accentuated tendencies of the business systems of these countries.

The literature has claimed, though without much empirical evidence, that LMEs may not provide much in the way of protection for employee interests since shareholder primacy is the overriding concern of management and as shareholders remain at arms length from the stewardship of the firm (see Lazonick and O'Sullivan, 2000; O'Donnell, Mitchell and Ramsay, 2005 for a discussion of this literature). Contrastingly, CMEs offer better prospects for the protection of employee interests since they are typified by closer relationships between debt finance providers and management. The assumption is that this relational approach provides a more stable context for progressive employment practices.

There are some difficulties with these assumptions. First, the financing and governance arrangements of firms varies considerably within economies and within industries. Privately owned firms or those with a higher debt to equity ratio exist in liberal market economies suggesting considerable variety within each type. Further, research has revealed that there is a growing concentration of ownership in some organisations operating in LMEs indicating that some firms at least more closely resemble those in CMEs (Waring, 2006). Second, high capital market liquidity may not be antithetical to the development of progressive HR practices where these are seen to be an important part of the firm's competitive advantage. If management can convince shareholders that the firm's competitive advantage lies in sustaining inimitable HR competencies (the resource-base view – see Boxall and Purcell, 2003) then progressive HR practices will be sustainable. A related but slightly different point is advanced by Deakin et al (2006:155) who contend that labour-management partnerships can endure in liberal market economies where management can persuade shareholders of the long term gains of such partnerships and where regulation helps to extend investment horizons. Their case study evidence identifies examples of regulation in the UK which assists management to promote the interests of employees. For instance, they cite utility regulation which mandates quality service levels as indirectly supportive of human resource investments. Third, Jacoby (2005:164) has argued that in the wake of the collapse of the 'equity bubble' and corporate governance scandals in LMEs, unrealistic short-term demands from shareholders may have been replaced with a longer term focus more consistent with employee development and other progressive HR practices.

Socially responsible investment (SRI) is significant in the context of these debates concerning varieties of capitalism, shareholder value primacy and its relationship with cost minimisation approaches to employment relations since outwardly at least, it represents a heterodox investment practice. Socially responsible investors are not disinterested investors purely focused on shareholder value but rather demonstrate concern for the environment, social issues and the governance of the firm. Return on investment is not the overriding concern of SRI although it is an important aim. Rather, SRI seeks both financial *and* social returns on invested capital. While the former are easy to identify and calculate, the latter are typically ambiguous and difficult to quantify.

Much of the literature on SRI has therefore tended to focus on the question of whether the financial returns from SRI are similar to that of regular investing with the balance of the literature suggesting that this is so (see Benson, Bailsford and Humphrey, 2006; Hellsten and Mallin, 2006 for a discussion). Surprisingly very little of the growing literature on SRI has focused on whether SRI actually does what it purports to do, that is, to promote corporate social responsibility. The potential for socially responsible investment to improve the social responsibility of corporations is the key point of difference between it and other forms of investing; it is unusual therefore that its *raison detre* has not been more thoroughly or regularly investigated (see Hawken, 2004 for an exception).

The very limited research on this question may also be the result of the differing ways that SRI can be conceived – as a means for private investors to be reassured that they are not deriving a financial benefit from certain unethical business activities or, more proactively, as an effective lever to improve levels of corporate social responsibility. If it is assumed that SRI is fundamentally about excluding morally unacceptable business activities then questions concerning the outcomes SRI produces may not be pursued since the very act of exclusion addresses investors' interests. This way of conceiving SRI also reflects the early use of negative screens which excluded investment in arms production, gambling, tobacco, prostitution and pornography. More recently many SRI funds have shifted from the sole application of negative screens so that, in addition, they adopt positive screens to guide their investments in firms with superior reputations which correspond with their investment tests. Others use a 'best of sector' approach which does not exclude any industries or sectors but rather seeks to invest in firms which are considered to observe the highest corporate social responsibility levels in that particular industry. Increasingly SRI funds may use a variety of these techniques combined with a strategy to engage management and a firm's board in dialogue over how the organisation can improve its CSR (Sparkes, 2002). Given these increasingly sophisticated approaches it is relevant to ask what impact SRI really has on the firm and its corporate governance and management practices.

The research reported in this chapter investigated whether SRI influences employment relations practices. 'Influence' has been construed imprecisely as we leave open the possibility that SRI may have an influence on firm-level and, more indirectly, national employment relations.

Following the introduction, the chapter outlines the size of SRI funds globally and reviews various explanations for SRI development across various developed economies. The paper then discusses the link between SRI and employment relations. Next the research methodology is explained followed by the presentation and discussion of the data. From the results it is concluded that for SRI to be more effective in delivering social returns to its investors, reform is required.

**SRI: Size, Objectives, Methods and Challenges**

SRI is said to have developed as a form of investment during the Vietnam War in the 1960s as investors sought to avoid investing in companies involved with the conflict. Since then it has grown significantly in terms of the number of funds available and the size of funds under management. It is estimated that SRI funds in the US exceed $US2 trillion (19.83% of GDP) while in the UK, Euro $331 billion (22.4% of GDP) is invested in socially responsible funds.

Table 1 A Comparison of SRI Funds Under Management (FUM) in the United States, the United Kingdom, Australia, Japan and Germany

| **Country** | **Size of SRI FUM (equities) in Home Country Currency** | **Size of SRI FUM (equities) in Euro (as at 29 April, 2005)** | **SRI FUM (equities) as a % of GDP** |
|---|---|---|---|
| US | $US 2.332 trillion | 1,800 billion | 19.83 |
| UK | £224.5 billion | 331 billion | 22.40 |
| Australia | 21.3 $Aus billion | 13 billion | 2.66 |
| Japan | 100 billion yen | 0.734 billion | 0.0002 |
| Germany | €7.7b* | 7.7 billion | 0.004 |

Source: Waring and Edwards (2005)

Waring and Edwards (2005) have observed that the large differences in the size and development of SRI funds correspond with the theoretical categories of the varieties of capitalism literature. In the coordinated market economies of Germany and Japan for instance, SRI is a small fraction of GDP while in the liberal market economies of the US and UK it is much larger and a significant proportion of GDP. Waring and Edwards speculate that the presence of state-funded pensions along with greater social regulation in Japan and Germany may largely explain the small size of SRI in those countries but at this point there is no clear explanation for these large differences.

SRI is available in many different forms including as debt instruments, but more typically SRI funds invest in equities according to the principles they have established. These principles vary and various funds prioritise different concerns. Generally though, SRI principles coalesce around three or four broad concerns. These include the exclusion of the so called ‘sin stocks’ (tobacco, munitions, gambling and pornography) and concern over environmental issues (especially in relation to global warming), community welfare and human rights, corporate governance and employment relations issues. Not every SRI fund will incorporate all of these concerns into their investment criteria however and some are only single issue SRI funds - the number of Australian funds applying employment relations criteria is discussed later.

Typically, SRI functions through funds managers who apply screening techniques to their portfolio allocations and/or develop engagement strategies. As explained earlier, negative screens are used to exclude investments in ethically undesirable stocks such as those involved in the manufacture of tobacco or munitions while positive screens identify companies with superior track records on the issues of concern. Engagement strategies may include elements of shareholder activism such as filing shareholder resolutions at AGMs or the use of proxy votes to support resolutions of concern to SRI funds. It may also include less visible approaches such as direct dialogue with management and the board of directors in an attempt to change the firm's practices and lift its corporate social performance.

The criteria used by SRI funds varies considerably and this is particularly true of those concerned with employment relations. Some funds have developed their own specific employment relations criteria while others adopt that incorporated into international codes such as the United Nation's Global Compact. The Global Compact adopts the four core labour standards of the International Labour Organisation including the standards on collective bargaining, freedom of association, equal employment opportunity/anti-discrimination and child labour.

One of the largest SRI funds managers in the US is Domini Social Investments which states in relation to its 'Employee Relations' criteria that:

> We seek companies with a commitment to worker involvement/ownership through employee stock ownership, cash profit sharing, and employee participation in management decision-making. We also look for companies with histories of fair labour negotiations and strong retirement benefits.

For Domini Social Investments, the employee relations screen is not exclusory but rather is a qualitative screen which means that a poor record in one area does not necessarily exclude a company from investment; rather Domini seeks to 'balance' the positive and negative traits of a company to reach a final investment decision. In relation to labour disputes, the fund indicates that it will avoid investments in companies which 'have encountered long term persistent problems with a major portion of their unionised workforce' (Domini Social Investments, 2006). Additionally, under the topic of 'union relations', Domini Social Investments indicate that they look to invest in companies with 'strong union relations' but do not assign a 'concern rating' to non-union companies on the basis that 'the vast majority of corporate managers in this country (US) are opposed to unions and the concept of a unionised workforce' (*ibid*.). So, while Domini Social Investment's employee relations criteria is extensive and detailed, the precise processes for weighing up the various pros and cons of a company's performance across these and other criteria remains a fairly subjective assessment.

While screening criteria and some aspects of shareholder activism are *direct* and tangible artefacts of SRI's potential influence on the firm, SRI funds may also *indirectly* influence the firm. It is often noted that SRI is a significant driver of the corporate social responsibility (CSR) movement as a whole (see Sparkes, 2002; Zadek, 2001; Waring and Lewer, 2004). SRI provides a financial justification for firms to make specific investments in corporate social responsibility even where SRI funds have small or no holdings in a company. The presence of SRI and the potential of a company to attract its investment we argue, lends credibility and legitimacy to managements' efforts to balance the competing interests of stakeholders. It also strengthens the advocacy of NGOs and other groups in civil society whose efforts to draw light on corporate (mis)behaviour tend to find a more receptive audience in SRI funds managers and related research organisations. SRI has also been instrumental in spawning related financial market developments such as corporate rating scales and the development of the FTSE4Good Index and the Dow Jones Sustainability Index; stock exchange indexes of companies with superior CSR records.

In recognising the importance of financial markets in promoting CSR, the UN Global Compact and the United Nations Environment Programme Finance Initiative (UNEP FI) together with a group of large institutional funds managers have developed *The Principles for Responsible Investment*. These principles require committed institutional investors to incorporate environmental, social and corporate governance (ESG) issues into their investment decisions. It also encourages investment managers, *inter alia*, to develop expertise in ESG issues, to develop an engagement capability to monitor corporate ESG issues and to establish ESG metrics, performance indicators and so on (UN, 2006). According to the United Nations, institutional investors and asset managers with over USD $4 trillion in funds under management have committed to the principles (UN, 2006a). This development may be seen as related to extending the influence of SRI but it also signals the mainstreaming of SRI principles to the wider investment community. According to Clarke and Hebb (2004), an increasing number of pension funds in particular are adopting ESG criteria as they seek to mitigate risks arising from corporate irresponsibility and to deliver their members long term stable returns. In this context, the UN's *Principles for Responsible Investment* perhaps should be seen as a strengthening of a trend towards mainstreaming SRI principles among pension funds.

SRI's indirect influence also extends to the development of private regulation (or soft law) of CSR within companies. The substantial growth in the private regulation of CSR within corporations is correlated with the growth in SRI although this phenomena can be attributed to a range of factors of which SRI is but one. This private regulation of CSR is manifest in systems of rules, policies, agreements, codes, governance committees, reporting and auditing mechanisms that collectively regulate corporations' approach to social responsibility (see Parker, 2002; Braithwaite and Drahos, 2000; Levi-Faur, 2006). The significance of this private regulation is that it is initiated by the corporation and is not imposed by the State. Typically this private regulation develops norms of corporate behaviour which address the corporation's stated approach to labour management, its approach to environmental issues, its relationship to the state and local communities in addition to other issues of ethics and business conduct. Estimates of the growth of such private regulation are generally limited to the measurement of the extent of sustainability reporting which we argue is only one manifestation of this private regulation. Nonetheless, a recent KPMG (2005) survey noted that 52 per cent of the top 250 companies on the Global Fortune 500 companies now issue environmental, social or sustainability reports; up from 35 per cent in 1999.

The growth in private regulation of CSR is part of what Levi-Faur (2006) has described as the era of regulatory capitalism which, despite neo-liberalism's ideological dominance, is an era of growing rather than retreating regulation. The form and balance that regulation takes however has changed in recent decades. Levi-Faur for instance points to the effects of privatisation in altering the public/private regulatory balance.

Until recently the public/private balance of regulation for CSR has arguably favoured private regulation developed at the initiative of corporations. Systems of rules applying to single corporations and across corporations competing within the same sectors have been visible in industries from textiles and foot wear through to electronics and the commodities industries (see Rivoli, 2003). These self-initiated regulatory norms pertain to the treatment of labour through to corporations' position on corruption and its acknowledged responsibilities to the environment and local communities.

The extent to which SRI has caused these soft law developments is difficult to estimate with precision but we would argue that the strong correlation between the screening criteria of SRI funds and what is typically reported in sustainability reports (including employment relations issues) at least suggests that SRI has played a part. Evidence of SRI's more direct role in influencing employment relations is discussed in the next sections.

**Research Methodology**

Two methodological techniques were chosen to address the central question of this research. First, a survey was conducted of the SRI funds that belong to the Ethical Investment Association (EIA) which draws its members from Australia and New Zealand. Established in 1999, the Association states its purpose is to 'promote the concept and practice of SRI to an increasingly curious general public, to the mainstream investment community, to analysts, superannuation trustees, financial advisers, regulators, religious, charitable and other values-based organisations . . .' (EIA, 2007). It claims that 'almost every fund manager, financial adviser and consultant working in the area is a member of the EIA together with many other professionals who work toward similar goals' (*ibid*.).

Data on the EIA members' investment principles was gathered from the funds managers' publicly-accessible websites and from product disclosure statements. Funds managers were contacted directly in some instances for additional information and, when required, clarification. The survey focused on generating information over the extent to which SRI funds incorporated employment relations criteria into their investment decisions, however and importantly, the data does not provide evidence of the managers' *actual* influence over firms' employment relations practices.

The survey of screening criteria was complemented by a small number of interviews with some of the most significant SRI funds managers, SRI research providers and consultants. These included AMP Capital Investors, Sustainable Asset Managers, Equity Trustees, UniSuper, VicSuper, Christian Super, SIRIS, UCA Funds Management, Stable Growth Consultants and ASrIA (The Association for Sustainable & Responsible Investment in Asia). Some SRI funds managers declined to participate in the study and others simply failed to respond to our invitations to participate – in all a dozen interviews were conducted. These interviews took place in Melbourne and Sydney between 2004 and 2005 and averaged one hour in duration. A consistent interview protocol was used which included questions concerning the processes used by SRI funds managers to ensure that they invested in companies consistent with their fund's investment criteria. Most importantly, we were interested in evidence of SRI funds managers' influence over the way in which the firms they invested in managed employment relations. Hence we asked for examples of where funds managers and/or consultants have exerted some influence. Interviews were recorded and transcribed while the analysis was conducted through flagging data relevant to the central research question.

## Survey Results

Twenty four SRI funds managers who were members of the Ethical Investment Association were contacted in the first quarter of 2006 to participate in the survey. Useable data was collected from twenty-two respondents; one was a subsidiary of a larger organization and two did not agree to participate. Information was gathered using email correspondence with senior managerial personnel with job titles such as ‘Director: Marketing and Superannuation’, ‘Manager Sustainable Investments’ and ‘Relationship Manager’ and from the SRI products promoted on the funds’ websites. The firms ranged from significant public and private sector superannuation to more ‘boutique’ funds managers. The purpose of the survey was essentially a scoping exercise to clarify the extent to which firms used negative or positive screening and, if so, whether employment relations criteria were incorporated into the screens.

Only a limited number of the respondents did not apply both types of screens; with three and two firms respectively, stating that their funds relied solely on positive or negative screens. Six in total stated that labour standards were not applied. Of these, three commented that ecological screening was the SRI focus of the fund. Negative labour screens centred on the abuse of human rights issues predominately child labour. Companies which discriminate in terms of race, religion or gender, poor occupational health and safety (OHS) performance and those which infringe employment laws (wages below minimum requirements and the like) were also included in negative screening criteria. One respondent stated that firms were scored on the number of incidences that they had been prosecuted. The most commonly occurring positive screens were workers participation in the ownership and control of their work organisations and equality of opportunity. One firm expressed these screens in terms of the International Labour Organisation’s conventions. They also applied the Freedom of Association convention. This approach though was the exception. Almost all expressed relatively broad principles rather than specific measures.

The general absence of detailed employment related screens is consistent with the emphasis given by the EIA itself. The Association’s Charter does not give such factors any prominence; not incorporating labour among its list of ‘environmental and social issues typically recognised by our membership . . .’. Rather, these include: the health risks of tobacco; problem gambling; old growth forest logging; the nuclear fuel cycle and armaments (EIA, 2007).

## Interview Data

This section presents and discusses the relevant interview data. The data has been organised around two themes, the first of which examines, in more depth than the previous section, the screening and engagement practices of SRI funds and consultants. The second theme addresses the key question of the extent of SRI funds managers’ influence over employment relations matters.

*Screening, Engagement and Impact*

SRI funds managers and consultants generally agreed that engagement practices are becoming more popular among SRI funds managers in Australia and indeed internationally. Positive screening and best of sector approaches are also typically used in selecting socially responsible stocks. However, as an interviewee at Sustainable Asset Managers (SAM) explained:

> There is no single means of increasing the social return of companies. Poorly conducted screening or 'activism' will get poor results. Well conducted screening and activism will get better results. Screening and 'activism' (broadly defined as engaging with companies) will be more effective when conducted as a package – if only as a deeper means of communicating shareholder concerns, and stimulating positive corporate reactions. A screening framework increases the rigour with which engaging (we prefer dialogue) takes place. Dialogue improves the quality of screening – by putting it to a robust test through discussion with companies.

Negative screening has typically become restricted to excluding the so called 'sin' stocks. These include those companies involved in gambling, pornography, tobacco and arms manufacturing. Historically, alcohol-related stocks were also included in this list but there has been a softening attitude towards investing in alcohol especially in Australia where many of the large supermarket chains have invested in hotels and alcohol-related businesses. One reason for the diminishing popularity of negative screening is the difficulty SRI funds managers have in deciding when to exclude a stock and this challenge is accentuated when the stock is performing well. Australian SRI funds managers have faced this choice in relation to BHP Billiton's acquisition of WMC Resources Ltd in August 2005 which included a portfolio of uranium interests. SRI funds have historically excluded uranium mining and nuclear power from their investment portfolios but BHP Billiton's economic success as a result of the long mining boom has resulted in many SRI funds rethinking their traditional opposition to uranium mining. AMP Capital Investors explained their decision in relation to this issue in the following terms:

> Yes it took some time for us to say yes to BHP…their CSR is actually quite good compared to other companies because they are in a high risk area. We had reservations but we had lots of conversations and engagements with BHP and so at the end of that because we felt resources was growing and we didn't want our unit holders to miss….it would be a risk for our unit holders if we didn't have BHP. As well as that, although this is a controversial investment, their CSR performance across governance and environment etc, meant they were one of the better ones.

This flexibility would seem to indicate that the imperative to earn financial returns may override certain ethical concerns, especially if the company outperforms its competitors on other measures of CSR performance. SIRIS (an SRI research and consulting firm) claimed that a number of their SRI fund manager clients loosened their criteria from time to time. It explained that:

> All of our clients have an indicator for workplace injury and death so anything

> in the courts or media we will write into our database. With BHP, they had a number of fatalities (17) and so BHP got kicked out of our database but some of our clients said that BHP is such a strong performer we can't really afford to kick them out. We say based on the criteria you have given us, you should not be investing in BHP. This is where SIRIS has little control over what happens to the data we produce.

It is unclear how often these compromises are made. The dilemma implicit in high performance stocks with poor CSR records has arguably strengthened the perceived utility of engagement approaches since engagement offers a way in which SRI funds can continue to hold high financial but low social return stocks. While this may seem expedient, engagement may also be a more effective way for SRI funds to influence corporate policy.

The utility of engagement or 'activism' strategies and the declining popularity of negative screening was simply explained by Equity Trustees in the following terms: 'Being inside the tent you can change a company but you can't change the company from outside of the tent'. Similarly, Sustainable Asset Managers argued that SRI funds lacked the critical mass needed for 'exit' strategies (sometimes described as the 'Wall St Walk') making 'voice' strategies more important. They stated that:

> Since SRI funds lack the raw clout of shareholder numbers (at this stage anyway), the sector must rely on its 'voice'. That is the quality, coherence and persuasiveness of its argument is the most powerful tool for informing corporate behaviour. This is assisted by the absence of competing paradigms (i.e. companies should maximize shareholder value), and an unmet demand in the corporate sector to understand how wealth creation can be integrated with social, environmental and economic sustainability. Sustainability (or SRI) investing influences management where it casts a spotlight on specific issues. More significantly this investing has a long term effect on companies when issues involve structural reforms of corporate activities. These structural reforms can deliver permanent increases in organizational performance.
>
> SRI has an influence over companies by turning two elements of the corporate 'ecosystem' in its favour. Corporations are competitive by nature and they prefer to have 'positive' discussions about what they are doing and planning. As a result companies like to be seen in the best light – and they like to be better than their peers. As a result companies would prefer (publicly at least) to be seen to be doing the right thing – and to be better at being 'good' than their peers. Secondly, the corporation seeks positive events and tries to avoid negative events. SRI assessments give some companies the chance to appear positive – and causes others deep concern that they may appear in a less than positive light (a standard quote here is 'we are not ready for this yet'). This gives respected and credible SRI funds considerable leverage.

Engagement strategies were also considered critical to VicSuper's approach to SRI. VicSuper claimed that:

> Rather than doing the 'Wall St Walk' we engage with companies. We deal with the top 200 ASX companies and we first thoroughly research issues, write to

> them and make an appointment to go and approach them. We use a team of people to do that – I've attended with them and found that you can't beat engagement in any form of work and this is the same – so we can't disclose names because it's a confidential process and that's the way its working for us but we have a lot of data on the top 200 – so things like the number of audit committees that were not independent but now are - so we have information that shows that the work we are doing is making change.
>
> Superannuation funds are significant investors in corporates (sic) and will continue to be so as the size of money coming in is growing exponentially so it's almost the way of the future and there is a gap between companies understanding what their owners are and what their concerns, views and needs are. So I've found that engaging in directors and chairs and CEOs that once you communicate who we are and see the face they say 'we had no idea what your issues were' so there is almost this need to communicate some opinion but its never been the view of the super fund. But once you go in and say that we represent members all they want to do is get a retirement cheque each week and leave something to their kids – this is the money that you're playing with each day and we are just here representing that'. What we are saying is that this capital comes with conditions.
>
> If you don't have significant holdings they tend not to bother with you. But through share service organisations like the Australian Superannuation Council we can knock on their doors and say well we're are ten or twenty super funds with x billions of dollars and this is our message and they tend to respond. And reputation risk is real for them.

The confidential nature of engagement, alluded to above, makes it difficult to assess both the extent of engagement and its impact on management. Moreover, the increasing application of engagement strategies means that much of SRI's efforts to influence corporate behaviour largely occurs behind closed doors. Nonetheless, SRI funds managers offered some examples of influencing corporate behaviour as a consequence of engaging with companies. These examples are discussed in the next section.

*Do SRI Funds Influence the Management of Employment Relations?*

SRI funds managers were asked a number of questions concerning the impact of SRI on corporate behaviour generally and more specifically on human resource management practices. The evidence on this issue is rather mixed. Some interviewees argued that SRI can and does influence corporate behaviour. Sustainable Asset Managers, for instance, gave an extended response to this question in which it was claimed that:

> SRI funds exert significant influence on corporations. They exhibit influence that is disproportionate to their size – in the experience of our fund managers. The influence is disproportionate to the size of the funds but small in the overall scheme of pressures acting on the corporate world. The reason for the disproportionate influence is twofold. Firstly, the 'information vacuum' in the corporate world about the means by which they should integrate environmental,

> economic and social concerns into their desire to create shareholder wealth. SRI funds have been providing some unique perspectives that inform the corporate world about their performance and the expectations of the community. Secondly the SRI world does not live in a void – the corporate world is voluntarily and spontaneously embracing sustainability. As a result these companies recognise the significance of SRI and sustainability investment styles, in reinforcing the corporate sustainability agenda.
>
> Thirdly, SRI funds have a significant influence through the reputational effects. Many companies are keen to ensure they have a good reputation. SRI funds have a large and disproportionate effect (for their size) on company reputations. The limits of this influence are quite clear though. Equally many companies are ‘careless’ with their reputations and hence are harder for SRI funds to influence. However it is the experience of our funds managers that ‘careless’ companies eventually do pay some regard to the input provided by SRI funds.

SAM’s comments indicate that although SRI funds exercise an influence beyond their size, their influence is limited when compared with the myriad of pressures operating on companies. When asked to provide an example(s) of SRI’s impact in employment relations SAM discussed SRI’s enhancement of corporate Occupational Health and Safety (OHS) reporting in the following terms:

> SRI and sustainability assessments have long considered OHS performance as a key indicator of managerial competence and effective HR management structure. As part of this our fund managers seek OHS performance data from all corporate entities. Since 2000 the increasing number of questionnaires with an SRI focus has ensured a rising number of companies reporting their OHS data. Some are even reporting this data in a systematic and comparable manner to assist investors, staff and other stakeholders see what type of company they are. Anecdotally, even financial analysts are beginning to use OHS data in this manner.

AMP Capital Investors provided two examples of their impact on corporate employment relations. One fund manager from AMP claimed that:

> If we can add value to their management they will listen. Increasingly, smaller companies want us to help them come up to CSR best practice standards. I just had a small chat with a company and we suggested that human resources is very important and the next time we saw them they had a full-time HR manager.

Another contended that:

> I think earlier on, we had an important engagement with retailers over sweatshop labour and clothing codes and that they should be a signatory to that. And a number became involved with the labelling after we became involved. So that’s one example but we would like to see more of that.

A consultant to Christian Super who also had experience with the Inter-Faith Centre on Corporate Responsibility (ICCR) strongly argued that SRI funds do exert influence over employment relations. She explained, in relation to her engagement experience with the ICCR:

> It's really fascinating – they (companies) knock back a lot of things but there are some extraordinary changes that go on. I mean Coco-Cola was influenced to treat all its employees in Sub-Saharan Africa for Aids and that is a direct outcome of engagement.

The consultant went on to identify two further examples of SRI engagement. She claimed that the ICCR:

> …focus on big transnational companies and where they have set up in low cost countries, they examine rights to collective bargaining and rights to organise and so on. They do a lot of work on developing measures for what they call a sustainable living wage.

More specifically the consultant contended that:

> As a result of shareholder engagement, Occidental (an oil company) signed up to a human rights policy, which sounds very high level and not very practical but when a big transnational like Occidental signs up to something like that then it requires performance measurement and reporting. Occidental *and* Exxon Mobil signed up to this as a result of shareholder engagement.

The Uniting Church Assembly (UCA) Funds representative did not provide specific examples of where UCA had influenced the employment relations policy of a company it had invested in but claimed that:

> In Australian companies you find that most companies do comply with the law and the real difficulty comes with offshore activities. We do look at some HR practices through our positive screens. Westpac is an example and it's a desirable stock to hold.

Sustainable Asset Managers were asked what influence they have previously exerted over employment relations issues. They stated:

> Firstly, the stock would score badly in those areas of the assessment relating to labour standards. Whether or not the company makes it into the investment portfolio depends on the scores achieved in the rest of the questionnaire. If the rest of the questionnaire scores reasonably well, relative to other companies, then the company may be admitted to the portfolio. However, if the breach of labour standards is sufficiently serious that it mitigates achievements in other areas then the company would be rejected for the portfolio.
>
> Normally this analysis is conducted before a company is chosen for the portfolio – and in that sense the company is unlikely to make it in to portfolio in the first place. If this behaviour becomes apparent after the company is chosen for the portfolio then the company can be removed (i.e. the equity holding can be sold). Where companies exhibit 'weaknesses' in their corporate approach (rather than a large underperformance), such as labour standards for example,

> we will have discussions with the company and other stakeholders on an ad hoc basis. This allows us to test our assessment of the company, and, in the process, helps us to convey a sustainability perspective to all concerned parties. We have conducted such informal discussions around freedom of association issues in the mining industry. 'Do nothing' is not an option, the only challenge is to work out what to do and find the opportunity to convey it.

The above examples constitute limited evidence of SRI influence over employment relations. In every example, SRI funds managers and consultants to funds managers claim they have influenced corporate policy towards employment relations issues through engagement approaches. These examples indicate that occupational health and safety along with minimum labour rights are the issues that SRI funds typically claim influence over. Occupational health and safety management is an issue which SRI funds would more easily influence since OHS data is objective; there are clearer links between safety performance and corporate risk and performance; and safety is an issue that is rarely ethically ambiguous. Minimum labour rights are also more easily advocated by SRI funds since they constitute a baseline against which corporate performance can be measured. It is also a baseline that is often, though not always, underpinned by the law and which attracts community support.

On the whole though, the examples of influence were limited in number and fairly weak in substance. There were no specific examples of SRI funds influencing companies to adopt collective bargaining over individual contracts, or intervening to end hostility towards a trade union. Nor were there examples of SRI funds successfully pressing companies to involve employees more in decision making or implement 'high road' employment arrangements. In short, the data indicates that SRI's influence over employment relations at this stage of its development is weak

**Conclusions**

The survey of SRI funds criteria in Australasia revealed that employment relations is a significant concern and an issue over which SRI funds manager's seek influence, However, the interview data revealed that socially responsible investment is at this point in its development incapable of exerting much influence over the management of employment relations. Its small scale relative to the rest of the investment universe combined with the typically diverse objectives and techniques of SRI funds managers restricts its capacity to alter corporate behaviour. There is also the problem of how individual SRI funds prioritise employment relations issues (typically lower than environmental concerns for instance). Further, SRI funds may continue to invest in a firm even where it has substantial concerns over the firm's employment relations if it 'outperforms' its competitors across other SRI criteria such as environmental performance. Moreover, the interview data and the literature suggested that when SRI funds are confronted with difficult investment choices – as AMP Capital's decision to invest in BHP Billiton suggested - that are seemingly inconsistent with their principles, the desire for strong financial returns may lead to compromises over ethical concerns.

The methodologies used by SRI funds managers also make it difficult to critically evaluate their influence on firm behaviour. SRI funds with positive screens or 'best of sector approaches' seek out those firms with established reputations as superior corporate citizens, clouding the impact of the SRI holding. Furthermore, engagement approaches tend to be informal, irregular and rarely documented making it difficult to assess whether SRI funds managers' appeals to management and the board produce change. It is possible that with an increasing number of SRI funds managers moving to engagement approaches that the influence of SRI will be underestimated for this reason.

Our interviews did reveal, however, some cases where SRI funds managers had successfully altered management decisions over employment relations choices, although these were limited. Nonetheless, it points to the potential of SRI, as a heterodox investment practice, to curb excessive emphasis on 'shareholder value primacy' and hence act in much the same way as labour law as a constraint on its negative impacts (see O'Donnell et al, 2005).

In our view, for SRI to maximise its potential influence, its principles and concerns must be extended more widely throughout capital markets – this is beginning to occur. As mentioned earlier, Clark and Hebb (2003) note that Pension Funds are increasingly applying SRI criteria and engaging with companies to reduce the risk associated with their investments. Similarly, the case study findings reported by Anderson, Marshall and Ramsay (2006) demonstrate increasing concern among mainstream institutional investors in Australia to influence the human resource management practices of investee companies. This institutional investor behaviour Anderson et al (2006:65) claim, does not stem from an ethical concern but rather from the belief that 'high commitment employment practices leads to long term value creation in individual companies and, conversely, unsound or poor employment practices can create a governance risk'. This discernible trend towards a longer term investment horizon among some institutional investors however, must also be balanced by acknowledging the growing presence of hedge fund activity which is a significant source of liquidity and short-term investment activity in capital markets.

Finally, we would argue that engagement strategies need to be more widely publicised for SRI for investors to be better able to assess the social returns from investing in SRI funds. If it were routinely recorded and published, information on engagement successes would immeasurably improve SRI's reputation for producing positive change. These two developments would substantially strengthen SRI's influence and, potentially, to encourage progressive employment relations practices.

## References


Anderson, K, Marshall, S and Ramsay, I (2006) 'Do Australian Institutional Investors Aim to Influence the Human Resource Practices of Investee Companies', Paper given to the Corporate Governance Workshop, Centre for Employment & Labour Relations Law, University of Melbourne, 7-8 December.

Benson, K, Brailsford, T and Humphrey, J (2006) 'Do Socially Responsible Fund Managers Really Invest Differently?', *Journal of Business Ethics*, 65, pp.337-357.

Boxall, P and Purcell, J (2003) *Strategy and Human Resource Management*, Palgrave Macmillan, Basingstoke Hampshire.

Braithwaite, J and Dahos, P (2000) *Global Business Regulation*, Cambridge University Press,

Clark, G and Hebb, T (2003) 'Understanding Pension Fund Corporate Engagement in a Global Arena', SASE Conference Paper, http://www.sase.org/conf2003/papers/clark-hebb.pdf [date accessed 10/09/06].

Clark, G and Hebb, T (2004) 'Why do they care? The market for corporate global responsibility and the role of institutional investors', *Oxford University Monograph*.
Crouch, C (2005) 'Models of Capitalism', *New Political Economy*, Vol. 10, No. 4, pp. 439-456.
Domini Social Investments (2006) *Domini Social Investments*, www.domini.com [date accessed 15/10/06].
Deakin, S, Hobbs, R, Konzelmann, S and Wilkinson, F (2006) 'Anglo-American corporate governance and the employment relationship: a case to answer', *Socio-Economic Review*, 4, pp.155-174.
EIA (2007) Ethical Investment Association, http://www.eia.org.au/[date accessed 23/2/07].
Gospel, H and Pendleton, A (eds) (2004) *Corporate Governance and Labour Management: An International Comparison*, Oxford University Press, Oxford.
Hall, P. and Soskice, D. (2001) *Varieties of Capitalism: The Institutional Foundations of Comparative Advantage*, Oxford, Oxford University Press.
Hawken, P (2004) 'Socially Responsible Investing: How the SRI industry has failed to respond to people who want to invest with conscience and what can be done to change it', *Natural Capital Institute*, www.naturalcapital.org [date accessed 25/10/06].
Hellsten, S and Mallin, C (2006) 'Are 'Ethical' or 'Socially Responsible' Investments Socially Responsible?', *Journal of Business Ethics*, 66, pp.393-406.
Hopner, M (2005) 'What Connects Industrial Relations and Corporate Governance? Explaining Institutional Complementarity', *Socio-Economic Review*, 3, 2, 331-358.
Jackson, G. (2005) 'Towards a Comparative Perspective on Corporate Governance and Labour Management: Enterprise Coalitions and National Trajectories' in Gospel, H. and Pendleton, A. (eds) *Corporate Governance and Labour Management: An International Comparison*, Oxford, Oxford University Press.
Jacoby, S. (2005) 'Corporate Governance and Employees in the United States' in Gospel, H. and Pendleton, A. (eds) *Corporate Governance and Labour Management: An International Comparison*, Oxford, Oxford University Press.
KPMG (2005) International Survey of Corporate Sustainability Reporting, *KPMG Global Sustainability Services*, De Meern, The Netherlands.
Lazonick, W. and O'Sullivan, M. (2000) "Maximizing shareholder value: A new ideology for corporate governance', *Economy and Society*, 29(1): 13-35.
Levi-Faur, D (2006) 'The Global Diffusion of Regulatory Capitalism', Working Paper, *Regulatory Institutions Network*, Australian National University.
O'Donnell, A, Mitchell, R, Ramsay, I (2005) 'Shareholder Value and Employee Interests: Intersections Between Corporate Governance, Corporate Law and Labour Law', *Wisconsin International Law Journal*, Vol. 23, No. 3, pp. 417-476.
Parker, C (2002) *The Open Corporation – Effective Self-Regulation and Democracy*, New York. Cambridge University Press.
Parkinson, J (2003) 'Models of the Company and the Employment Relationship', *British Journal of Industrial Relations*, Vol. 41:3, pp. 481-509.
Rivoli, P (2003) 'Labour Standards in the Global Economy: Issues for Investors', *Journal of Business Ethics*, Vol. 43 No. 2, pp. 223-232
Sparkes, R (2002) *Socially Responsible Investment: A Global Revolution*, John Wiley & Sons Ltd, England.
United Nations (2006) *The Principles for Responsible Investment*, http://www.unpri.org/ [date accessed 18/10/06].
United Nations (2006a) *International Funds Worth $4 Trillion Now Endorse UN Principles for Responsible Investment*, http://www.unpri.org/ [date accessed 18/10/06].
Waring, P and Bray, M (eds) (2006) *Evolving Employment Relations: Industry Studies from Australia*, McGraw-Hill, Sydney.
Waring, P (2006) 'Institutional Investors and Contemporary Corporate Governance: Prospects for Enhanced Protection of Employee Interests in Liberal Market Economies', *International Employment Relations Review, forthcoming*.
Waring, P and Lewer, J (2004) 'The Impact of Socially Responsible Investment on Human Resource Management: A Conceptual Framework', *Journal of Business Ethics*, Vol. 52 No. 1, pp. 99-108.
Waring, P and Edwards, T (2005) 'Socially Responsible Investment: Explaining its Uneven Development and Employment Consequences', Paper presented to the *17th Annual Meeting on Socio-Economics Central European University and Corvinus University of Budapest*, Budapest, June 30 - July 2.
Zadek, S (2001) *The Civil Corporation*, Earthscan Publications Ltd, UK.