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**Investing in the workforce:**

**Social investors and  
international labour standards**

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Multinational  
Enterprises  
Programme

Job Creation and  
Enterprise  
Development  
Department

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## Preface

The primary goal of the ILO is to contribute, with member States, to achieve full and productive employment and decent work for all, including women and young people, a goal embedded in the ILO Declaration 2008 on *Social Justice for a Fair Globalization, and*<sup>1</sup> which has now been widely adopted by the international community.

In order to support member States and the social partners to reach the goal, the ILO pursues a Decent Work Agenda which comprises four interrelated areas: Respect for fundamental worker's rights and international labour standards, employment promotion, social protection and social dialogue. Explanations of this integrated approach and related challenges are contained in a number of key documents: in those explaining and elaborating the concept of decent work<sup>2</sup>, in the Employment Policy Convention, 1964 (No. 122), and in the Global Employment Agenda.

The Global Employment Agenda was developed by the ILO through tripartite consensus of its Governing Body's Employment and Social Policy Committee. Since its adoption in 2003 it has been further articulated and made more operational and today it constitutes the basic framework through which the ILO pursues the objective of placing employment at the centre of economic and social policies.<sup>3</sup>

The Employment Sector is fully engaged in the implementation of the Global Employment Agenda, and is doing so through a large range of technical support and capacity building activities, advisory services and policy research. As part of its research and publications programme, the Employment Sector promotes knowledge-generation around key policy issues and topics conforming to the core elements of the Global Employment Agenda and the Decent Work Agenda. The Sector's publications consist of books, monographs, working papers, employment reports and policy briefs.<sup>4</sup>

The *Employment Working Papers* series is designed to disseminate the main findings of research initiatives undertaken by the various departments and programmes of the Sector. The working papers are intended to encourage exchange of ideas and to stimulate debate. The views expressed are the responsibility of the author(s) and do not necessarily represent those of the ILO.

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Executive Director  
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<sup>1</sup> See [http://www.ilo.org/public/english/bureau/dgo/download/dg\\_announce\\_en.pdf](http://www.ilo.org/public/english/bureau/dgo/download/dg_announce_en.pdf)

<sup>2</sup> See the successive Reports of the Director-General to the International Labour Conference: *Decent work* (1999); *Reducing the decent work deficit: A global challenge* (2001); *Working out of poverty* (2003).

<sup>3</sup> See <http://www.ilo.org/gea>. And in particular: *Implementing the Global Employment Agenda: Employment strategies in support of decent work*, "Vision" document, ILO, 2006.

<sup>4</sup> See <http://www.ilo.org/employment>.

## Foreword

This paper identifies important trends in the use of ILS in equity markets and examines why investors globally are motivated to take up ILS and how they are doing so. It also identifies promising initiatives for dialogue between investors, companies, trade unions and other actors such as NGOs in hopes of contributing to ongoing efforts to improve protection of workers' rights globally.

CSR issues are specific to each industry structure. Key factors include: the degree to which production is concentrated in relatively few suppliers; the power relationship between the brands and the suppliers, which is a function of, *inter alia*, how easily production can be moved between suppliers; and the level of commitment brands are willing to make to support suppliers in their efforts to upgrade labour practices. Not least, national legal frameworks of countries in which production is concentrated strongly influence whether internationally recognized fundamental principles and rights at work are realized in practice at the factory level.

However, there is a common thread throughout all industries: companies need simple, effective, yet credible solutions to the challenge of reconciling competitive pressures and social concerns, whether as brands or as suppliers. This implies that solutions must benefit workers and make good business sense in order to be sustainable.

Socially responsible investment (SRI) is unique in that its business is to influence the social responsibility of other businesses. Investors, especially institutional ones, can be a powerful lever for influencing corporate behaviour, and an important force in helping to raise labour standards in corporate practice worldwide. Although investors have been slower to take up labour issues than other areas of SRI, such as environment, interest is growing. Important networks exist for investors to share information, learn from each others' experiences and coordinate strategies to improve outcomes. More recently, strategies are shifting from screening out or divesting to dialogue and remediation to support companies to understand the issues and make improvements. Lastly, some financial institutions and trade unions have joined forces to improve the quality of information received and further open up the dialogue with companies.

The ILO Tripartite Declaration of Principles concerning Multinational Enterprises and Social Policy (MNE Declaration) is designed to guide private initiatives, both company policy such as codes of conduct for suppliers, and industry-wide initiatives. It is the only international CSR instrument which has the full backing of workers, employers and government. This tripartite origin makes it both highly credible and yet sensitive to the concerns of enterprises facing tough competition.

The MNE Declaration covers the fundamental principles and rights at work—concerning child labour, forced labour, freedom of association, collective bargaining, and non-discrimination—as well as wages, hours of work, and occupational health and safety. Some of the activities and initiatives taking place in the area of socially responsible investment are focused on many of these issues and investors and analysts may find these principles to be a useful starting point for dialogue with companies and trade unions on how best to protect workers' rights while helping companies to retain, or even enhance, their competitiveness.

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# 1 Introduction

This paper examines why investors globally are motivated to take up issues concerning international labour standards (ILS), and how they are doing so.

Investors, especially institutional ones, can be a powerful lever for influencing corporate behaviour, and an important force in helping to raise labour standards in corporate practice worldwide. However, this potential remains underdeveloped.

Investors' knowledge of ILS remains superficial in many cases. At times they have used their leverage to push for policies and codes to improve labour standards in the operations of corporations whose shares they own. However, in most cases they have not been successful at addressing the larger situation in which the root causes of persistent labour violations are embedded, although some have made efforts in this direction.

Institutional investors also have not yet built strong alliances with like-minded parties (such as trade unions) who could boost their leverage on ILS. In addition, the incorporation of ILS into investment faces obstacles that the incorporation of other non-financial factors (environmental, social and governance, or "ESG") does not.

This paper examines a number of these elements. The first section outlines the rise of Socially Responsible Investment (SRI) in general and labour-related SRI in particular. It touches on some of the main forces and actors behind this rise, and highlights various SRI practices of institutional investors, with reference to earlier research commissioned by the ILO, as well as newer research.

The second section examines specific challenges facing labour-related SRI, and explores why the incorporation of ILS into investment criteria might pose more challenges than do other ESG factors. Sections III and IV look briefly at the impact of SRI on corporate behaviour and workers' rights, respectively. Section V looks at some suggested ways forward. Appendix I presents select mechanisms, initiatives and platforms that could support the spread of labour-related SRI, and Appendix II provides a closer look at an institutional investor that has specific guidelines around the labour rights performance of companies in which it invests.

This paper seeks to illuminate some of the important trends in the use of ILS in equity markets, to point up gaps not only in the research but in the actions of investors and others, and to highlight promising initiatives in this area. In this way, it is hoped that the paper will contribute to ongoing efforts to raise labour standards globally.

## 2 The expansion of SRI

SRI is the practice of incorporating environmental, social and governance (ESG) factors into one's investment decisions. Social investors are concerned with a corporation's social and environmental impact, not simply its financial performance. SRI uses three key strategies: screening companies according to ESG criteria; shareholder advocacy; and community investing.<sup>5</sup>

Labour standards have long been an important issue for social investors. Along with environment and corporate governance, labour rights in global supply chains figure perennially among the top three or four issues of concern to social investors. Most SRI funds and ratings agencies include performance on international labour standards (ILS) among the key issue areas on which they evaluate company performance on environmental, social and governance factors (ESG) overall.

Looking generally at SRI, the picture has been one of steady growth in recent years. According to the US Social Investment Forum (SIF) *2007 Report on Socially Responsible Investing Trends in the United States*, between 2005 and 2007, SRI assets increased about 18% while all managed assets in the U.S. grew less than 3% over the same period.<sup>6</sup> According to another source, SRI fund assets have grown over 12% per year on average from 1997 to 2007.<sup>7</sup> A commonly cited figure is that in the U.S. today about \$1 in \$9 under management is in SRI assets. As of 2007 there were approximately 100 SRI mutual funds in the U.S.<sup>8</sup>

Table 1: SRI Assets in the US

Year	Assets in the U.S. <sup>9</sup>
1995	\$639 billion
2003	\$2.16 trillion
2005	\$2.29 trillion
2007	\$2.7 trillion

According to a report in 2008 by the European Social Investment Forum (Eurosif), as of the end of 2007, total SRI assets under management in Europe amounted to 2.67 trillion

<sup>5</sup> See, for example, the US Social Investment Forum, <http://www.socialinvest.org/resources/sriguide/srifacts.cfm>

<sup>6</sup> US Social Investment Forum (SIF), "Social Investment Forum 2007 Report on Socially Responsible Investing Trends in the United States: Executive Summary", 2008 (<http://www.socialinvest.org/resources/pubs> accessed 17 August 2008)

<sup>7</sup> *Investment Management Weekly*, April 2, 2007.

<sup>8</sup> Sam Mamudi, "The Rise of the Activist Shareholder in the US Boosts Socially Responsible Investment", *Financial Times*, November 5, 2007.

<sup>9</sup> All figures are from the Social Investment Forum 2007 Report Executive Summary, *op. cit.* They include assets linked to social screening, shareholder advocacy and community investing.



Euros.<sup>10</sup> In 2005, social investment research firm Avanzi reported that there were 375 “green, social and ethical funds operating in Europe”, a rise of about 6% from the previous year.<sup>11</sup> While the UK accounts for a good portion of European SRI funds (about one-third, according to Avanzi), growth has been brisk in other countries. In France, institutional SRI almost doubled from 2005 to 2006, from 5.4 billion to 10.5 billion Euros. Novethic, a subsidiary of Caisse des Depots that conducts research and analysis of SRI and corporate social responsibility (CSR), notes that large pension funds have pushed this trend.<sup>12</sup> EIRIS, a UK-based SRI research firm, reports that, as of September 2007, the global total of funds that integrate ESG into their analysis was about US\$4 trillion.<sup>13</sup>

One source concludes that retail investors in the U.S. are driving SRI growth in that country, while institutional investors are behind the growth in Europe.<sup>14</sup> The U.S. is generally seen as lagging behind Europe in ethical investment; both the EU and individual European governments have shown support for SRI (and CSR). However, certain US public pension funds have long been involved in SRI, and others are becoming more so: one example is their engagement with the Sudan divestment movement, as noted briefly below (legislation in several states has mandated public pension funds to divest from Sudan).

## 2.1 Factors behind the growth of SRI

There are several factors behind the growth of SRI:

- **Changes in the concept of *fiduciary duty*:** in 2005, the law firm Freshfields Bruckhaus Deringer published a report that concluded that the incorporation of ESG factors into investment decision-making was “clearly permissible and is arguably required in all jurisdictions”.<sup>15</sup> Many considered the report groundbreaking on the issue of ESG incorporation, and it has been widely cited, including within mainstream finance.
- **Demonstration effect:** a number of large institutional investors are very publicly bringing SRI into their investing. In 2007, TIAA-CREF, one of the world’s largest pension funds, published a “Policy Statement on Corporate Governance” and proxy voting guidelines that clearly “put social and environmental issues on par with corporate governance issues”.<sup>16</sup> The policy statement was expected to send a message to other institutional investors, as

<sup>10</sup> European Social Investment Forum, “European SRI Study 2008”, Paris, 2008, p. 10.

<sup>11</sup> Avanzi, Green, “Social and Ethical Funds in Europe : 2005 Review”, Milan, October 2005.

<sup>12</sup> IPE.com (UK), “Pension Funds Drive SRI Boom in France”, June 8, 2007

<sup>13</sup> EIRIS, “The State of Responsible Business: Global Corporate Response to Environmental, Social and Governance (ESG) Challenges”, September 2007, p. 6.

<sup>14</sup> See Jessica Papini, “Environmental Concerns Boost SRI Funds”, *Investment Management Weekly*, April 2, 2007, which cites a report by Celent.

<sup>15</sup> Freshfields Bruckhaus Deringer, “A Legal Framework for the Integration of Environmental, Social and Governance Issues into Institutional Investment”, UNEP-Finance Initiative, October 2005, p. 13.

<sup>16</sup> Anne Moore Odell, “TIAA-CREF Ups the Ante with New Stance on ESG Issues”, *SRI News Alerts*, SocialFunds.com, March 20, 2007.

well as to companies, about the importance of environmental and social considerations. The statement noted that, among other issues, boards should “pay careful attention to...[a] company’s labour and human rights policies and practices and their applicability through the supply and distribution chains”.<sup>17</sup>

- **Legislative changes** and national and regional debate that have raised awareness of certain environmental and social issues among investors. A number of authors have pointed out that a crucial driver of the growth of SRI in the United Kingdom was legislation in 2000 that required pension funds to disclose the extent to which they incorporated ESG criteria.<sup>18</sup> And there is ongoing debate in the UK around public company non-financial reporting, including on supply chains<sup>19</sup>. In March 2007, the European Parliament voted in favour of mandatory reporting on corporate environmental and social impacts.<sup>20</sup> Tougher regulations on environment (e.g. greenhouse gas emissions) have led to shareholder concerns about corporations’ environmental impact and their environmental management systems and, in 2007, US shareholders asked the Securities and Exchange Commission (SEC) to require companies to disclose risks related to climate change.
- **Corporate scandals**, beginning in the early 2000s, have helped push investors toward SRI and shareholder activism, and have raised awareness of corporate governance issues in particular.<sup>21</sup>
- In December 2006, the heads of the six **largest accounting firms** in the world released a statement calling for “**social auditing**”, or a “radical overhaul” of global financial accounting “to take greater account of social and environmental factors”, a development that *Ethical Performance* called “unprecedented”.<sup>22</sup>
- **Mainstream investment houses** are turning their attention to the incorporation of ESG factors. Some have published reports showing that investors who incorporate ESG into their decision-making do not necessarily have lower investment returns (see below, on mainstream interest in ESG).

<sup>17</sup> TIAA-CREF, “Policy Statement on Corporate Governance”, issued March 13, 2007.

<sup>18</sup> See Jon Robinson, “Workers’ Capital and Corporate Social Responsibility,” in *Labour Education*, 2003/1, no. 130, “Corporate Social Responsibility: Myth or Reality?”, p. 71, and Rory Sullivan and Craig MacKenzie, “Shareholder Activism on Social, Ethical and Environmental Issues: An Introduction” in Sullivan and MacKenzie, eds., *Responsible Investment*, Greenleaf Publishing, 2006, p. 151.

<sup>19</sup> The UK government decided in late 2005 not to make mandatory the so-called Operating and Financial Reviews, which would have required companies to report on environmental and social factors. But in late 2006 the government did pass an amendment to the Company Law Reform Bill that requires public companies to report on their supply chains. This was welcomed by rights groups but was opposed by industry groups. See for example Jean Eaglesham, “Government Cracks Down on Corporate Accountability”, *Financial Times*, October 19, 2006.

<sup>20</sup> Richard Howitt, Member of European Parliament for UK Labour Party, “Vote Confirms Mandatory Social Responsibility Standards for Business”, news release, March 13, 2007.

<sup>21</sup> Tim Smith, Director of SRI at Walden Asset Management, cited in Mamudi, op. cit, November 5, 2007.

<sup>22</sup> *Ethical Performance*, “‘Big Six’ Firms See New Dawn for Social Auditing”, December 2006.

- In 2006, the UN launched its **Principles for Responsible Investment (PRI)**: this voluntary initiative has as its stated aim to “help investors integrate consideration of environmental, social and governance (ESG) issues into investment decision-making and ownership practices”. At its launch, there were 65 signatories, many of them institutional investors. As of late 2008, there were over 400 signatories, among them asset owners, investment managers, and service providers.

Each of these developments has increased the impetus on investors to consider ESG factors in investment decisions.

Social investors have evolved in their methods and strategies over the years. Whereas SRI through the 1990s was associated primarily with negative screening, in recent years social investors have used positive screening - seeking out companies with good performance on ESG factors – and have increasingly turned to engagement of companies on issues of concern. Divestment, which was a key SRI strategy in relation to companies invested in South Africa during apartheid, remains an option, usually of last resort, for SRI. The Sudan divestment movement, in which social investors are active, has moved to “targeted divestment” precisely because it is thought to be more effective than blanket divestment and less likely to harm Sudanese citizens.<sup>23</sup>

### 2.1.1 *Mainstream interest in ESG: A mixed blessing?*

The last five years have seen the publication of numerous, high-profile reports by mainstream investment banks, brokerage houses, law firms and the UN, on the importance of incorporating ESG into investment. While the trend has arguably contributed to the growth of SRI, it also brings challenges such as potential dilution of standards.

These reports have included:

- “The Materiality of Social, Environmental, and Corporate Governance Issues to Equity Pricing” (June 2004). The report, commissioned by UNEP-FI, summarized the findings of 11 studies by brokerage house analysts, concluded that ESG factors should be considered in investment decision-making. It also called on governments and regulatory bodies to revise definitions of fiduciary duty to include consideration of ESG factors.<sup>24</sup>
- The lawfirm Freshfields Bruckhaus Deringer released a report in 2005, commissioned by UNEP-FI, stating that fiduciary duty allows, and sometimes requires, incorporation of ESG issues.<sup>25</sup>
- The investment bank Goldman Sachs’ “GS Sustain” (July 2007) concluded that companies that incorporate ESG policies outperformed the MSCI (Morgan Stanley Capital International) index by 25% between August 2005 and mid-2007. Goldman Sachs noted that “*there is no evidence that ESG or*

<sup>23</sup> Mamudi, *op. cit.*, November 5, 2007.

<sup>24</sup> UNEP-FI, “The Materiality of Social, Environmental and Corporate Governance Issues to Equity Pricing”, June 2004, pp. 4-5 and 7.

<sup>25</sup> Freshfields Bruckhaus Deringer, *op. cit.*, p. 13.

*SRI investing on their own add value*”, and investors therefore need to incorporate ESG “into a long-term industrial analysis”.<sup>26</sup>

UNEP-FI and Mercer, the investment consulting company, published a joint report, “Demystifying Responsible Investment Performance: A Review of Key Academic and Broker Research on ESG Factors” (October 2007). The report reviewed 20 academic studies examining the relationship between ESG incorporation and financial performance.

As with previous studies, the short timeframe of some of the research involved makes it difficult to formulate definitive conclusions about those data.<sup>27</sup> However, the report’s coordinators concluded that “the evidence suggests that there at least does not appear to be a performance penalty”.<sup>28</sup>

There are downsides to this mainstream interest:

- **A disjuncture between “saying” and “doing”:** the fact that CEO interest in CSR is increasing, and that corporations have “embraced the idea that [business] plays a wider role in society”<sup>29</sup> contrasts sharply with the failure of companies actually to implement CSR. The *McKinsey Quarterly* surveys of business executives in 2005 and 2007 found large gaps between what companies say they should do (for example, integrate ESG factors into their operations) and what they actually do.<sup>30</sup> A case in point: even large, mainstream firms that have focused their attention, in a high-profile manner, on the possible connection between ESG and financial performance are not necessarily committed in practice. In October 2007, a campaign group in the UK, FairPensions, scored large asset managers on their transparency and engagement on ESG criteria at the companies in which they invest. Goldman Sachs tied for last place on both counts.<sup>31</sup>
- **Ethics still loses out to return on investment:** even where mainstream financial analysts seek to move closer to SRI analysis, financial returns are still prioritised over all else. For example, Citigroup Smith Barney’s 2005 report, *Crossing the River*, which was an effort to bridge SRI and the mainstream, suggests SRI investors will “prioritize shareholder interests” over

<sup>26</sup> Goldman Sachs, “GS Sustain”, June 22 2007, p. 1, emphasis added. Interestingly, GS found that with regard to employee compensation, “the more you pay, the more you get. This raises questions about the theory of cost-control and downsizing as the key to success” (*Ibid*, p. 7). Coming from a mainstream investment bank, this conclusion should spark useful debates in the global marketplace.

<sup>27</sup> UNEP-FI and Mercer, “Demystifying Responsible Investment Performance: A Review of Key Academic and Broker Research on ESG Factors”, October 2007, p. 36.

<sup>28</sup> *Ibid.*, p. 6.

<sup>29</sup> Lenny Mendonca of McKinsey & Co., cited in Alison Maitland, “The Frustrated Will to Act for Public Good”, *Financial Times*, January 25, 2006.

<sup>30</sup> See, for example, Bill Baue, “Analysis Advocates Strategic Approach to Corporate Social Responsibility”, *SRI News Alerts*, SocialFunds.com, April 4, 2006, and Jeremy Oppenheim, Sheila Bonini, Debby Bielak, Tarrah Kehm and Peter Lacy, “Shaping the New Rules of Competition: UN Global Compact Participant Mirror”, McKinsey & Co., July 2007, p. 21.

<sup>31</sup> FairPensions, “Fund Manager Transparency and Engagement on Environmental, Social and Governance Issues”, October 15, 2007.

all else.<sup>32</sup> There is thus a danger of the mainstream diluting SRI instead of SRI influencing the mainstream to make fundamental changes in analysis and investment.

- **Timeframe:** investor mentality is still dominated by short-termism, which works against the incorporation of ESG.<sup>33</sup>
- **ILS:** the mainstream incorporation of ILS faces its own challenges (as detailed in Section II). As a McKinsey analysis pointed out in 2007, “there are still significant free-rider problems and a risk for those companies that wish to deploy higher ‘international norms’ (for example, with respect to child labour) that they will lose out to less scrupulous competitors. There are still strong ‘race to the bottom’ pressures”.<sup>34</sup>

Indeed, the biggest performance gap McKinsey & Co. found between what companies say they should do and what they actually do (32%) was in the area of *global supply chain management*.<sup>35</sup>

Given these downsides, it is interesting to note the appearance of a study like Pictet’s *Less Can Be More...A New Approach to SRI Research*, in March 2005, both because it came from a private Swiss bank (albeit one with an interest in sustainable investing), and because it posits an indicator of particular relevance to the ILO – job generation – as the key social indicator for measuring CSR.<sup>36</sup> Whether this argument holds up is another question, and one seasoned observer of SRI has criticized the study’s “radical reductionism” as going against the “diversity of SRI”.<sup>37</sup>

Still, the idea is a provocative one, and in 2006 Pictet followed up with a report that argued *against* choosing only indicators that have a “material impact” on corporate financial performance, and *for* “criteria that are desirable from a purely sustainable point of view”.<sup>38</sup> Views like these are worthy of the attention of both SRI and mainstream investors.

<sup>32</sup> Citigroup Smith Barney, *Crossing the River*, cited in Bill Baue, “Citigroup Smith Barney Report Seeks to Bridge Divide Between SRI and Traditional Analysis”, *SRI News Alerts*, SocialFunds.com, November 21, 2005.

<sup>33</sup> See, for example, Oppenheim et al., “Shaping the New Rules...” *op.cit.*, p. 19, and Steven Lydenberg, “Long-Term Investing: A Proposal for How to Define and Implement Long-Term Investing”, paper presented at the 2007 Summit on the Future of the Corporation, Boston, MA, 13-14 November, 2007.

<sup>34</sup> Oppenheim et al., “Shaping the New Rules”, *op. cit.*, pp. 20-1.

<sup>35</sup> *Ibid.*, p. 21, Exhibit 11.

<sup>36</sup> Christoph Butz, “Less Can Be More...A New Approach to SRI Research”, Pictet & Cie, Geneva, March 2005.

<sup>37</sup> Bill Baue, “Study Argues Less Is More in Socially Responsible Investment Research”, *SRI News Alerts*, SocialFunds.com, April 25, 2005.

<sup>38</sup> Christoph Butz and Olivier Pictet, “Do Stock Markets Reward the Creation of Jobs?”, Pictet & Cie, Geneva, June 2006, p. 16.

## 2.1.2 Expansion of SRI in Developing Countries

### Overview

Investor interest in developing countries or “emerging markets” (EM) continues to grow, and investors who specifically seek SRI opportunities globally are among those turning their attention to these markets. An important driver, as described by Garcia, is the “growing aging population” in developed countries: “to prevent the anticipated stress on payouts by public pension funds, these institutional investors are thinking of creative and riskier ways of increasing their assets by expanding their international portfolios”.<sup>39</sup>

According to one source, investment in developing countries expanded greatly in 2006.<sup>40</sup> Another source reported that, although the World Bank’s International Finance Corporation (IFC) has calculated that “only 0.1% of *SRI funds worldwide* are invested in emerging market assets”, SRI in emerging markets is expanding.<sup>41</sup>

This interest, as well as the realization that there has been little reliable research on developing country corporate performance on environmental, social and governance factors, has provided some of the motivation behind a small but growing number of SRI funds and indexes geared toward investment in developing countries.

There are various strands of SRI in relation to emerging markets. One consists of western funds and indexes based *on* those countries, of which there is a number. For example, in 2000, the California Public Employees Retirement System (CalPERS), one of the largest pension funds in the world, began screening the emerging market countries in which it invested, according to labour practices (including adherence to ILO conventions), political stability, financial transparency, and other governance factors.<sup>42</sup> There are also funds and indexes based *in* those countries, which are an interesting recent development. This section touches on a few of these, and the context in which they have arisen.

The first SRI funds based in an emerging market country were the Fundos Ethical, launched in Brazil in 2001 by ABN-Amro Brazil.<sup>43</sup> Since those early days, a number of recent developments indicate SRI is destined to grow significantly in developing countries, and several studies over the past five years have outlined key elements necessary for this growth.

<sup>39</sup> Astrid Garcia, “A Turning Tide: Investment Practices of Public Pension Funds and the Integration of International Labour Standards” August 2007, (research conducted for the ILO), p. 6.

<sup>40</sup> Specifically, foreign direct investment flows to developing and former Communist countries grew more in 2006 than in any previous year, increasing 21% to the former and 68% to the latter: UNCTAD, “World Investment Report 2007”, Switzerland, 2007, p. xv.

<sup>41</sup> David Tozer, “Broadening Horizons for Responsible Investment: An Analysis of 50 Major Emerging Markets Companies”, EIRIS, September 2006, p. 6. Emphasis added.

<sup>42</sup> Other examples include: BankInvest, a Scandinavian emerging market investor, which offers a Global Emerging Market SRI Fund; Calvert’s World Values International Equity Fund; and the IFC’s Emerging Market SRI Fund, launched in 2007 (with IFC as the lead investor, management by State Street Global Advisors and Rexiter Capital, and research from Innovest Strategic Value Advisors. See *Environmental Finance News* March 2007 <http://www.environmental-finance.com/2007/0703mar/news.htm> )

<sup>43</sup> <http://ces.fgvsp.br/index.cfm?fuseaction=content&IDassunto=62&IDsubAssunto=139&IDidioma=2>

In 2003, the IFC published a report, “Towards Sustainable and Responsible Investment in Emerging Markets”. It concluded there would not likely be “rapid, ‘organic’ growth of SRI in emerging markets over the short term”, but that “in the medium and long term...growth prospects appear solid, particularly among institutional investors (both in developed countries and emerging markets), fuelled by promising SRI fund performance, improving regulatory standards, growing demand for SRI, and increasing acceptance by institutional investors of SRI as a financially worthy and even desirable approach”.<sup>44</sup>

The same year, the Association for Sustainable and Responsible Investment in Asia (AsRIA) published, with IFC support, a report entitled “SRI in Asian Emerging Markets”. The report’s project manager observed that “the introduction of SRI into Asian markets will cause new forms of SRI to emerge, widening and broadening the debate on what values, screens and approaches are most effective in each market”.<sup>45</sup>

The report, which focused on seven Asian countries, concluded that there was “plenty of evidence that would support the successful introduction of SRI” in all seven. This was due to a number of developments throughout these countries, including “gradually improving corporate transparency”, increasing environmental and social awareness in the general population as well as among investors in these countries, “encouragement by regulatory authorities for adoption of higher standards of corporate governance”, and an opening up to foreign investment.<sup>46</sup>

The report cautioned that “the introduction of *superficial SRI funds* may mobilize investment interest in the short term but *harm long-term support for SRI*”.<sup>47</sup>

In 2006, AsRIA published another IFC-supported report entitled, “Taking Stock – Adding Sustainability Variables to Asian Sectoral Analysis”. The report focused on eight high-impact sectors (including banks, metals and mining, supply chain companies, and energy), and was aimed in part at “Asian investors, companies and policymakers”.<sup>48</sup> Its goal was to address a research gap in Asia: that of the lack of evaluation of ESG-related risks and opportunities in relation to Asian listed companies. AsRIA found that environmental issues “dominate” but that there was a lack of incentives to address these. It noted that “rising incomes and expectations across Asia” would likely bring tighter regulations and enforcement, something already being seen in some parts of Asia.<sup>49</sup>

Looking more broadly at developing countries over the past five years, we see the beginnings of SRI expansion in several countries, with interesting developments in both the public and private sectors. Both South Africa’s Johannesburg Stock Exchange (JSE) and Brazil’s Bovespa launched SRI indexes (see Box 1 below), South Africa in 2004 and Brazil in 2005. South Africa’s was the first SRI index in a developing country market, and

<sup>44</sup> Report cited in Bill Baue, “Emerging Markets Represent Underdeveloped Opportunities for SRI, Study Says”, *SRI News Alerts*, October 20, 2003.

<sup>45</sup> David St. Maur Sheil, quoted in Bill Baue, “SRI Growing Amongst European Institutional Investors and in Asian Emerging Markets”, *SRI News Alerts*, October 17, 2003.

<sup>46</sup> AsRIA, “SRI in Asian Emerging Markets”, 2003, p. 9.

<sup>47</sup> *Ibid.*, p. 10. Emphasis added.

<sup>48</sup> AsRIA, “Taking Stock – Adding Sustainability Variables to Asian Sectoral Analysis”, February 2006, p. 2.

<sup>49</sup> *Ibid.*, p. 9.

Brazil's was the first SRI index in Latin America. In 2006, the first SRI index in Malaysia was launched.<sup>50</sup> The following year, the Malaysian government began to require public companies to publish CSR information.<sup>51</sup> Also in 2007, ABN-Amro launched the first SRI fund in India,<sup>52</sup> followed in early 2008 by a pilot SRI index in India (See Box 2 – KLD/S&P index).

Most recently, a study in late 2008 by social investors in the United States called attention to the “move towards increased reporting standards by regulatory bodies and stock exchanges” in several countries. Among the countries discussed are the above-mentioned examples from Malaysia, Brazil and South Africa, and the study notes that these developments have been “largely driven by governmental goals to increase investment and keep markets competitive.”<sup>53</sup>

<sup>50</sup> The OWW Responsibility™ Malaysia SRI Index was launched in 2006 by OWW Consulting, a business consultancy based in Malaysia and Singapore that specializes in CSR and SRI research. The motivation behind the index was to provide international social investors with information on the ESG performance of Malaysian and Singaporean companies to give them increased investment opportunities abroad; to raise awareness among Malaysian companies about CSR and SRI; and to bring more social investment into Malaysia and Singapore from regional investors. See AsRIA, “The First Socially Responsible Investment (SRI) Index for Malaysia”, press release, December 4, 2006.

<sup>51</sup> See Steve Lydenberg and Katie Grace, “Innovations in Social and Environmental Disclosure Outside the United States”, Domini Social Investments, November 2008, <http://www.domini.com/about-domini/News/index.htm>, accessed December 22, 2008.

<sup>52</sup> ABN-Amro Sustainable Development Fund, 2007 (exact date not available), downloadable at: [http://www.abnamro.co.in/popups/sustainable\\_dev/AASDF\\_leaflet.pdf](http://www.abnamro.co.in/popups/sustainable_dev/AASDF_leaflet.pdf)

<sup>53</sup> Lydenberg and Grace, op. cit., p. 7.



## Box 1

### Examples from South Africa and Brazil

#### South Africa

In South Africa, the Johannesburg Stock Exchange SRI Index (JSE SRI) was launched in May 2004 in response to a “burgeoning debate around sustainability globally and particularly in the South African context”.<sup>54</sup> It was the first SRI index in an emerging market country, and the first SRI index launched by a stock exchange. It ranks companies according to ESG and economic factors.

There were several drivers. The Second King Report on Corporate Governance emphasized the so-called TBL or “triple bottom line” (environmental, social, financial), but companies “needed guidance” on TBL practices. Investors wanted to invest in companies with good ESG performance, and this index is meant to offer criteria for evaluating this performance, as well as an “aspirational sustainability benchmark”.<sup>55</sup>

Interestingly, Ethical Corporation noted in 2004 that the maintenance of the JSE SRI index was not contracted out, as many developed country indexes are. The index puts an emphasis on issues of particular concern in South Africa, such as Black Economic Empowerment (BEE) and HIV/AIDS.<sup>56</sup> As such, the index demonstrates the potential importance of “homegrown,” as opposed to imported, indexes in developing countries. However, in late 2007, the Johannesburg Stock Exchange announced that it was partnering with UK-based SRI research firm Ethical Investment Research Services (EIRIS). As of 2007 the JSE SRI index based its environmental criteria on those of FTSE4Good, and its indicators were aligned with the UN Principles for Responsible Investment.<sup>57</sup> Tozer reported in 2006 that South Africa had 21 SRI funds, with a total of USD 1.6bn assets under management.<sup>58</sup> The JSE SRI index does not impose any exclusions (that is, it does not exclude any industries or sectors). The index has come in for criticism, with one observer arguing, for example, that it is “not well monitored”.<sup>59</sup>

Further, in 2007 UNEP-FI and a number of partners released a study, *The State of Responsible Investment in South Africa*, based on a survey of pension fund officers, asset manager officers, and investment advisory service providers in the South African investment community. Among the findings: about 70% said most ESG issues were “at least somewhat material in ‘evaluating the likely performance of investments’”. However, most also said they were “either doing nothing about this or had a limited proportion of assets in responsible investment portfolios”. The report called, in response, for a “very simple business case” to be made clearly that “a broad range of ESG issues are material” to performance evaluation. Most respondents also called for “more stringent legislation” to drive responsible investment, but not surprisingly, “almost no-one really liked the idea”.<sup>60</sup>

<sup>54</sup> <http://www.jse.co.za/sri/>

<sup>55</sup> <http://www.jse.co.za/sri/introduction.jsp>

<sup>56</sup> *Ethical Corporation*, “South Africa Leads the Way In African Corporate Responsibility Moves”, October 24, 2004.

<sup>57</sup> JSE-SRI press release, “The JSE’s SRI Index Challenges Investors to Invest Responsibly”, November 27, 2007, [www.jse.co.za](http://www.jse.co.za)

<sup>58</sup> Tozer, “Broadening Horizons...”, op. cit., p. 7.

<sup>59</sup> Patrick Bond, “Social Movements and Corporate Social Responsibility in South Africa”, in *Development and Change*, Vol. 39, No. 6, November 2008, p. 1038

<sup>60</sup> UNEP-FI, Noah Financial Innovation and UNISA Centre for Corporate Citizenship, “The State of Responsible Investment in South Africa”, October 2007, pp. 5-6.

## Brazil

In Brazil, the Bovespa Corporate Sustainability Index (Índice de Sustentabilidade Empresarial, ISE) was launched in December 2005. It had financing from the IFC and was developed by the Center for Sustainability Studies at the Fundação Getúlio Vargas. In early 2001 Brazil's Unibanco had started conducting ESG research on Bovespa companies, "exclusively" for non-Brazilian SRI funds. Later that year Banco Real ABN Amro launched the first two emerging market SRI funds in the world.

In 2004 Banco Itau launched the Itau Social Excellence Fund; Bovespa also created the New Market (Novo Mercado) and launched the Corporate Governance Stock Market Index, tracking companies with good corporate governance performance. Bovespa was the first stock exchange to join the Global Compact.

Membership in the Global Compact, as well as the "lack of a benchmark for SRI funds," were two motivating factors behind Bovespa's launch of the ISE. A working group was created to develop an index methodology. The group proposed the methodology to the IFC, which funded the initiative. Bovespa joined the Center for Sustainability Studies/Fundação Getúlio Vargas and created the index (the advisory board included IBASE, Instituto Ethos, and the Environment Ministry, among others). The Center studied the GRI, the Dow Jones Sustainability Index, FTSE4Good, and the JSE-SRI, among other sources.<sup>61</sup>

The Center then sent out questionnaires to companies and conducted a public consultation around the questionnaire, both with specialists and the general public. According to Bovespa, the resulting questionnaire is an extensive one that is continuously improved.<sup>62</sup>

One press account of the launch of Bovespa ISE noted that ISE had the Brazilian Association of Pension Funds (known as ABRAPP) on its board, a sign of local institutional investor interest in SRI<sup>63</sup> (the entity, ABRAPP, is still on the board). At the time of its launch, only 10 Brazilian companies met GRI reporting requirements, and the article noted that "battling the lack of transparency in Brazil's private sector, much of which remains family-owned, requires a cultural shift".<sup>64</sup>

The Bovespa ISE does not exclude any sectors, using positive screening instead. However, companies in high-impact sectors have their "management" and "performance" scores weighted more heavily than their "policies". The index is based on analysis of triple bottom line factors (environmental, social, financial) plus corporate governance, and has a maximum of 40 companies. Its stated goal is to create a "Brazilian benchmark" for both Brazilian and international social investors.

### 2.1.3 *Future prospects for SRI in developing countries*

Commentary on the SRI market in developing countries or regions has underscored the fact that families often control large companies (in Asia, India and Brazil, for example<sup>65</sup>). This presents a potential barrier, at least in the immediate future, to transparency and independence, both of which are valued by social investors. Further, the

<sup>61</sup> The above account draws on "Bovespa Corporate Sustainability Index", Centro de Estudos em Sustentabilidade, <http://ces.fgvsp.br/index.cfm?fuseaction=content&IDassunto=62&IDsubAssunto=139&IDIIdioma=2> accessed November 8, 2007

<sup>62</sup> [http://www.bovespa.com.br/Market/MarketIndexes/ise\\_i.shtml](http://www.bovespa.com.br/Market/MarketIndexes/ise_i.shtml)

<sup>63</sup> Oliver Balch, "Brazil and SRI: Indexing Responsible Companies", *Ethical Corporation*, September 27, 2005

<sup>64</sup> Ibid.

<sup>65</sup> On Asia, for example, see Florian Gimbel, "Responsible Investing On Rise in Asia", *Financial Times*, April 3, 2006; on Brazil, see Balch, op. cit.

AsRIA report of 2006 pointed out that the prevalence in Asia of state-owned enterprises could also constitute a barrier to SRI, in part because of the limits to shareholder power.<sup>66</sup>

Indeed, in a 2006 report for EIRIS entitled “Broadening Horizons for Responsible Investment: An Analysis of 50 Major Emerging Markets Companies”, Tozer notes that factors holding back SRI investment in emerging markets include:

- lack of disclosure on corporate activities and performance;
- fund managers’ tendency to underestimate differences across emerging market countries, both in terms of corporate structure and governance and in terms of “key drivers and attitudes” toward CSR and investment;
- lack of third-party research organizations based in developing countries that can conduct research on corporate ESG performance.<sup>67</sup>

Tozer hits on an important issue regarding the expansion of SRI into developing countries: that the phenomenon of western investors exporting a model is not only likely to breed resentment; it also fails to prepare the ground for a homegrown model of responsible investment in these countries, which is the only way it is likely to take root successfully. Certain tenets of SRI can and should be translated globally, such as demanding respect for universal labour standards from all corporations. But that does not take away from the fact that the spread of SRI in developing countries is complex and does not lend itself to blueprints.

Tozer concludes that “the overwhelming majority of companies in the study have shown evidence of addressing at least some environmental, social and governance issues in their public disclosures, with some significantly so”.<sup>68</sup> South African companies are “notably ahead of other emerging markets” on CSR disclosure, and some countries’ companies do well on one measure while doing poorly on others (e.g. some Taiwanese companies perform well on environment but poorly on governance). Some of the emerging market companies studied “compare favorably” on some measures with their counterparts in developed markets.<sup>69</sup> It is worth noting that, in late 2008, the IFC and GRI launched a joint initiative to build the capacity of emerging markets companies to report according to GRI standards.<sup>70</sup>

A number of observers have underscored the question that the EIRIS report itself has raised: whether companies in developing countries should be judged by the same standards as in developed countries. Tozer has said that the relevant point was not that investors had

<sup>66</sup> AsRIA, “Taking Stock...”, pp. 7-8.

<sup>67</sup> Tozer, “Broadening Horizons...”, op. cit., pp. 6-8. As Tozer points out, the IFC competition that led to the KLD-CRISIL-S&P project discussed in this section was meant specifically to address this research gap.

<sup>68</sup> Tozer, “Broadening Horizons...”, op. cit., p. 1.

<sup>69</sup> Ibid., Executive Summary, and p. 27. See also UNCTAD, “2008 Review of the Reporting Status of Corporate Responsibility Indicators”, October 31, 2008, TD/B/C.II/ISAR/CRP.2.

<sup>70</sup> See “IFC Partners with the Global Reporting Initiative to Promote Sustainability Reporting in Emerging Markets”, IFC press release, September 16, 2008, <http://www.ifc.org/ifcext/media.nsf/content/SelectedPressRelease?OpenDocument&UNID=23DAD70E5BB610ED852574C70062D139>, accessed November 8, 2008.

to lower their standards to invest in developing country companies, but rather that they should engage companies “to try and get them to raise their standards.”<sup>71</sup> Such a position is consistent with a shift in SRI as practiced in some developed countries as well, away from exclusion and toward engagement. This works where shareholder rights are strong, but may be less realistic where such rights are weak, a point AsRIA has made in its research on emerging markets.

Further, it is not so much a question of developing markets looking toward the west, but rather a two-way street; western markets should also be looking with interest toward developing country markets such as South Africa and Brazil, and monitoring what happens, for example, when stock exchanges incorporate ESG into their listing standards.

#### Box 2

##### India’s Pilot SRI Index

In early 2008, a consortium made up of Indian economic research firm CRISIL Ltd. (Standard & Poor’s India affiliate), investment research and index firm Standard & Poor’s, and social investment research firm KLD Research & Analytics, Inc.<sup>72</sup> launched a pilot SRI index in India. The index had its origins in an international competition to encourage better ESG research in emerging market countries: in 2006, the IFC had awarded a grant to the consortium to develop a pilot SRI index of Indian companies based on ESG performance. The index is envisioned as a potential model for other emerging markets.

## 2.2 Labour-related SRI

With regard to labour-related SRI in particular, there are multiple factors driving its growth, though there seems to be little research in this area. The section below on Institutional Investors and SRI looks at some proxies for this growth, such as the number of labour-related shareholder resolutions filed in recent years, and provides preliminary commentary.

Some of the factors driving labour-related SRI include:

- **exposes** throughout the 1990s on ILS violations in the global supply chains of many well-known public companies, such as Wal-Mart, Nike, Disney and Gap. These exposés have been based in large part on the early and continued work of **labour rights groups and unions** to reveal what goes on in those supply chains<sup>73</sup>
- **domestic politics**: controversy, particularly in the U.S., over companies increasingly moving production overseas, bringing further attention to the

<sup>71</sup> David Tozer, quoted in Riva Froymovich, “Emerging Markets Test Socially Conscious Investors”, *Investment News*, October 9, 2006.

<sup>72</sup> The author was a senior research analyst at KLD Research & Analytics, Inc. from 2001 to 2007.

<sup>73</sup> Groups doing important work in this area include Clean Clothes Campaign; Maquila Solidarity Network, National Labour Committee, Worker Rights Consortium, Asia Monitor Resource Center, Human Rights Watch, China Labour Watch, etc.

move to low-wage countries and the labour conditions that prevail there (as well as criticism about the resulting loss of domestic jobs)

- increased **availability of information** on what is going on in overseas supply chains, which has driven not only consumer anger but investor demand for companies to address ILS in their supply chains
- continued and more sophisticated **investor demand**, often through shareholder resolutions on ILS, but also through increasingly pointed questions to companies, which has helped keep the issue on the front burner (see section III).
- For example, in the UK, Adam Ognall of the UK Social Investment Forum (UKSIF) has noted the increasing interest investors have in knowing what is affecting company performance in the area of supply chain management, and what reputational risk around supply chain management means in financial terms. Ognall has pointed out that audits of factories and other data that companies report on supply chain management do not address this need or interest. UK investors are increasingly looking at supply chain management and performance in terms of materiality.<sup>74</sup>
- the “**demonstration effect**” of well-known players in the investment world focusing specifically on labour standards and the workplace. For example:
- U.S.-based Parnassus Investments launched its Workplace Fund in April 2005, which seeks to invest in companies that are considered exceptional places to work<sup>75</sup>
- In 2004, FTSE4Good, in collaboration with the ILO, began incorporating labour standards criteria in its index, and now makes yearly announcements on companies that have been removed from the index due to failure to comply with these standards

### 2.2.1 *Key actors in the rise of labour-related SRI*

Key actors have also influenced the take-up of labour-related SRI, including the following:

- **Labour rights and human rights groups** broke the story in the 1990s of violations of international labour standards (ILS) in the supply chains and/or owned operations of foreign companies. Social investors rely on the research and reports of these groups, not only for raw data for use in evaluating individual companies, but also as barometers of trends in how corporations treat ILS in their operations<sup>76</sup>. The SRI community is also

<sup>74</sup> Telephone interview of Adam Ognall, Deputy Chief Executive, UKSIF, November 1, 2007

<sup>75</sup> Parnassus works with the co-author of Fortune magazine’s annual list, “100 Best Places Companies to Work For”, to choose the fund’s constituents. See <http://www.parnassus.com/parnassus-mutual-funds/workplace/default.aspx>

<sup>76</sup> A good example of an NGO report on ILS that social investors found particularly helpful was Oxfam International’s “Trading Away Our Rights” (2004), which was a critical look at labour conditions in overseas

increasingly working with labour rights and human rights organizations in the global north and south to address ILS in global supply chains.<sup>77</sup>

- **Social investors** – in particular, so-called “pure-play” SRI funds such as Trillium Asset Management and Domini Social Investments in the U.S., and Sustainable Asset Management in Europe – have helped drive the incorporation of labour standards in investment decisions by pushing the issue with companies.
- **SRI research and ratings agencies**, such as KLD Research & Analytics, Innovest, EIRIS, and CentreInfo provide investors with essential information on corporate performance. Companies in turn are increasingly turning to SRI research and ratings agencies to know what SRI is interested in.

### Box 3

Vigeo is a French social rating agency founded in 2002 by former trade union leader Nicole Notat. It is unique in its level of trade union involvement: three trade union representatives sit on its tripartite board of directors, which also has three corporate representatives and three representatives of asset and pension fund managers. Vigeo bases its ratings criteria on ILO conventions, among other things

Source: [www.vigeo.com](http://www.vigeo.com).

Mainstream asset managers are becoming more important players in SRI. In addition, certain fund managers, particularly in the UK, have “developed an SRI strategy for their mainstream funds”.<sup>78</sup> As Peter Frankental of Amnesty International notes, SRI fund managers have been “a good conduit of issues between pressure groups and business; they have better access to companies than NGOs, they can speak the language of business and can frame issues in a way that is more likely to evoke a positive response”<sup>79</sup> (however, see the end of Section III for Frankental’s own reality check on this issue). In some cases, asset managers have been more active on ESG incorporation than asset owners have been.<sup>80</sup>

- **Certain activist public pension funds** are particularly important because they have taken public stances on ESG incorporation, because they manage such large sums of money (and often hold enough shares

farms and factories that supply western companies. The report expressly called on institutional investors, among others, to promote protection of ILS in international supply chains.

<sup>77</sup> It is worth underscoring the role of coalitions of these groups, or dedicated campaigns around the protection and promotion of ILS in global supply chains. In specific instances, these campaigns have brought cases of mistreatment of factory workers into the international spotlight and have brought pressure to bear on international retailers or brands buying from those factories. See Florence Palpacuer, “New Forms of Social Dialogues in Transnational Production Networks: A Comparative Analysis of Activist Campaigns in the Global Apparel Industry”, presentation at UNRISD conference on “Business, Social Policy and Corporate Political Influence in Developing Countries”, Geneva, November 12-13, 2007.

<sup>78</sup> Peter Frankental, “Why Socially Responsible Investment Requires More Risk for Companies Rather Than More Engagement”, in Rory Sullivan and Craig MacKenzie, eds, *Responsible Investment*, Greenleaf Publishing, 2006, p. 243. Frankental lists Morley, Hendersons, F&C and Insight as examples.

<sup>79</sup> *Ibid.*, p. 244.

<sup>80</sup> See, for example, UNEP-FI and Global Compact, “PRI Report on Progress 2007”, July 2007.

in individual companies to get their attention), and because other institutional investors look to them as models. Some of these (e.g. CalPERS and the Norwegian Pension Fund Global) have been activist on ILS issues in particular.<sup>81</sup> Initiatives such as the UN Principles for Responsible Investment have targeted these players. As of late 2007, 76 signatories to the initiative were public or union pension funds.<sup>82</sup> These funds are not always moving forward steadily on the incorporation of ESG. For example, according to a 2007 survey of 278 pension funds of companies in the FTSE4Good UK index, over half declined to participate in a study of responsible investment practices, and only a small percentage (12%) provided “usable information” to the survey.<sup>83</sup> However, pension funds remain a key player in the growth of both SRI in general and labour-related SRI in particular, and their potential to drive further growth is enormous.

- Major public pension funds have identified **international inter-governmental organizations**, such as the OECD (Organization for Economic Cooperation and Development) and the ILO, as well as the UN Global Compact, as having “helped shape the basis of the international principles” that they, as investors, have adopted.<sup>84</sup>
- The **Principles for Responsible Investment**, spearheaded by UNEP-FI and the Global Compact is expected to further drive the incorporation of ESG into investment. While the PRI does not focus on SRI *per se* but on mainstreaming ESG into investment and on “active ownership,” it tries to encourage signatories to address issues that are relevant to their portfolios<sup>85</sup>, which may include ILS. UNEP-FI has also had an essential role in advancing research – including by mainstream players – on the link between ESG and financial performance (see above, on mainstream interest in ESG).
- Certain **companies** have begun to work with groups with which they had only a confrontational relationship in the past, in an effort to address concerns about ongoing labour rights violations in their international operations. For example, Gap, Inc. is working with the International Textile, Garment and Leather Workers’ Federation (ITGLWF) to bring labour unions into the assessment of supply chain

<sup>81</sup> CalPERS has an extensive labour screening process for emerging market investments. The Norwegian Pension Fund’s Council on Ethics, in addition to researching information in the public domain, also makes field visits in some cases “to verify the quality of commissioned work” and “to obtain first-hand knowledge on specific company cases” (including cases of child labour and other labour violations in developing countries: email communication with Secretariat of Norwegian Pension Fund’s Council on Ethics, December 10, 2007.

<sup>82</sup> Email correspondence from James Gifford, Chief Executive, UN PRI, November 18, 2007. As of September 2008, the PRI website showed a total of 420 signatories: 140 asset owners; 195 investment managers and 85 service providers ([www.unpri.org](http://www.unpri.org)), with a total of USD 15 trillion assets under management.

<sup>83</sup> *Ethical Performance*, “Pension Funds Keep Their SRI Lights Under a Bushel”, November 2007. The UK Social Investment Forum and FTSE Group conducted the survey.

<sup>84</sup> Astrid Garcia, “A Turning Tide: Investment Practices of Public Pension Funds and the Integration of International Labour Standards”, August 2007, p. 10 (research conducted for the ILO).

<sup>85</sup> Telephone interview of James Gifford, Executive Director, UNPRI, November 5, 2007.

working conditions. The ITGLWF is training Gap compliance officers on freedom of association and collective bargaining.

#### Box 4

##### What Social Investors Do In Relation to ILS

Screening and shareholder resolutions give a rather two-dimensional view of SRI work. In addition to resolutions, research and dialogues, some of the things social investors and SRI researchers do in relation to ILS include:

- Direct involvement with companies working on supply chain management.
- Ex. Social investors visit factories supplying companies in which they invest.
- Participation in workshops and multi-stakeholder initiatives with companies, unions and NGOs on issues well beyond codes of conduct and policies.
- Ex. EICC, Business for Social Responsibility's Beyond Monitoring.
- Providing both public and private feedback to companies on draft CSR reports.
- Networking with others in the SRI and NGO communities to increase leverage.
- Brokering discussions between companies and other stakeholders.
- Lobbying government agencies and elected officials directly through letters and meetings (social investors work with civil society organizations to put out public statements on issues of mutual concern, and they enter into direct dialogue with government agencies and elected officials on these issues).<sup>86</sup>
- Ex. SEC in the U.S., regulatory agencies in Europe.
- Meeting with affected parties.
- Ex. Factory workers alleging ILS violations in the supply chains of investee companies.

### 2.2.2 The role of trade unions

Trade unions have been important actors – and could expand their role – in the growth of SRI. They have the potential to influence corporate behaviour through **workers' capital**; the money invested in funds to cover workers' retirement represents an important force, as workers are “indirect owners” of equity shares through pension funds.<sup>87</sup>

A 2002 source estimated total workers' capital globally at over \$5 trillion.<sup>88</sup> Another source cited an estimate in 2003 of US\$11 trillion.<sup>89</sup>

<sup>86</sup> For an account from the UK, see Craig MacKenzie and Rory Sullivan, “Insight’s Approach to Activism on Corporate Responsibility Issues”, in Sullivan and MacKenzie, eds., *Responsible Investment*, Greenleaf Publishing, 2006, p. 188.

<sup>87</sup> See [http://www.workerscapital.org/What\\_Is\\_Workers\\_Capital/lang/en/](http://www.workerscapital.org/What_Is_Workers_Capital/lang/en/) on workers capital.

<sup>88</sup> AFL-CIO Investment Product Review Working Group, “AFL-CIO Investment Product Review – Private Capital”, November 2002, pg. v.



According to one set of data, the so-called Taft-Hartley funds, or union-managed pension funds in the U.S., owned a total of \$438 billion.<sup>90</sup> This amount is relatively small when compared to corporate or government pension funds.<sup>91</sup> But public pension funds often cover substantial numbers of unionised state employees, who frequently have representation among pension board trustees.<sup>92</sup>

In 1999 the Committee on Workers Capital (CWC) was created to coordinate activity on areas such as shareholder activism and educating pension fund trustees.<sup>93</sup> And since 1997 the US union confederation AFL-CIO has had a Capital Stewardship Program; in 1998 it began a review process through which it has regularly reviewed “worker-friendly investment products” in several asset classes.<sup>94</sup>

In addition, unions have worked with social investors to address individual cases of concern about corporate behaviour, including through **dialogue or exchange of information** with faith-based investor groups and SRI rating agencies.

- Union pension funds also file **shareholder resolutions**, sometimes jointly with other investors. According to one source, as of 2007 in the U.S., “after faith-based investors, more labour unions and union affiliates...are filing social issues resolutions than any other segment of institutional investors”<sup>95</sup> (see section III, Box 5 for an interesting example of a joint resolution).
- Individual unions (for example, the Service Employees International Union, SEIU) have done substantial work to **educate pension fund trustees** on issues of concern to organized labour. Unions are also beginning the work of getting pension funds to adopt the UN PRI.<sup>96</sup>
- In the UK, although union-led shareholder activism is not as well-developed as in the U.S., trade unions are poised to influence pension funds on company behaviour, in part because of favourable legislation as well as union initiatives. As Tom Powdrill, formerly with the UK Trades Union Congress (TUC) has noted: (1) by law, one-third of

<sup>89</sup> Jon Robinson, “Workers’ Capital...”, op. cit., p. 67.

<sup>90</sup> Email communication from Patrick O’Meara, AFL-CIO, citing data from *2007 Standard & Poor’s Money Market Directory of Pension Funds and Their Investment Managers*.

<sup>91</sup> According to the US Social Investment Forum, Taft-Hartley accounts for 0.1% of socially screened assets, compared to 9.2% for corporate and 80.9% for public pensions. *Pension Benefits*, “Public Pensions Conduct More Social Screening of Investments Than Other Groups”, March 2006: 15, 3, p. 4.

<sup>92</sup> Email communication from O’Meara, op. cit.

<sup>93</sup> See [www.workerscapital.org/About\\_CWC/](http://www.workerscapital.org/About_CWC/)

<sup>94</sup> See “AFL-CIO Investment Product Review...”, cited in footnote 88, for example.

<sup>95</sup> Email communication from Joshua Humphreys, Director, Center for Social Philanthropy, Harvard University, December 12, 2007. Humphreys has directed research for the SIF’s biennial report on SRI trends, but was speaking in his individual capacity, not as a representative of the SIF.

<sup>96</sup> Telephone interview of Christy Hoffman, Organizing Director, Union Network International (UNI) Property Services Global Union, Nyon, November 6, 2007.

pension fund trustees must be member-nominated, and many member-nominated trustees (MNTs) are members of unions. This will rise to one-half in the near future; (2) the TUC has created a network (TUC Member Trustee Network), through which it works to encourage shareholder activism by trustees; and (3) TUC itself conducts shareholder voting campaigns each year, including on labour-related issues.<sup>97</sup>

- Powdrill acknowledges that one challenge for unions on shareholder activism is “whether trade unions can legitimately raise questions as investors without compromising their fiduciary duty as trustees”. He also recognizes that unions were “perhaps slow to respond to the opportunities presented by responsible investment”. But he notes that this is beginning to change.<sup>98</sup>
- The European liaison of the US-based SEIU, Michael Laslett, who works with investors and asset managers in Europe, reports that unions in the U.S. and Europe are beginning to explore opportunities to promote pension fund trustee incorporation of ESG into investment decisions. Underscoring Powdrill’s point about laws, Laslett notes that opportunities in this area are stronger in the UK than elsewhere because of recent “sympathetic legislation”, and also because the incorporation of ESG into mainstream investment is farther along in the UK than elsewhere.<sup>99</sup> Relations between unions and SRI may also be better developed in the UK than in the U.S.

### 2.2.3 General observations

The rise in labour-related SRI is also evident in new partnerships (see Appendix I), increasingly sophisticated approaches of social investors to the issue of ILS, and an increase, albeit slow and uneven, of transparency around supply chain labour standards among a handful of companies.

And yet, despite this progress, serious labour rights violations remain commonplace, even in the supply chains of companies considered leaders in this area. The recent findings of EIRIS on labour standards in particular were discouraging: in all regions but Europe, most companies that rely substantially on global supply chains show “little or no evidence of having a supply chain labour standards policy. Over 80% of companies in North America and Australia/New Zealand and over 90% of Asian companies” have no such policy, although over 50% of European companies do.<sup>100</sup>

These challenges and others will be discussed in more detail in section II.

<sup>97</sup> Tom Powdrill, “Workers’ Capital: Promoting Trade Union Concerns Through Investment”, in Sullivan and MacKenzie, eds., *Responsible Investment, op. cit.*, p. 266-8.

<sup>98</sup> *Ibid.*, p. 271.

<sup>99</sup> Telephone interview of Michael Laslett, Director, SEIU Capital Stewardship Program – Europe, November 26, 2007.

<sup>100</sup> EIRIS, “The State of Responsible Business,” *op. cit.*, p. 10.

## 2.3 Institutional investors and SRI: Recent data

Institutional investors, which represent large amounts of money and may hold significant shares in public companies, are increasingly incorporating ESG into their investment decision-making. They are doing this, for example, through incorporation of ILO core conventions, with child labour and freedom of association considered the most important.<sup>101</sup> However, moving from “incorporation” of ESG to an in-depth consideration of labour-related issues in investment decision-making is a big step, and brings its own challenges.

As mentioned earlier, there are few comprehensive data on the spread of labour-related SRI *per se*. But there are indicators that reflect the long-term, ongoing interest of social investors in labour-related issues, as well as some indication of growth in this area. This section discusses ILO-commissioned research from 2007, on large institutional investors’ consideration of labour standards; data from the Interfaith Center on Corporate Responsibility (ICCR) on North American shareholder resolutions around labour-related issues; and labour-related indicators connected to a major SRI index maintained by US research firm KLD Research & Analytics. It also incorporates qualitative accounts from shareholder activists and others in the SRI field.

**Garcia (2007)**, citing data on two large groups of public pension funds, captures the outlines of the trend of institutional investor integration of labour standards in decision-making:

Two-thirds of major international public pension funds surveyed by UNEP-FI/UKSIF in 2007 (representing almost \$3.5 trillion) consider labour standards in investment decisions

15 out of 26 of the major international public pension funds studied by Garcia (representing over \$4 trillion) do so<sup>102</sup>

As Garcia notes, public pension funds are incorporating ESG both to “meet their fiduciary duties” and to “minimize the risks” of international investment.<sup>103</sup> Overall, public pension funds are considered a natural fit for responsible investment, in part because their trustees are often publicly elected and, in principle, are more likely than commercial fund managers to be authorized to incorporate social issues in investment decisions.<sup>104</sup>

Garcia also finds the trend in shareholder activism among public pension funds is on the upswing, citing the 2005 SIF report, which noted a 16% rise in ESG-related resolutions in the U.S. from 2003 to 2005. She notes that 20 of 26 public pension funds surveyed use proxy voting to “guarantee the long-term health of their investments”.<sup>105</sup> It is worth noting that the filing of shareholder resolutions on ESG issues is much more prevalent in the U.S.

<sup>101</sup> Garcia, “A Turning Tide”, *op. cit.*

<sup>102</sup> *Ibid.*, p. 3. Garcia notes that some pension funds belong to both the UNEP-FI sample and her own sample.

<sup>103</sup> *Ibid.*, p. 6.

<sup>104</sup> John Russell, “Long-term Savings – In the Public Interest”, *Ethical Corporation*, November 14, 2006.

<sup>105</sup> Garcia, “A Turning Tide”, p. 7. The US SIF 2005 report cited above contains a full table of social shareholder resolutions filed in the U.S. in 2003-2005 (fig. 4.2, p. 19), ranging from global labour standards to climate change to executive pay.

than in any other country, due in part to the ease with which shareholders can do so.<sup>106</sup> And while shareholder resolutions in the U.S. are non-binding, they alert companies to issues of major concern to shareowners.

Another set of data comes from the **ICCR EthVest shareholder resolution database**. ICCR is a coalition of 275 faith-based institutional investors that seeks to “press companies to be socially and environmentally responsible”. Among its members are pension funds, religious orders, asset management companies, colleges, unions, and foundations. While ICCR does not own stock itself and therefore cannot file resolutions, each year it coordinates filings for its members on over 200 shareholder resolutions on issues of concern to these member organizations, whose combined portfolio value is about \$110 billion.<sup>107</sup>

ICCR’s database shows the following<sup>108</sup>:

Table 2: Human Rights (HR) and Labour Rights (LR) Shareholder Resolutions filed

Year	Total number of HR and LR Resolutions Filed	Number and percentage which concerned LR	Number and percentage which concerned non-labour human rights
2007	68	49 (72%)	19 (28%)
2006	70	46 (66%)	24 (34%)
2005	72	57 (79%)	15 (21%)
2004	50	43 (86%)	7 (14%)
2003	55	48 (87%)	7 (13%)

The resolutions counted under “labour rights-related” are those that specifically discuss labour issues and/or ILO conventions or standards.<sup>109</sup> These include, among others, resolutions on vendor standards concerning ILS; discrimination in the workplace; the MacBride Principles (fair employment principles for US companies operating in Northern Ireland); and child labour. The more general human rights resolutions cover areas such as involvement in Burma, indigenous community impact, use of security forces, privacy, and Internet freedom of expression. Note that the totals above include resolutions that were withdrawn.

The data show a rise, though with fluctuations, in the total number of Human Rights and Worker Rights shareholder resolutions from 2003 to 2007. It is interesting to note that over the same period there is a decline in the *percentage* of labour-related resolutions among human rights and worker rights resolutions overall, although ILS-related resolutions clearly represent the lion’s share of the total human rights resolutions over these years. It is tricky to interpret the reasons behind the numbers of resolutions. As one ICCR staff

<sup>106</sup> For a brief comparison of resolution filing in the U.S. and the U.K, see Rory Sullivan and Craig MacKenzie, “The Practice of Responsible Investment”, in Sullivan and MacKenzie, eds., *Responsible Investment*, p. 335.

<sup>107</sup> See ICCR website, [www.iccr.org](http://www.iccr.org). Also email communication from Julie Wokaty, Director of Publications and Website, ICCR, November 7, 2007.

<sup>108</sup> ICCR, EthVest database, accessed November 5 and November 14, 2007.

<sup>109</sup> This was the author’s own classification, as the ICCR database groups human rights and labour rights resolutions together, and does not break them down into categories, though it does give a title to each resolution so that in many (not all) cases, it is easy to tell whether a resolution is primarily labour-related or more generally a human rights resolution.

member points out, fluctuations in the numbers from one year to another may reflect a temporary decline in the number of resolutions by a large filer, or could indicate that shareholders are involved in more dialogues in a particular year and therefore might file less on an issue.<sup>110</sup>

Rev. David Schilling, also of the ICCR, has made several observations: (1) there is “more energy” in the investor community now around business and human rights more broadly, and sometimes “the labour piece gets lost”; (2) most companies are not getting resolutions because there are other ways to engage them (through multi-stakeholder initiatives or dialogue); and (3) resolutions are only one part of the picture. That is, the agenda has become larger, as opposed to labour being dropped from it, as ICCR has been pushing for international standards, of which core ILO standards are a “key piece”.<sup>111</sup>

The EthVest database reflects a somewhat similar pattern for environment and corporate governance resolutions: that is, a gradual rise (with some fluctuation) in the overall number of environment-related and corporate governance-related shareholder resolutions.

Environment-related resolutions include energy efficiency, climate change reporting, genetically modified organisms, and water use. Corporate governance resolutions include separation of CEO and chair, executive compensation, and diversity inclusiveness of board directors.

Table 3: Environmental resolutions filed

Year	Number
2007	86
2006	74
2005	74
2004	65
2003	74

Table 4: Corporate governance resolutions filed

Year	Number
2007	65
2006	50
2005	56
2004	32
2003	43

With regard to how the resolutions did at company annual general meetings, the following reflects the change in average votes for each issue area:

<sup>110</sup> Personal communication from Julie Wokaty, Director of Publications and Website, ICCR, November 14, 2007.

<sup>111</sup> Interview of Rev. David Schilling, Director, Global Corporate Accountability, ICCR, New York City, November 21, 2007.

Table 5: Change in average votes by category of SRI issue

Issue	Average Vote 2007	Average Vote 2003
Human Rts/Worker Rts	32.78%	10.42%
Environment	12.86%	14.31%
Corporate Governance	34.58%	28.03%

A proper interpretation of these figures would require further research, probably through direct consultation of a number of filers on these issues. But it is worth noting that a number of shareholder resolutions on non-discrimination in the workplace (focused on non-discrimination in relation to sexual orientation) have done well each year, many of them receiving over 30% of shareholder votes (considered quite high for ESG resolutions) and some of them receiving over 90% in a particular year.

Research is needed in the future on whether and to what degree this type of engagement is successful in changing corporate behaviour in the area of ILS, as well as improving working conditions themselves. Sections III and IV below provide some commentary on these questions.

The author is not aware of specific data on how often institutional investors remove companies (or decline to invest in them) due to labour issues. For example, Schilling has noted that ICCR’s focus is primarily on engagement to bring change, not on divestment. ICCR data therefore are focused on resolutions and dialogues, though individual members do divest from companies on specific issues.<sup>112</sup>

Another relevant set of data is that of labour- or employee relations-related removals and additions of companies to the **Domini 400 Social<sup>SM</sup> Index (DS400)**, the flagship index of social investment research firm KLD Research & Analytics, Inc. From 1990 (the year KLD created the index) to October 2007, there were 358 removals (and simultaneous additions, because each time a company is removed from the DS400, one is added, as the index must remain at exactly 400 companies). Of those 358 removals, the vast majority (267, or about 75%) were for so-called “corporate actions” (mergers, acquisitions, bankruptcy, delisting, etc.).

Setting aside corporate action removals, the remaining 91 removals are listed as “social.” These include companies removed for controversies in issue areas such as employee relations, product safety, or environment; and companies removed for involvement in activities screened out by the index, such as nuclear energy or gambling. It also includes those removed for general lack of a “social story” (i.e. companies that were originally placed on the index because of strong performance on social and/or environmental issues, but which have declined in these areas and no longer have an outstanding social story).

Of those 91, 11 removals were primarily for labour- or employee-related reasons, such as supply chain labour controversies or union relations controversies. This represents only 3% of the total 358 removals from 1990 to 2007, but about 12% of the “social” removals

<sup>112</sup> Ibid.

Except for Product concerns, this is higher than other individual issue areas represented within the “social” removals category.<sup>113</sup>

The above data represent only one SRI index in the U.S., albeit a long-established one, and a widely used benchmark for those employing ESG screening.<sup>114</sup>

In the UK, Adam Ognall of UKSIF notes that UKSIF members include supply chain management and labour standards issues among their top concerns.<sup>115</sup> This is true for many social investors in the U.S. as well.

#### Box 5

##### Trade Unions and Shareholder resolutions on labour issues

There are notable challenges for trade unions as shareholders: in the U.S., labour unions commonly file shareholder resolutions on corporate governance issues as opposed to labour rights issues, because companies can make the case easily for the SEC to exclude the latter as “personal grievance” resolutions. This affects unions’ ability to file resolutions on labour rights.<sup>116</sup>

In the UK, a key challenge to union-led shareholder activism is the difficulty of filing resolutions in general, whether on environment, labour or other issues. This is one reason there have been so few labour-related shareholder resolutions filed in the UK to date.<sup>117</sup> See Box 7 below for an interesting example of one such resolution.

Further, data from UN PRI in 2007 show that, among PRI signatories who engage companies in their portfolios, investment managers address human rights and labour issues at a high rate in their shareholder engagement initiatives, though not as high as governance or environment:

<sup>113</sup> Interpretation of past records of removal is not an exact science, as the dataset involved provides only brief comments on why a company was removed (e.g. “union relations, employee safety and product marketing concerns”). The author is grateful to Karin Chamberlain, Manager of Indexes at KLD, for providing these data.

<sup>114</sup> On the DS400 index, see <http://www.kld.com/indexes/ds400index/index.html>

<sup>115</sup> Telephone interview of Adam Ognall, Deputy Chief Executive, UKSIF, November 1, 2007

<sup>116</sup> Telephone interview of Simon Billenness, Senior Advisor for Special Projects and Shareholder Advocacy, AFL-CIO, October 19, 2007.

<sup>117</sup> Telephone interview of Tom Powdrill, Head of Communications, PIRC Limited, December 10, 2007. Powdrill was formerly with the Trades Union Congress (TUC) of the UK.

Table 6: ESG-related issues addressed in shareholder engagement: data from UN-PRI<sup>118</sup>

	Investment Managers	Asset Owners
Governance	76%	73%
Climate Change	76%	49%
Environment	74%	61%
Human Rights	71%	43%
Labour Issues	68%	45%
Health	53%	35%
HIV/AIDS	42%	12%

The executive director of the UN PRI has stated that the level of engagement on labour issues was “pretty impressive” and that the issue ranked high among those on which signatories engage. He points out that across all issue areas, not just labour, asset owners showed lower rates of engagement than investment managers.<sup>119</sup>

Finally, Garcia looks at two groups of pension funds: those that are “leading” by dint of their total holdings, and those that are “leading” by dint of their holdings and their integration of ESG. In the latter group – public pension funds that integrate ESG – labour issues figure more prominently in investment decisions (10 out of 15) than they do for the group that is leading simply by dint of their holdings (in that group, eight out of 19 considered labour).<sup>120</sup>

It is difficult to tell from just those data whether mainstream numbers are changing. Within SRI, ILS have been a major issue since at least the 1990s, so it is not surprising two-thirds of investors incorporating ESG would say they consider ILS important. And “considering” ILS in this sense can be as minimal as asking a company if it has a policy mentioning the ILO core conventions.

Garcia points out that international entities such as the ILO and OECD, and initiatives such as UN PRI, have laid the groundwork for institutional investors to incorporate ESG, and that these investors are “seeking clarity and consistency of international standards”.<sup>121</sup> This view is echoed by Thomas Kuh, managing director of indexes at KLD, who has noted that “increasingly in Europe, Australia and New Zealand...pensions and other institutional investors are adopting screens based on ‘global norms’ such as ILO standards. This trend will grow as more institutions adopt an SRI/ESG/sustainability stance”.<sup>122</sup>

In sum, there is a strong and steady history of social investors incorporating labour issues into their decision-making, and of SRI activism on labour (particularly ILS) issues. But there is much room for growth, including in comparison to other issue areas, and for

<sup>118</sup> The table shows data from Chart 9, UNEP-FI & Global Compact, “PRI Report on Progress 2007”, July 2007, p. 23.

<sup>119</sup> Telephone interview of Gifford, op. cit.

<sup>120</sup> Garcia, “A Turning Tide”, op. cit., pp. 8-9.

<sup>121</sup> *Ibid.*, p. 10.

<sup>122</sup> Thomas Kuh, Managing Director, Indexes, KLD Research & Analytics, personal communication, Oct. 22, 2007.



more depth in incorporation. There is also a need for more research on the extent to which *mainstream* investors take up ILS issues in particular. In recent years, environmental issues have accounted for a significant portion of social investor and mainstream investor interest. Further, there are challenges inherent to incorporating labour into investment decisions. Section II deals with both of these points.

### 3 Specific challenges of labour-related SRI

#### 3.1 Evolution of SRI thinking on labour-related issues

“Let’s put aside issues of audits and inspection for the time being and ask ourselves whether this whole model of outsourcing is sustainable and ethical”.<sup>123</sup>

Most SRI funds and indexes, or the SRI research firms whose services they use, look at ILS in some form when evaluating corporate ESG performance. There is a spectrum on ILS: at the lower end, an SRI ratings agency or SRI fund might simply check to see if a company has a labour code of conduct for its overseas operations or supply chain. Increasingly, SRI practitioners look for explicit mention of the core ILO conventions. Other areas in which social investors and NGOs look to measure corporate performance extend beyond the core conventions to areas such as wages and hours, benefits, health and safety. Experts have noted that health and safety conditions constitute one of the easiest areas for companies both to measure and to address.

Regarding direct employees, social investors also look at general work environment issues (e.g. benefits and perks, training, internal promotion rates), employee-related controversies (e.g. labour-management disputes, retaliation claims), and employee involvement (e.g. stock options, cash profit sharing programs). These data are more readily available for direct employees than for supply chain/contract workers (and in some cases, such as employee involvement, the programs simply do not exist for contract workers).

#### *Moving Beyond Compliance*

As concerns have mounted within the labour rights and SRI communities about the problems associated with using labour codes of conduct as a benchmark, and the limits of monitoring, SRI practitioners are seeking more stringent ways of evaluating performance on ILS. The idea is increasingly to go “beyond compliance”, or “beyond monitoring”. This section discusses this trend in more depth.

There is a well-documented history of the uptake, mostly by western brands, of corporate codes of conduct in response to sweatshop exposés that began in the early-mid 1990s. There is also an extensive literature on the weaknesses of codes of conduct and the auditing systems that have sprung from a so-called “compliance” approach to supply chain labour standards.

Problems have included fraud in recording wages and hours, the coaching of workers to give auditors answers that (falsely) indicate factory compliance, and the inability of auditing to capture serious labour violations such as sexual harassment and lack of freedom of association.

The evolution of thinking among social investors about ILS has tracked that of labour rights activists and experts who investigate the implementation of ILS in global supply chains. In the early 2000s there was a growing realization that auditing is not only limited as a tool for uncovering ILS violations and incapable, on its own, of preventing these

<sup>123</sup> Richard Welford and Dennis Cheung, “Tesco, the ETI and Child Labour”, *CSR Asia Weekly*, vol. 2, no. 42, October 18, 2006.

violations; it is also actually causing or exacerbating problems by putting pressure on factory managers to show that their facilities have passed inspection.

In October 2006, the Ethical Trading Initiative (ETI), a coalition of NGOs, companies and trade unions that aims to improve working conditions for workers producing for the UK market, released a report it had commissioned on the impact of its Base Code. The study showed the code had had a positive impact on health and safety, and helped reduce overtime and child labour and improve wages. However, it found the code had been less effective on ensuring freedom of association and tackling discrimination, and had benefited migrant workers much less than permanent workers.<sup>124</sup>

The results confirmed what many observers from organized labour, NGOs and SRI already knew: after years of codes, monitoring and auditing, many workers still are not better off.

In the early 2000s, a few key NGO reports had already pointed to fundamental flaws in the outsourcing model, and to structural elements that made ILS violations inevitable. For example, in its 2001 report on toy factories in southern China, the Hong Kong Christian Industrial Committee (HKCIC) noted that although the foreign companies sourcing from the factories had codes of conduct, there were serious labour violations in the factories. The group argued that the toy companies' sourcing model itself, including low prices and "just in time production", was a root cause of the labour violations.<sup>125</sup>

These revelations were picked up early on by SRI as well, and in 2002 the ETI and UKSIF's *Just Pensions* released a brief entitled "Assessing Company Approaches to Labour Standards: Labour Standards for Investors". It was an early example of important questions that investors should ask companies about their supply chain management. The brief made specific reference to the following:

- ILO conventions
- Integration of supply chain labour standards compliance with buying practices
- Training of staff on ILS
- Dialogue with trade unions and NGOs
- Supply chain mapping
- Grievance procedures
- Going beyond first-tier supplier performance on ILS
- Auditors specifically trained in labour rights
- Public reporting on supply chains

<sup>124</sup> Stephanie Barrientos and Sally Smith, "ETI Code of Labour Practice: Do Workers Really Benefit?", Institute for Development Studies, October 2006

<sup>125</sup> Hong Kong Christian Industrial Committee, "How Hasbro, McDonald's, Mattel and Disney Manufacture Their Toys," December 2001.

- Independent scrutiny
- Collaboration among companies<sup>126</sup>

Social investors have been trying to ask these questions of companies for several years, but because only a handful of companies (mostly in footwear and apparel, electronics and retail) have progressed much on supply chain labour standards performance, response rates from companies are generally low. Furthermore, reporting on supply chain management is voluntary so social investors often have had to rely on spotty and incomplete data to evaluate corporate performance in this area. Social investors also have continued to push certain major companies each year just to get them to create internal vendor standards, which are considered *de minimus*. Nonetheless, labour and human rights organizations, many social investors, and a few companies have entered the “beyond compliance” generation.

Most fundamentally, there has been a realization for several years (again, with civil society organizations leading the charge) that the entire outsourcing model needs reexamining, as it seems to be an integral factor driving certain ILS violations. Certain industry-led groups have begun to join the debate, as well. For example, in mid-2007, the US-based Business for Social Responsibility launched an initiative, “Beyond Monitoring”, to address the root causes of social and environmental problems in global supply chains. In addition to multinational buyer companies, social investors are among the stakeholders involved in the initiative, whose work is centred on some of the points discussed in this section (buyer internal alignment, worker empowerment) as well as public sector engagement, which is touched on in section V.<sup>127</sup>

In moving beyond compliance, and beyond the tick-box exercise of supply chain auditing, labour rights groups and SRI look for indications that a company is making a good faith effort to address ILS in the supply chain. These can include the following indicators, some of which were already among the demands of NGOs and social investors over five years ago (as indicated, for example, by the above-mentioned ETI-*Just Pensions* brief):

- Examination of purchasing practices and how these can cause or exacerbate labour violations (for example, unrealistic delivery times, or frequent, last-minute changes to orders).<sup>128</sup>
- Worker grievance systems.
- Corporate intervention in labour-management disputes overseas (for example, a number of companies have sent open letters recently to government officials in Mexico and the Philippines expressing concern about crackdowns on worker organizing).

<sup>126</sup> Dan Rees, ETI, and Duncan Green, Just Pensions, “Assessing Company Approaches to Labour Standards: Labour Standards for Investors”, consultation draft, 2002. The author is grateful to Adam Ognall of UKSIF for pointing out this brief.

<sup>127</sup> See Business for Social Responsibility, “Beyond Monitoring: A New Vision for Sustainable Supply Chains”, July 5, 2007.

<sup>128</sup> In connection with this, see Appendix I on ICCR’s purchasing practices sub-group. ETI has also had a purchasing practices working group for several years.

- Engaging critics, including unions, NGOs and shareholders.
- Training buyer staff on ILS.
- Building trust through long-term relationships with suppliers.
- Training workers in labour rights so that they can monitor the shop floors themselves.

In fact, it is possible to distinguish certain emerging “good practices,” both within and among companies. Many of these, too, have been on labour rights groups’ radar screens for years, and were discussed in the ETI-*Just Pensions* brief:

- **Common codes of conduct**, specifically at **industry-level**: for example, the Electronic Industry Code of Conduct (EICC)<sup>129</sup>. These are multi-stakeholder efforts involving companies, NGOs, SRI and in some cases unions, to harmonize the approach to ILS in global supply chains. It is worth recalling the downsides, described above, to codes, but they are still considered an important first step to holding companies and their suppliers accountable for supply chain labour standards. The labour rights group Maquila Solidarity Network has recently stated that “the emergence of multi-stakeholder and industry code of conduct initiatives...has resulted in an upward harmonization of labour standards and greater consistency with international standards enshrined in ILO standards”. However, MSN also points out “significant inconsistencies” across these initiatives, and argues that industry initiatives are less stringent than those of multi-stakeholder groups.<sup>130</sup>
- In this vein, a few companies have called for “**brand collaboration**” on ILS (e.g. Nike, Timberland).
- In-depth, **independent evaluation** of corporate impact on supply chain labour standards: in 2005-2006, Nike provided access to a team of researchers from the Massachusetts Institute of Technology (MIT) to evaluate working conditions in several of the company’s supplier factories. Nike provided a link in its FY05-06 report to the team’s study, which was candid in its assessment of the “limited results” of monitoring, despite the resources Nike had expended on it over the years. Social investors and others welcomed the study as a step forward on transparency. But concerns remain about continued ILS violations in the company’s supply chain, and about the potential impact on working conditions of Nike’s switch to so-called “lean manufacturing”.<sup>131</sup>

<sup>129</sup> A common code adopted by major electronics companies and their suppliers.

<sup>130</sup> Maquila Solidarity Network, “Who’s Got the Universal Code?” MSN Codes Memo 23, April 2008, p. 12.

<sup>131</sup> See the Nike, “Innovate for a Better World: FY05-06 Corporate Responsibility Report”, [http://www.nike.com/nikebiz/nikeresponsibility/pdfs/color/Nike\\_FY05\\_06\\_CR\\_Report\\_C.pdf](http://www.nike.com/nikebiz/nikeresponsibility/pdfs/color/Nike_FY05_06_CR_Report_C.pdf) See also Richard Locke, Fei Qin and Alberto Brause, “Does Monitoring Improve Labour Standards? Lessons from Nike”, MIT Sloan Working Paper No. 4612-06, Massachusetts Institute of Technology, July 2006.

- **Transparency:** social investors are pushing companies to report more candidly on supply chain management, and are sitting on report review committees (see Appendix I) as part of the effort to raise the bar on reporting. It is worth noting here Nike’s disclosure in 2005 of its entire factory base, a move hailed by the ITGLWF as “groundbreaking”; only a few companies have followed suit.
- **Integration of buyers and compliance,** including through buyer training on ILS (e.g. Marks & Spencer). An interesting initiative is a buyers’ consultative forum spearheaded by the ILO, International Finance Corporation (IFC) and BSR, as part of the ILO-IFC joint Better Work program, a global initiative to assess labour standards compliance, provide training and build capacity at factory level. In September 2007, BSR was chosen to convene an international consultative forum for buyers to address working conditions.<sup>132</sup>
- **Bringing unions into the management** of supply chain labour standards: one example, cited in Section I, is that of the work between Gap and ITGLWF. In addition, in October 2007 Spanish retailer Inditex signed a framework agreement with the ITGLWF on upholding ILS in supply chains. The Ethical Trading Initiative (ETI) also brings together unions, companies and NGOs on supply chain labour standards.
- **Supplier training on ILS:** electronics companies such as Dell and Hewlett-Packard have been active in this area; social investors have monitored this process through direct participation in some of the trainings.
- Experimentation with **worker representation** in factories. This can be controversial, as some see it as a sidestepping of full freedom of association, particularly in countries where this right is suppressed.<sup>133</sup>
- **Worker involvement in social auditing:** for example, Timberland reported in 2007 that it was working with Verité, a non-profit organization specializing in ILS, on a project to involve factory workers in monitoring compliance with codes of conduct.<sup>134</sup>
- **Research on compliance and productivity.** There are ongoing studies by academics, companies, and NGOs to examine the relationship between labour standards compliance and productivity in factories.<sup>135</sup> To the extent

<sup>132</sup> The Better Work program was inspired by the ILO’s Better Factories Cambodia project. See “ILO, IFC Link with Business for Social Responsibility (BSR) to Promote Better Work in Global Supply Chains”, *CSR Wire*, September 25, 2007

<sup>133</sup> See for example, Lisa Roner, “North America Special Report: Workplace Rights – Supplier Labour Conditions – Giving Workers A Voice”, *Ethical Corporation*, May 1, 2007.

<sup>134</sup> See Timberland’s “2006 Corporate Social Responsibility Report”, August 2007, p. 28.

<sup>135</sup> See for example, Gap, Inc.’s 2004 Social Responsibility Report, “Facing Challenges, Finding Opportunities”; also Gap, Inc. website, “Examining Factory Operations – Impactt/HKPC Productivity Program Findings”, [www.gapinc.com/public/documents/impactt\\_hkpc\\_results.pdf](http://www.gapinc.com/public/documents/impactt_hkpc_results.pdf) ; Gap, Inc. website, “Examining Factory Operations – Tufts University Study Findings”, [www.gapinc.com/public/documents/tufts\\_study.pdf](http://www.gapinc.com/public/documents/tufts_study.pdf) ;

these findings strengthen the business case for ILS compliance, they could push companies forward. However, it is important also to underscore the ethical and legal – not just business case – reasons to uphold ILS.

- **De-emphasis on audits:** for example, the Fair Labour Association (FLA) is focusing less on audits and increasingly on capacity building in factories and assessing root causes of labour violations.<sup>136</sup>
- Connected to this, an incipient emphasis on **capacity building**, specifically buyer companies working to increase *local government capacity* to monitor labour conditions in factories.<sup>137</sup>
- **Lobbying:** corporate lobbying is sometimes referred to as the elephant in the room. While there are few examples of corporations publicly lobbying in favour of ILS protection, social investors increasingly expect companies to address their lobbying activities and how these influence social issues at both the national and international levels.

All of these are interesting developments, and some of them are promising. But there are major caveats:

- So far, relatively few companies are involved in a meaningful way in addressing ILS, some of them through labour-intensive, long-term dialogues with social investors. These efforts often do not extend to the industry level; where they do, there is potential for real change.
- All of the above are voluntary. While voluntary initiatives have their advantages, they tend to attract the companies that are already working on these problems, or are open to dialogue, leaving most other companies below the radar. Voluntary initiatives are also non-enforceable and can fall apart at any time.

To return to the business model question that opened this section: it is not clear that a few companies, along with social investors and NGOs, can push this debate to a tipping point. The question of pricing alone is a crucial one: the relentless drive in retail, for example, to sell things at lower and lower prices, which, as described earlier, manifests itself in ILS violations up the supply chain. And because low prices are supported – or even demanded – by the market (e.g. consumers and investors), they will continue to be an integral part of the business model, and thus continue exacerbating labour rights violations.

Impactt Ltd and AsRIA, “An SRI Perspective on the Impactt Overtime Project: Tackling Supply Chain Labour Issues”, September 2005; Impactt Ltd, “Changing Over Time”, December 2005; and Locke, Qin and Brause, op. cit. See also Center for International Private Enterprise and Social Accountability International, “From Words To Action: A Business Case for Implementing Workplace Standards”, February 2009.

<sup>136</sup> See [http://www.fairlabour.org/about/fla\\_30\\_-\\_toward\\_sustainable\\_compliance](http://www.fairlabour.org/about/fla_30_-_toward_sustainable_compliance). This is part of FLA 3.0, or its “third generation”.

<sup>137</sup> See Global CSR “Business and Human Rights” Newsletter #10, September 2008, p. 6. Global CSR, a Danish consultancy, discusses in particular ILO’s Better Factories Cambodia program as an example in which buyer companies work not only with suppliers but also with local inspectorates to improve monitoring capacity. They refer to this as “Supply Chain Management 3.0”, beyond codes of conduct or even multi-stakeholder, common initiatives; it calls to mind FLA 3.0 referred to above.

SRI practitioners will continue to struggle with these questions, and their thinking will continue to evolve, in collaboration with NGOs, labour unions, and companies themselves, on how to respond to these challenges.

## 3.2 Labour Vs. other issues: how and why take-up differs

While there seems to be little formal research on the question of whether it is harder to get investors to focus on labour than on other issues, a discussion of the key challenges surrounding the incorporation of labour considerations into investment sheds some light on the issue.<sup>138</sup>

There are several explanations for why evaluation of corporate performance on ILS differs from that of other areas that social investors care about. These include the difficulties of data collection and interpretation, and the comparative ease with which other areas (such as environment) can be quantified and shown to represent economic risk or opportunity for companies. This section looks at several of these challenges to incorporating labour into investment decision making, and then at how social investors and others are addressing – or could address – these.

### 3.2.1 Data collection and interpretation

As a starting point, it is not so much a question of defining labour standards as it is of implementing them,<sup>139</sup> a point on which both companies and countries fall short<sup>140</sup>. Sometimes investor groups across different regions choose to emphasize different aspects of labour standards: for example, within the core convention of non-discrimination in the workplace, social investors in the U.S. have put substantial effort into eliminating discrimination based on sexual orientation. That particular aspect of non-discrimination is not well developed among social investors in many other regions of the world. However, as section I underscored, there seems to be a general consensus among SRI practitioners about the importance of core ILS.

A company's performance on ILS is often interpreted in relation to its global supply chain. While there seems to be broad agreement across SRI on the main ILS issues to measure (core ILO conventions, plus wages and hours, safety and health, and in some cases

<sup>138</sup> In late 2008, as this paper was being readied for publication, Aaron Bernstein of Harvard Law School's Labour and Worklife Program published an Occasional Paper entitled "Incorporating Labour and Human Rights Risk into Investment Decisions" (September 2008), available at: [http://www.law.harvard.edu/programs/lwp/pensions/publications/occasional\\_paper2.pdf](http://www.law.harvard.edu/programs/lwp/pensions/publications/occasional_paper2.pdf). The paper discusses the fact that investors face particular difficulties in assessing labour and human rights risks because of "lack of objective and quantitative data about corporate activities in these areas," (p. 1) and suggests some ways to address this.

<sup>139</sup> This point is underscored in a recent joint publication by the International Business Leaders Forum and the International Finance Corporation, *Guide to Human Rights Impact Assessment and Management: Road-Testing Draft*, June 2007, pp. 73-74.

<sup>140</sup> See Poulomi Mrinal Saha, "The Ethical Index Performance Challenge", *Ethical Corporation*, June 21, 2005. See also Carol Pier, "Discounting Rights: Wal-Mart's Violation of US Workers' Right to Freedom of Association", Human Rights Watch, May 2007. The report argued that the U.S. has failed to uphold the international right to freedom of association, and thus has "opened the door" for employers like Wal-Mart to "violate their employees' basic rights with virtual impunity" (Summary, p. 1).



benefits), both quantitative and qualitative data in these areas are often scarce, spotty and/or not standardized.

When dealing with companies' overseas operations, scarcity and lack of consistent data can also be a problem for other issues that social investors care about (e.g. environment, community relations). And as companies expand their global operations, and investors' interest in emerging market companies grows, this challenge will follow all areas of corporate performance.

For data points on supply chain labour standards, specific challenges include:

- the notoriously high turnover of workers in overseas factories producing for companies with global supply chains means year-on-year data on working conditions, if reported at all, say less about how the workforce is treated than the data would if that workforce were more stable.
- the kind of monitoring generally carried out does not capture the most egregious violations, and often provides only a snapshot of labour conditions on any given day.
- as touched on earlier, there is a major problem with falsified data from factory inspections and cover-ups.
- even where there might be standardized indicators across regions, for example, on worker health and safety, if regulatory systems are weak and corporate reporting is not mandatory, it has fallen in many cases to NGOs or labour unions to collect data where they can. Resource constraints and lack of access to supply chain factories are among the obstacles to third-party data collection.

there is no harmonized system of evaluating or interpreting performance on ILS, even where consistent raw data are collected. For example, what constitutes a “minor” controversy in connection with freedom of association in the supply chain versus a “major” one? Does this differ from one country to the next? What is a reasonable indicator or “data point” on freedom of association?

For these reasons and others, after years of practice, even the reports of so-called “leaders” on supply chain management reporting (e.g. Nike, Gap) do not necessarily tell us how workers are faring.

Social investors and ratings agencies commonly gather ILS data from the following sources:

- reports by NGOs, labour unions, or researchers in the field
- direct communication with such parties
- company public documents
- direct communication with companies
- press accounts
- government documents (if a host government investigates a particular case, for example, and reports on it publicly)

In rare cases (e.g. the Norwegian Pension Fund’s Council on Ethics; see Appendix II), a large investor might make a field visit to verify labour conditions or allegations of violations. But in general, social investment research has relied on others to do primary research. The level of reliability of others’ research can vary. Social investors tend to consider major rights organizations (Oxfam, Amnesty International, Human Rights Watch, Clean Clothes Campaign) and their field partners to be reliable sources of information, and are increasingly working with these groups either bilaterally or in multi-stakeholder initiatives to address issues of mutual concern, such as ongoing serious labour rights violations in global supply chains. This kind of work can increase the level of trust between the parties, and facilitate exchange of information.

In 2006, ILO commissioned the Association for Independent Corporate Sustainability and Responsibility Research (Ethibel) to undertake a survey of practitioners to understand better which indicators SRI researchers are using concerning labour rights. The Ethibel survey shows that SRI research analysts, drawing on the work of labour rights activists and experts over the years, have constructed extensive sets of indicators to evaluate companies on labour standards. Some of them focus on policies over performance; others, vice versa. Some ratings agencies use a point system; some use qualitative grades (best – medium – low); some use systems based on indicators; others use a “Conventions conformity approach”<sup>141</sup>, in which they focus on press coverage of breaches of ILO conventions. Indicators range from those directly relevant to global supply chain management (e.g. code of conduct), to those also relevant to domestic or direct employees (e.g. job creation in Europe), to those that are applicable only to the latter (e.g. career management, internal promotion rate).

Lack of corporate reporting and lack of a common approach are two reasons that a number of these indicators remain aspirational, while others may be well covered but only for a handful of companies. For instance, according to the Ethibel survey, some SRI ratings agencies ask companies whether they have a formal policy statement on minimum living wages. This is an important question, as a living wage is a fundamental element of a decent workplace. But the question itself, like many in the area of ILS, generally focuses on *policy*, as it is very difficult to measure a company’s *performance* on this issue across its global supply chain. Anything we might know about performance in this area is largely from negative stories by third parties.

Similarly, if the researcher uses the “Convention conformity approach”, a company is judged “compliant” on ILS unless there are stories in the public domain on non-compliance. This is highly unsatisfactory from the social investor’s perspective of needing reasonable information to evaluate and compare companies, since there are scarce resources to probe which companies are non-compliant and, as a result, many companies pass muster simply by staying out of the press.

On the flip side, positive performance on ILS – as opposed to a lack of negative stories (which one could perhaps call “neutral” performance) – can be harder to determine than for other areas that SRI tracks. For example, on diversity, companies in the U.S. must disclose certain data on inclusiveness in the workplace. Social investors therefore need not look solely at controversies in the area of employee diversity (or lack thereof) but rather can use the public record to find reliable positive data.

<sup>141</sup> Association for Independent Corporate Sustainability & Responsibility Research (AICSRR), “Labour Indicators Used in Socially Responsible Investment”, research project for the ILO, November 2005, and telephone interview with Herwig Peeters, chair, AICSRR, October 25, 2007.

These difficulties do not mean that some of the raw data on supply chain labour standards are not useful: they can be. But for the moment, social investors and their counterparts in the labour rights community – as well as companies – are struggling to define and standardize indicators that are meaningful in measuring corporate impact on worker rights. And these difficulties have led to a tendency to look more at systems and structures than at performance. Where there is relatively robust research on a company’s ILS program, dialogue and shareholder resolutions can be helpful, as they can focus on specific areas of concern. But where information is vague or general (“Company has a policy”), investors and research providers must start from the basics.<sup>142</sup>

For some institutional investors, therefore, “integration” of labour considerations means simply checking that a company has a policy that makes explicit reference to ILO core standards, or implicit reference, for example, via implementing the ILO MNE Declaration, OECD Guidelines or the Global Compact, and perhaps a system to monitor its application (with all the weaknesses of such systems outlined earlier in this section). The challenge is how actually to evaluate a company’s performance on ILS, since adoption of a policy is a necessary first step but often meaningless in practice.

This situation also explains why, even in 2008, many shareholder resolutions still call on companies to establish labour codes of conduct or vendor standards, although the dialogue between SRI and a number of large companies has moved well beyond this, as the above discussion on “beyond monitoring” shows.

### 3.2.2 *Rights of direct and indirect employees*

It is worth noting that, although they are not always seen in this way, ILS apply not only to global supply chain operations but also to direct employees and domestic supply chain operations (for example, relations with domestic trade unions, or discrimination in the workplace). But in practice, the evaluation of corporate performance on worker rights has been split into that relating to domestic, or at least direct, employees (sometimes labelled “employee relations” or “workplace”) and that relating to global supply chains (more commonly associated with ILS.) Information on the former is often easier to collect, in part because in some cases companies themselves are required to gather and report on at least some of those data domestically.<sup>143</sup>

It is possible to delineate between performance on supply chain management and treatment of direct employees, but these lines will become blurred with increased outsourcing and pressure on companies to take responsibility for ILS in their supply chains. The division in interpretation seems to imply that these are somehow different sets of rights, and that the rights of direct employees are more important, relevant or “material” to a company, but this is a false dichotomy.

<sup>142</sup> For example, CentreInfo, a Swiss-based SRI research provider, studied 1673 companies from 23 countries. Only 6% of the companies had a “formal, clear and detailed policy on freedom of association and right to collective bargaining”. Philippe Spicher, “Human Rights – Best Practice in Mainstream Investment Decisions?”, in *Human Security and Business*, eds. Benjamin K. Leisinger and Marc Probst; Rüffer and Rub, Switzerland, 2007, pp. 153-4.

<sup>143</sup> Investors use different terms to describe various aspects of worker rights (“labour relations” might be used to describe labour-management relations, while supply chain labour standards are often defined as a “human rights” issue; and employee diversity issues are sometimes described generally as falling under “employment” or “workplace” issues).

In a related vein, the so-called “sphere of influence” presents a challenge. Although it is increasingly unacceptable for companies to claim that supply chain workers are outside their sphere of influence, a double standard still prevails in comparison to other areas of corporate social and environmental impact. It is evident, for example, that a company’s impact on consumer safety captures the attention of the public – and the company – more easily than the does the welfare of supply chain workers.

This was brought home in the summer of 2007, when public and government concern in Europe and the U.S. erupted over the revelation of lead paint and unsafe magnets in toys made for export in China. One generally did not hear companies claiming that they could do nothing about product safety measures upstream in their supply chains; the double threat of heightened government regulation and potential lawsuits by angry parents loomed large, and companies promised to do all they could to eliminate lapses in product safety. But there were very few voices reminding the public, the companies and the governments that lead paint and other aspects of toy production were harmful to *supply chain workers*, not just to children using the toys.<sup>144</sup> Social investors, however, were among those few voices, and not long after the story broke they pressed companies on that very point. In this case, they were able to use product safety to bring attention to ILS.<sup>145</sup>

### 3.2.3 *Economic risks and opportunities*

Another difference between the evaluation and take-up of labour issues in comparison to other issues has more to do with the nature of those other issue areas: specifically, that a number of them are viewed increasingly through the lens of the business case, or even that of national security and the well-being of future generations.

#### *Lessons from Environmental assessment*

Environmental issues are perhaps the best example of an ESG issue with rapid uptake in the last few years. Within the private sector, the environment is increasingly seen as both a clear risk factor for companies (tightening regulations, climate change risk) and a source of opportunity (energy efficiency savings, profits from new “green” products). This is a complex phenomenon that is outside the scope of this paper, but it can be explained in part by the growing global awareness about climate change; increasing alarm about pollution levels in China and other countries experiencing rapid development; and geopolitical developments such as the war in Iraq and the rising price of oil, which have helped drive the debate on energy dependence and national security. Adding to this momentum were the delivery of the high-profile Stern Review on the Economics of Climate Change to the UK government in 2006 and Al Gore’s Nobel Prize in 2007.

A brief look at recent initiatives and news stories on the environment, some of them involving SRI directly, sheds light on the continued and growing interest in the issue within the investor community.

Carbon Disclosure Project: a not-for-profit group that aims to join shareholders and corporations in a dialogue on climate change. Institutional investor members represent \$57

<sup>144</sup> Elizabeth Umlas, “Product Safety Vs Worker Rights: The Double Standard in International Supply Chains”, KLD blog, July 5, 2007, <http://blog.kld.com/supply-chain-management/product-safety-vs-worker-rights-the-double-standard-in-international-supply-chains/>

<sup>145</sup> Anne Moore Odell, “Making Toys Is Not Child’s Play”, *SRI News Alerts*, SocialFunds.com, November 14, 2007.

trillion of assets under management. According to the CDP website, the organization works on behalf of these investors to gather climate change and greenhouse gas emissions data from large companies and to disseminate information on related “business risks and opportunities”<sup>146</sup> The CDP benefits from the association of such high-profile figures as former US president Bill Clinton, who spoke at the September 2007 UN Climate Change Conference, “exhorting the corporate audience to see the profit potential in going green”.<sup>147</sup> CDP is a growing force for pressuring companies to measure and disclose their environmental impact.

Institutional investors in the U.S., including state pension funds, have joined the Investor Network on Climate Risk (INCR). In September 2007, US institutional investors, including pension funds and environmental NGOs, petitioned the Securities and Exchange Commission (SEC) to require companies to disclose potential risks to their profits from climate change.

The same month, New York state attorney general Andrew Cuomo subpoenaed five major energy companies to gather information on whether their proposed coal-fired power plants carried “undisclosed financial risks” for investors.<sup>148</sup>

The US Climate Action Partnership (USCAP) joins corporations and environmental organizations in calling on the US government to create legislation capping greenhouse gas emissions ([www.us-cap.org](http://www.us-cap.org)). In comparison, it would be unusual to see corporations pushing for government regulations in other areas of social investor concern, such as diversity, labour rights or corporate governance.

In a similar vein, in October 2007 several large European and US companies formed a group called the Supply Chain Leadership Coalition to push suppliers to report on their level of greenhouse gas emissions. The *Wall Street Journal* reported that the initiative “comes amid growing concern that stricter climate change laws could drive up costs for businesses”. The same article noted that two weeks earlier, Wal-Mart had said it would ask suppliers for energy efficiency data, “in partnership with the CDP.”<sup>149</sup> While there have been examples of corporations joining together to address concerns over labour violations in their supply chains, those initiatives have been plagued by the kinds of data challenges discussed above, and companies have also claimed that there may be anti-trust implications if they group together to push suppliers on certain issues that could be related to labour conditions, such as pricing.

UNPRI reported in 2007 on the participation of signatories in issue-related engagement. None of the initiatives were labour-related per se, and the environment seemed to get the lion’s share of investor engagement (Carbon Disclosure Project, Institutional Investors Group on Climate Change, etc).<sup>150</sup> This could be changing, however,

<sup>146</sup> <http://www.cdproject.net/whatiscdp.asp> Accessed September 12, 2008

<sup>147</sup> Elisabeth Rosenthal, “What Color Is a US Dollar Bill?” *The International Herald Tribune*, September 27, 2007.

<sup>148</sup> Felicity Barringer and Danny Hakim, “New York Subpoenas 5 Energy Companies”, *New York Times*, September 16, 2007.

<sup>149</sup> Jane Spencer, “Big Firms to Press Suppliers On Climate”, *Wall Street Journal*, October 9, 2007.

<sup>150</sup> UNEP-FI and Global Compact, “PRI Report on Progress 2007”, op. cit., p. 31.

as the UNPRI's Engagement Clearinghouse (see Appendix I) has begun to help investors address ILS-related issues.

It is difficult to think of equivalent, ILS-related examples to most of the above initiatives, and labour-related risks have not been defined in such sweeping terms as those used to talk about global warming. As Schilling has aptly put it, a "Labour Rights Disclosure Project" would not succeed in the same way the Carbon Disclosure Project has. Further, once people realize that climate change affects their grandchildren, the "visceral connection is made", and freedom of association for workers "doesn't have that resonance".<sup>151</sup>

Proponents of these environmental initiatives are also aided by being able to make clear financial arguments (both positive and negative) about corporate environmental impact, particularly in relation to climate change, and by the progress being made in measuring and quantifying these impacts. For example, the headline of a recent press clip from SustainableBusiness.com underscores the financial motivation behind investor interest in environmental issues: "Morgan Stanley, Deutsche Bank Call Green Business \$1 trillion Mega-Market".<sup>152</sup>

One study on SRI engagement on ILS notes that for some industries, such as general retailers, "issues such as food miles (as opposed to supply chain labour standards), where it is potentially easier to quantify materiality, is where the SRI community will get the easy wins with the mainstream".<sup>153</sup>

Further, insurance and reinsurance companies have taken a particular interest in climate change because of the related risks connected to changing weather patterns, which further drives efforts to measure and report on corporate environmental impact (though it is worth noting that reporting on environment is not yet standardized, either).<sup>154</sup>

As outlined earlier, labour and human rights issues can be harder to quantify – and "monetize", as one SRI expert has put it – than are many environmental and corporate governance issues.<sup>155</sup> To give two examples: the market for quantifying and measuring a company's environmental "footprint" – including greenhouse gas emissions – is expanding and capturing the attention of investors, companies, banks and insurers alike, not to mention the public. And with governance issues such as executive compensation and board independence, investors can often easily frame these in terms of the financial consequences of company behaviour, or at least argue in terms of long-term "shareholder value".

<sup>151</sup> Interview of Schilling, *op. cit.*

<sup>152</sup> SustainableBusiness.com, "Morgan Stanley, Deutsche Bank Call Green Business \$1 trillion Mega-Market", October 18, 2007.

<sup>153</sup> Cassandra Higgs, "An Assessment of SRI Engagement: A Study on Supply Chain Labour Standards", Just Pensions, December 2005, p. 7.

<sup>154</sup> For example, Michelle Chan-Fishel of the Green Investments Program of Friends of the Earth, who conducted research for the investor/ENGO petition to the SEC in 2007, noted that "disclosure rates [on climate change impacts] are improving...but it's a question of reporting. There's a lot of variance. Investors need to receive information in a format that is consistent and accurate". Michelle Chan-Fishel cited in Francesca Rheannon, "Investors, States and Activists Petition SEC to Mandate Climate Risk Disclosure", *SRI News Alerts*, SocialFunds.com, October 8, 2007.

<sup>155</sup> The expert, from an asset management firm, was a participant at the UN PRI conference, "PRI in Person 2007", in Geneva, July 3-4, 2007.

The above points notwithstanding, ILS evaluation has the advantage of being based, for many social investors (and companies) on a set of standards, namely the ILO core conventions, around which there is significant consensus. The fact that those conventions are increasingly taken as a starting point for corporate performance on ILS provides a foundation on which to conduct research and evaluation.

The challenges emerge because, as the previous section notes, it is a large step from a core convention to the definition of indicators on which to measure performance on these conventions. As one key SRI figure has noted, when those in SRI talk about ILS, they are referring primarily to the ILO core conventions, but knowledge of these is not “deeply embedded” within either SRI or companies. However, he also points out that this knowledge rises where SRI engages with unions.<sup>156</sup>

Finally, it is important to point out that there are situations where there just might not be a business case for companies to uphold labour rights. As three SRI practitioners writing in the *Financial Times* in 2006 asked provocatively:

“Imagine a company that tolerates massive child labour in a remote developing world mining village. Suppose that, for whatever reason, it is unknown to the rest of the world. Should we really not care, just because it doesn't happen to impact the bottom line?”<sup>157</sup>

In other words, rights such as those enshrined in ILS should be upheld regardless of the business case. But this is a hard argument to make in the context of finance and investment, where economic risks and opportunities are the central focus.

### 3.3 Looking Ahead

There are possible ways forward on at least some of these challenges.

#### 3.3.1 *Strengthening supply chain reporting.*

With some exceptions, supply chain management reports often fail to reveal the real impact on worker rights. As key players such as trade unions, labour rights NGOs, SRI and corporations advance in their ability to measure corporate impact on ILS through better and more revealing indicators, it will become more feasible to evaluate and compare companies on their performance in this area. This will come in part through more comparable reporting and evaluation frameworks. It will also come through **collaborative work** in this area, of which there are interesting examples:

- The UN Special Representative on Business and Human Rights (SRSG), John Ruggie, announced in 2007 that he and the labour rights group Clean Clothes Campaign (CCC) would collaborate to clarify how to implement supply chain codes of conduct effectively.<sup>158</sup> This is an initiative to watch,

<sup>156</sup> Interview of Schilling, op. cit.

<sup>157</sup> Christoph Butz, Stephen Barber, and Jean Laville, “Time for a Rethink on Responsible Investing”, *Financial Times*, November 13, 2007.

<sup>158</sup> “SRSG and Clean Clothes Campaign Collaborate”, October 1, 2007. <http://www.business-humanrights.org/Documents/Ruggie-Clean-Clothes-Campaign-announcement-1-Oct-2007.pdf>

as CCC has extensive field experience on the issue, and the SRSG has the ear of at least some of the business world and certain governments.

- Unions and companies: it is worth watching the collaborative initiative between Gap, Inc. and the ITGLWF, mentioned in section I, whose aim is to bring unions into the assessment of supply chain working conditions.
- In a slightly different vein, there have been recent examples of efforts at direct engagement of SRI by human rights and labour rights groups on ILS-related issues. For example, Human Rights Watch sent an open letter to FTSE4Good in August 2007, asking it to review its inclusion of Smithfield Foods on its index, given Smithfield's poor record on upholding US labour laws.<sup>159</sup> In July 2007, the US union International Brotherhood of Teamsters released a report criticizing the labour rights record of Cummins, Inc., and called on SRI firms to remove the company "from their lists of approved companies unless and until Cummins stops and remedies its violations of workers' collective bargaining rights".<sup>160</sup> As a result of the report, the Teamsters began a dialogue with the SRI community. And in December 2008, SRI research firm Vigeo and UNI Global Union signed an agreement whereby UNI would provide Vigeo with data and commentary on companies in relation to labor issues.<sup>161</sup> These examples could herald a new form of direct and public dialogue between SRI, human rights groups and organized labour on the issue of ILS and what constitutes a "socially responsible company."
- The Global Reporting Initiative (GRI) seeks to create a framework for standardized and comparable reporting on environmental and social performance. Challenges remain: for example, in creating indicators that accurately capture a corporation's labour rights performance, and in presenting a framework that is "user-friendly" for all. The initiative is a work in progress, but standardized reporting remains an important tool for SRI.

### 3.3.2 *Improve coordination*

**Improve coordination** between proponents of ILS and others. The take-up of ILS could benefit from social investors – and those working for "worker-friendly investment" – forming **cross-cutting alliances** with those working on non-labour-related issues. There are signs that SRI, labour rights groups and companies themselves are increasingly looking at the connections between environment and supply chain labour rights, and between the latter and product safety. Examples include:

- ICCR working groups on both ILS and environment have begun to look at the overlap between their areas of work. Companies themselves also are

<sup>159</sup> Arvind Ganesan, Director, Business and Human Rights Program, Human Rights Watch, Letter to FTSE Group, August 21, 2007.

<sup>160</sup> Lance Compa, "Every Abuse - Violations of International Labour Standards by Cummins: The Manipulation of Corporate Governance to De-Unionize Its American Workforce", report commissioned by the International Brotherhood of Teamsters, July 2007, p. 4.

<sup>161</sup> Vigeo and UNI, "Accord de partenariat entre UNI et VIGEO », press release, 12 December 2008.



starting to look at environmental issues in supply chains, sometimes in the same framework as that of labour standards compliance (for example, Nike is examining hazardous waste in its supply chain, although it is not clear how much the company is integrating the two).<sup>162</sup>

- As described above, ICCR members used the toy recalls of 2007 to bring attention to worker safety and worker rights in the supply chains producing these products, thus showing how the incorporation of ILS can be bolstered by existing investor (and consumer) concern about product safety and other issues. For example, social investors have strengthened ties with groups such as the Investor Environmental Health Network (IEHN).
- The AFL-CIO is working with environmental NGOs to increase investment in sustainable energy projects that also create jobs for its union members.<sup>163</sup>

### 3.3.3 *Boosting corporate response rate*

Boosting corporate response rate to inquiries on social and environmental issues. This might begin to happen as institutional investors such as major pension funds demonstrate their own incorporation of these issues. The Norwegian Government Pension Fund's divestment of Wal-Mart in 2006 due to labour rights violations in the company's supply chain was a strong signal to industry that these issues matter to large investors. Before divesting, the Fund gave Wal-Mart an opportunity to engage in dialogue regarding the alleged labour violations, but the company did not respond, a fact made public after the divestment.<sup>164</sup> In the future, this kind of high-profile, negative publicity and direct, public pressure from a big player could conceivably bring up company response rates on how they are handling ILS in their operations. (For more information on the functioning of the Ethics Council of the Norwegian Government Pension Fund - Global, see Appendix II.)

In general, major public pension funds are increasingly incorporating ESG factors into their investment decisions (see Section I). A number of these funds (e.g. CalPERs, Previ) have traditionally focused on corporate governance issues,<sup>165</sup> but to the degree that they extend their evaluation to social and environmental factors, labour standards can be expected to grow in importance in their decision-making. Garcia cites pension funds such as the Second Swedish National Pension Fund (AP2) and CalPERs as examples of major public pension funds explicitly incorporating labour standards into their policies.<sup>166</sup>

<sup>162</sup> See, for example, Nike's FY05-06 CR Report, <http://www.nikeresponsibility.com/#crreport/main>

<sup>163</sup> Telephone interview of Billenness, op. cit.

<sup>164</sup> Bill Baue, "Norwegian Government Pension Funds Dumps Wal-Mart and Freeport on Ethical Exclusions", *SRI News Alerts*, SocialFunds.com, June 16, 2006.

<sup>165</sup> UNEP-FI and UKSIF, "Responsible Investment in Focus: How Leading Public Pension Funds Are Meeting The Challenge", 2007.

<sup>166</sup> Garcia, "A Turning Tide", op. cit., pp. 15-17.

### 3.3.3 *The business case for ILS:*

Several research and evaluation projects are underway, involving companies, NGOs, academics and organized labour, to evaluate the relationship between labour standards compliance and productivity. Some of these have generated preliminary results suggesting a link between better ILS compliance and increasing productivity, but more research is needed.<sup>167</sup> Positive results could bolster the case for upholding ILS.

An interesting example of the business case for human rights comes from a recent study by World Resources Institute (WRI), “Development Without Conflict: The Business Case for Community Consent”. Using four case studies from around the world, the report makes a strong financial case for gaining community consent in large-scale development projects. Such studies may hold lessons for ILS, though as noted earlier, it is important not to rely solely on the business case for ILS, as one can certainly point to cases where a company has done better financially by violating labour rights than by upholding them, an outcome that is the opposite of what SRI – and its allies – are striving for.

<sup>167</sup> See the examples cited in footnote 136.

## 4 Impact of investment practices on corporate behaviour

### 4.1 Changing views

“Fund managers have many anecdotal examples of the positive results of engagement, but systematic evidence of their effectiveness is very limited”.<sup>168</sup>

There is not much formal research on how SRI practices affect company behaviour, and it is generally tricky to ascribe a change in corporate behaviour to the actions of one particular actor, such as investors, as change is often the result of several influences reaching a critical mass of pressure on a company.

However, social investors have clearly been among these important sources of influence in numerous cases. Further, companies have become increasingly aware of the influence of SRI and have sought out social investors on a number of levels. This section looks at some examples.

In their 2006 edited volume, *Responsible Investment*, Rory Sullivan and Craig MacKenzie included several case studies on shareholder activism and how it can affect company behaviour. The cases show where investors “contributed to” better company “policies, management systems and disclosures”,<sup>169</sup> but they do not touch on company performance on ILS *per se*.

In the same book, an expert on business and human rights from Amnesty International concludes candidly that while SRI has been one driver of change, NGOs would more likely view SRI as an “amplifier” of NGO concerns.<sup>170</sup>

As noted earlier in this paper, SRI analysts and social investors have often taken their cue from rights groups and other civil society organizations on the ground who are also striving to monitor and evaluate corporate social and environmental impact. On one level, this involves SRI “pushing the envelope” by asking companies questions that, if answered properly, could help flesh out important indicators on performance. Even if some questions are beyond what a company is prepared or able to answer, the act of asking in itself can have, and has had, an effect on companies. This is evident from the fact that, as some companies are turning increasingly to SRI to clarify what social investors want to know, these questions get registered as important (see Box 6).

<sup>168</sup> Powdrill, “Workers’ Capital...”, op. cit., p. 270.

<sup>169</sup> Rory Sullivan and Craig MacKenzie, “The Practice of Responsible Investment”, op. cit. p. 331.

<sup>170</sup> Frankental, “Why Socially Responsible Investment...”, op. cit., p. 241.

## Box 6

### Questions to companies

SRI analysts' and social investors' asking questions of companies may help lead to change: this is one of the premises behind the ICCR Purchasing Practices Working Group described in Appendix I. In targeting industry leaders with focused questions – themselves the result of research and interviews with ILS experts – the group expects to raise awareness of the effect of purchasing practices on factory working conditions. The group hopes that its findings will bolster efforts of companies already working on the issue, and act as a lever to influence more broadly those industries that rely on global supply chains but have not yet made the link between procurement processes and labour conditions in manufacturing.<sup>1</sup>

On this point, UKSIF's *Just Pensions* published a brief in December 2005 (for which the author was interviewed), assessing SRI engagement around supply chain labour standards. A company representative interviewed for the brief emphasized that it was important for investors to ask questions that companies might not be able to answer at present, so that “the questions would get [the issue] onto our radar screens”.<sup>171</sup>

*Just Pensions* also concluded that effective practice included SRI analysts working “collaboratively with their mainstream colleagues and other stakeholders to push for systemic change...to tackle endemic supply chain labour standards abuses”.<sup>172</sup>

Against this backdrop, below are some examples of the impact of investment practices on company behaviour:

- **Report Review Committees (RRC)** (see Appendix I): a handful of companies, particularly those implicated in supply chain labour controversies in previous years, have begun to institutionalize their consultation of stakeholders, including investors, around CSR reporting. Nike and Gap have done this through stand-alone RRCs; Timberland, McDonald's and others through “stakeholder teams” organized by Ceres, a U.S.-based coalition of investors, environmental organizations and public interest groups that work with companies on issues of sustainability in capital markets. In seeking feedback on their reporting, companies are reacting to the growing demand for better CSR reporting in general, and the expanding efforts of various shareholders to measure and evaluate corporate performance in areas such as ILS in particular. As of 2007, 40-50 companies had ongoing Ceres stakeholder teams.<sup>173</sup>
- **Indexes:** companies are sometimes responsive to SRI firms when threatened with removal from indexes maintained by these firms. There are clear instances in which companies have agreed to enter into dialogue with a research firm about a particular issue of concern when

<sup>171</sup> Higgs, “An Assessment of SRI Engagement”, op. cit., p. 10.

<sup>172</sup> *Ibid.*, p. 11, emphasis added.

<sup>173</sup> Email communication from Beth Ginsberg Holzman, Manager, Corporate Accountability Program, Ceres, December 8, 2007.

an index decision was on the line. In theory, ESG indexes provide an incentive to companies to improve their performance.<sup>174</sup>

- **Shareholder resolutions and engagement:** shareholder resolutions are not binding on companies in the U.S., but sometimes the mere possibility of a resolution going to a vote has motivated companies to enter into dialogue with shareholders, who may then decide to withdraw the resolution. In a few cases, shareholders have filed resolutions repeatedly, and some eventually succeed in having an impact on company behaviour. (For example, after several years of shareholder resolutions on both equal employment opportunity and sustainability reporting, Wal-Mart published a Diversity Report in 2006 and a sustainability report in 2007. The resolutions were only one source of pressure, albeit an important and consistent one.)
- It is worth noting a fundamental difference between the U.S. and the UK: Sullivan and MacKenzie have pointed out that US institutional investors, especially faith-based groups, “have been very effective at using proxy resolutions to encourage companies to respond” on issues including international labour standards in supply chains. In Europe, “this kind of religious, shareholder resolution-based activism has not been popular, due perhaps to the smaller scale of religious assets and the significantly greater obstacles in filing shareholder resolutions”. And yet, mainstream institutional investors have also “undertaken a significant body of shareholder activism” on social and environmental issues since the late 1990s<sup>175</sup> (see for example the actions of CalPERS).
- Resolutions are only one strategy, and shareholder voting “is generally seen as being most effective in the context of a range of other activities.”<sup>176</sup> See Box 7 for more.

<sup>174</sup> Sullivan and MacKenzie, “The Practice of Responsible Investment”, op. cit., p. 336, and Will Oulton, “The Role of Activism in Responsible Investment”, in Sullivan and MacKenzie, *Responsible Investment*, op. cit., pp. 196-205.

<sup>175</sup> Sullivan and MacKenzie, “Shareholder Activism on Social, Ethical and Environmental Issues” in *Ibid*, p. 153-4.

<sup>176</sup> *Ibid*, p. 155.

## Box 7

### Labour-related shareholder resolutions: an example

An interesting example of a labour-related shareholder resolution that joined US and UK players involved the British international transport company FirstGroup Plc. In 2006, the Service Employees International Union (SEIU) and the International Brotherhood of Teamsters, both US-based unions, came to the UK to speak with investors about labour-related concerns regarding FirstGroup Plc's US subsidiary, First Student. The unions formed a coalition with the aim of filing a shareholder resolution asking the company to create a workplace human rights policy to address these concerns.

Filers included an SEIU pension fund, the Trades Union Congress pension fund, the large British institutional investor Cooperative Insurance Society, and over 100 unionised members of FirstGroup who owned company shares. The level of support plus abstentions for the vote was approximately 15% at FirstGroup's 2006 annual general meeting, considered a large percentage for a non-corporate governance-related resolution in the UK.

The resolution was also only the second labour-related shareholder resolution in UK history, adding to its significance. Although the resolution was filed again in 2007 and received a lower percentage, the company agreed to take several steps to address labour concerns at First Student, including setting up a whistle-blower hotline for complaints related to anti-union behaviour and hiring consultants to monitor how FirstGroup manages industrial relations at First Student.<sup>177</sup>

The role of Cooperative Insurance was, in one participant's view, crucial because it is an institutional investor, and because of the high threshold to filing resolutions in the UK.<sup>178</sup> The campaign demonstrated the potential for collaboration both between unions and investors, and across players located in different countries. It was also the "relative success" of the campaign that led the SEIU to place a full-time liaison in the UK to strengthen relationships with the SRI community in the UK and Europe.<sup>179</sup>

## 4.2 Impacts on Share Prices

There is not much solid evidence of companies whose stock price drops were tied directly to behaviour in relation to ILS controversies. Anecdotally, Nike, Gap, Inc. and a few others have been cited in this context, but it can be difficult to tie stock price movements to a single controversy such as a sweatshop exposé.

For example, Vogel has noted:

Nike's labour practices made the giant sporting goods company a target of boycotts, and its sales appear to have suffered owing to controversy over its labour practices though it is unclear by how much...Typically, even high-profile protests have only negligible financial impact...More recent protests have failed to hurt sales at the Gap, Disney, Ford, or WalMart – or for that matter, sales of SUVs. And even when boycotts have an impact, it is usually short-lived.<sup>180</sup>

<sup>177</sup> This account of the FirstGroup campaign is drawn primarily from a telephone interview of Tom Powdrill, Head of Communications, PIRC Ltd., December 10, 2007. Powdrill was closely involved in the campaign.

<sup>178</sup> Ibid and email correspondence from Powdrill, December 6, 2007.

<sup>179</sup> Telephone interview of Laslett, op. cit.

<sup>180</sup> David Vogel, "Social Cause", in *Economic Times* (India), September 18, 2005.

More recently, allegations that Starbucks was “union busting” in the U.S. raised the potential for damage to the company’s reputation, but still it is not clear that this would be tied directly to its share price: *Ethical Corporation* cited one commentator as saying that the “intangible damage” to Starbucks’s reputation “could be very material”, and that the company’s share price had fallen 23% in the past year “for a number of reasons”. But the magazine was not willing to tie this directly or solely to the company’s labour-related controversies.<sup>181</sup>

Finally, after Yahoo! settled a human rights lawsuit in November 2007, the *Los Angeles Times* noted that “investors appeared to shrug off the negative attention”, and the company’s shares actually rose over 5%. The *Times* quoted a financial analyst as saying, “Does the brand take a hit? Yes, definitely...Will it have an impact whether people will want to do business with it or use their services? No, I don’t think it will.”<sup>182</sup>

Because it is difficult to find concrete examples of a controversy driving share price (at least for more than a short time), it is even more difficult to find examples of a stock price drop forcing a change in company behaviour (and even where this might happen, companies generally do not admit that the change is linked to ESG issues).

On the other hand, many observers have pointed out that for brands and, in certain industries such as fashion and retail, reputation accounts for a significant portion of stock price.<sup>183</sup>

MacKenzie and Sullivan write that “as active managers, our investment decisions can influence the share price of companies”. They note that investors have not tried to influence share price directly, and it is not clear whether there are actual examples of indirect influence due mainly to shareholder action on ESG issues *per se*.<sup>184</sup>

Powdrill, formerly of the UK Trades Union Congress (TUC), writes that “finding a causal link between a company’s behaviour in relation to a particular issue and share price performance is the Holy Grail of the SRI community, but remains notoriously hard to prove. What might be termed ‘labour’ issues are no different to any other in this regard.” But he notes that health and safety could be a “breakthrough issue” for unionists, in the sense that it might be possible in the near future to demonstrate a link between health and safety performance and share price behaviour.<sup>185</sup>

Clearly this is an area for further research.

<sup>181</sup> Lisa Roner, “Employee Relations – Prove Your Case, Starbucks”, *Ethical Corporation*, November 13, 2007.

<sup>182</sup> Alex Pham, “Yahoo To Pay Chinese Families”, *Los Angeles Times*, November 14, 2007.

<sup>183</sup> See for example Poulomi Mrinal Saha, “Supply Chain Management – Weak Links in Bangladesh”, *Ethical Corporation*, February 5, 2007. Saha notes that in the international fashion industry, “about 30% of stock value is based on reputation”.

<sup>184</sup> Craig MacKenzie and Rory Sullivan, “Insight’s Approach to Activism on Corporate Responsibility Issues”, in Sullivan and MacKenzie, *op. cit.*, p. 194 and Sullivan and MacKenzie, “The Practice of Responsible Investment”, *op. cit.*, p. 335.

<sup>185</sup> Powdrill, “Workers’ Capital...”, *op. cit.*, pp. 270-1.

### 4.3 Conclusion

On one level, EIRIS's 2007 findings, cited earlier, on the low rate at which most companies have established supply chain labour standards policies, are discouraging, particularly after years of SRI engagement and NGO and consumer pressure. And Peter Frankental of Amnesty has pointed to some serious limitations of SRI:

- fiduciary constraints dictate that financial aspects trump all others in investment decisions
- human rights issues “are rarely material to a company’s performance or earnings”.

In fact, Frankental goes so far as to say that “the purpose of the SRI operations of the mainstream fund managers” is “not to...bring about systemic change in the behaviour of companies” but rather to serve as a “branding exercise”. In his view, SRI engagement puts too much emphasis on the “reputational dimension”, when in fact most companies will not face “reputational damage related to human rights impacts” because such damage depends on media and NGO exposure, which affects only a fraction of companies. In this light, he argues that unless investors keep divestment as an option, they are “disarming themselves”.<sup>186</sup>

Divestment, or the threat of it, has arguably led some companies to change. It is hard to establish causality, but some argue that pressure for divestment can lead, and has led, some companies to pull out of pariah states (e.g. Sudan), though again companies are likely to claim that their withdrawal was not due to external pressures over human rights. Therefore, the extent to which such “sticks”, as opposed to “carrots”, as Frankental puts it, have changed corporate behaviour could use further research.

On another level, things *have* changed, in part due to SRI practices. In the words of one expert on SRI trends:

There’s no question that social investors are influencing corporate behaviour by engaging in dialogue with management about issues of concern, filing shareholder resolutions and using their social research to hold companies accountable. Much more research needs to be done to quantify the precise impacts of these strategies, but the trends are clear: shareholder support for social and environmental issues is increasing and companies are changing policies and practices in response.<sup>187</sup>

With regard to labour standards in particular, in the view of David Schilling, Director of Global Corporate Accountability at ICCR and one of the best-known figures in the SRI community, there is “no question” that SRI practices have affected company behaviour on ILS. As he points out, ten or twelve years ago, few companies had codes of conduct. SRI has been a key driver in the establishment of these codes and in the incorporation of core ILO standards in the codes. There has been a “continuum” along which SRI has pushed companies, right up to the current ICCR initiative around purchasing practices mentioned in Box 4 and described more fully in Appendix I.

<sup>186</sup> Frankental, “Why Socially Responsible Investment...”, op. cit., p. 244.

<sup>187</sup> Email communication from Joshua Humphreys, Director, Center for Social Philanthropy, Harvard University, December 17, 2007. Humphreys was speaking in his individual capacity (see footnote 95).



In Schilling's view, company policies would be much weaker – and “much less aligned with ILS” – without the influence of SRI. But he points out that while SRI has been successful in influencing company policies on ILS, it has been less so in getting companies to implement these policies, especially on freedom of association and discrimination, and in pushing ILS in industries where there are no brands. It has also been less successful in affecting the “economic space” in which companies find themselves (e.g. the short-term mentality of the financial mainstream, free market pressure for flexible labour, a push against unionisation, and so forth). In this sense, SRI needs to influence not just policies and performance, but to look at the big picture of corporate lobbying and economic globalization.<sup>188</sup> The final section of this paper takes up these and other points.

Similarly, Sullivan and MacKenzie note that shareholder activism has been less successful in addressing “market failure”, and that there is a “long way to go” before responsible investment becomes mainstream.<sup>189</sup>

<sup>188</sup> Interview of Schilling, op. cit.

<sup>189</sup> Sullivan and MacKenzie, “The Practice of Responsible Investment”, op. cit., pp. 332-346 and Sullivan and MacKenzie, “Looking Forwards”, in Sullivan and MacKenzie, *Responsible Investment*, p. 348.

## 5 The Effect of Labour-Related SRI on Workers' Rights – Or Lack Thereof

### 5.1 Limits of analysis

The author is not aware of formal research on the effect of labour-related SRI per se on workers' rights. The previous section made some statements on the effect of selected investment practices on corporate behaviour. There are also efforts to examine the effect of *corporate* ILS initiatives on actual working conditions (see below), though much remains to be done, at the level of both self-reporting and third-party reporting on how companies are doing in that area. So far, both types of reporting paint a discouraging picture in general.

Further, from there to making statements about *SRI's* effect on workers' rights – an indirect relationship – will be a challenge. So it is a two-step process of measuring SRI's effect on company behaviour, and the effect of that change in behaviour on workers' rights.

SRI practices -----► Corporate behaviour -----► Workers' rights

The following are selected examples of research on the effect of corporate ILS initiatives on working conditions. There are not, apparently, equivalent examples of the effect of SRI on workers' rights. But to the extent that SRI has provided some of the impetus for these initiatives, there could be an indirect connection.

- The work of the UK-based Ethical Trading Initiative is centred around the ETI Base Code, which in turn is based on ILS ([www.ethicaltrade.org](http://www.ethicaltrade.org)). As described in section II, the ETI's commissioned study, published in 2006, showed decidedly mixed results on the effectiveness of the Base Code in improving labour conditions in supply chains.<sup>190</sup> The study's results were disappointing. On the other hand, the research could serve as a benchmark for follow-up research on the effect of corporate behaviour on ILS.
- Also in 2006 (and also mentioned in section II), a research team from the Massachusetts Institute of Technology (MIT), led by Professor Richard Locke, released a study, "Does Monitoring Improve Labour Standards? Lesson from Nike", which was subsequently published in a journal.
- Using data from over 800 Nike suppliers in 51 countries, the team concluded that, despite Nike's "significant efforts...to improve working conditions among its suppliers, monitoring alone appears to produce only limited results". The authors argued that "new, *more systemic approaches*" were necessary to raise labour standards. In this context, they underscored the importance of "external pressures" (including from NGOs, unions and governments), in combination with "management

<sup>190</sup> Barrientos and Smith., "ETI Code of Labour Practice...", op. cit.

systems” that address “*root causes*” of labour violations, as crucial to improving labour standards.<sup>191</sup>

- Although not mentioned in the MIT research, social investors could be included in the panoply of pressure groups that the authors list as important elements of “systemic change.”
- Garrett Brown, of the California division of the Occupational Safety and Health Administration (OSHA), wrote in 2007 that despite “small improvements” in health and safety in many factories in global supply chains, “the actual impact of all this CSR activity on working conditions on the factory floors...has been marginal.” He also noted that “there has been a flood of reports...indicating that not much has changed”.<sup>192</sup>
- According to Brown, there has been “no progress” on the ILO core standards of freedom of association and forced labour, and progress at only some multinational corporations (MNCs) on child labour and discrimination. Further, progress on occupational health and safety has been “undermined” by “conflicting demands” of MNCs.<sup>193</sup>

Professor Dara O’Rourke of the University of California at Berkeley has also done extensive work on the effect of corporate behaviour on working conditions, including specifically on occupational health and safety in global supply chains.<sup>194</sup>

Returning to the question of the effect of labour-related SRI on workers’ rights, the lack of research in this area is one challenge. Another is the fact that it is not always clear whether what SRI has pushed for has led to better working conditions. Schilling points out that Locke et al.’s research on Nike is relevant for social investors, as some of the study’s findings call into question certain assumptions that SRI has made over the years regarding ILS. For example, while SRI has helped push companies on ILS, social investors are not sure if this “translates into empowered workforces” and improved rights. Sometimes it does, but in other instances, for example, the result of external pressure is that factory workers are fired for trying to organize.<sup>195</sup> It is for this reason that research on the effect of responsible investment practices on workers’ rights would be useful, despite the challenges of undertaking such research.

<sup>191</sup> Locke, Qin, and Brause, “Does Monitoring Improve...”, op. cit., pp. 36-38. Emphasis added. The authors published an article with the same title in *Industrial Labour Relations Review*, vol. 61 (1), October 2007, pp. 3-31.

<sup>192</sup> Garrett Brown, “Corporate Social Responsibility Brings Limited Progress in Workplace Safety in Global Supply Chains”, *Occupational Hazards*, August 1, 2007. Brown provides a useful list of key reports, most of them from NGOs, on the subject.

<sup>193</sup> Ibid.

<sup>194</sup> See for example O’Rourke’s work in the *International Journal of Occupational and Environmental Health and Safety* in 2003 and 2007.

<sup>195</sup> Interview of Schilling, op. cit.

## 5.2 Future directions

There is already a growing body of work assessing the effect of corporate ILS programs on worker rights. An effort to look at this in a comprehensive, objective manner could yield a clearer picture.

Company reports, with few exceptions, have failed to present candid, comprehensive or comparable accounts of their supply chain management. However, a small number of companies are making progress in this area, with consistent pressure from labour rights groups, social investors and others. And research such as the Locke et al. study of Nike's supply chain, where the company gave independent researchers access to its data, could be promising.

What is also needed is a systematic assessment, which establishes baselines, of the influence of SRI on corporate practice in the area of ILS. This research would have to control for other factors that could affect corporate behaviour. This in itself will be complex, as will any subsequent effort to draw concrete conclusions about what is essentially an indirect relationship: that of the effect of SRI on workers' rights.

## 6 Suggested ways forward

This section offers select recommendations to various parties on how to improve the take-up of ILS in equity markets, as well as on how to address some of the challenges discussed in previous sections.

As this paper has pointed out, there are promising developments – but also potential for more robust development – in the area of investment and labour standards. While some investors have begun to incorporate ILS into their decision-making, this trend does not seem as strong as the incorporation of environmental or corporate governance issues, for reasons discussed primarily in section II.

Further, sometimes the “incorporation” or take-up of ILS by both investors and companies is minimal or superficial, not to mention difficult to measure. Companies have often failed to protect ILS within their sphere of influence, and investors often lack more than passing awareness of what ILS really are. And while investors and labour unions should be natural allies in the incorporation of ILS in investment decision-making, this relationship could be much stronger, as could organized labour’s exercise of its role as responsible investors in general.

Finally, with a few exceptions, investors have a long way to go to realize their potential influence on public policy, not just on ILS but in general. As one expert on ethical investing notes, outside of “ethical investors and pioneering pension funds”, investors are “the missing stakeholder in most policy discussions on sustainable development”, and yet investment has a crucial role to play in this area.<sup>196</sup>

The following are a few recommendations, directed mainly at investors, unions and governments, but also at international organizations and corporations, since they, too, play a key role in promoting and upholding ILS.

### Investors

- SRI should go beyond evaluating individual companies and also look at public policy questions, such as the impact of entire industries or business models on society. If responsible investment is to contribute to the ultimate aim of sustainable development, investors will have to become more involved in “helping to correct market failures”, including by pushing governments to address these failures.<sup>197</sup> There are, of course, challenges involved in investor engagement in policy.<sup>198</sup> But as one SRI practitioner notes, there are also inherent limits to shareholder activism in changing corporate behaviour, and where voluntarism is insufficient or there is no business case to be made, only public policy “can transform incentives for business to make more sustainable paths

<sup>196</sup> Nick Robins, “Shaping the Market: Investor Engagement in Public Policy”, in Sullivan and MacKenzie, *Responsible Investment*, op. cit., p. 313.

<sup>197</sup> Rory Sullivan and Craig MacKenzie, “The Practice of Responsible Investment”, op. cit., p. 338

<sup>198</sup> See, for example, Steve Waygood, Rory Sullivan, and Alan Morley, “Harnessing Investors to Support the Implementation of Health and Safety Public Policy”, in Sullivan and MacKenzie, op.cit., p. 328.

commercially rational”.<sup>199</sup> It is therefore vital for investors to be more aware of how they can be involved at the policy level.

- Investors should also focus on systemic issues such as corporate lobbying, in order to address the fact that companies may put policies in place while also lobbying in direct opposition to the principles underlying those policies. In collaboration with a number of NGOs, social investors have started the extensive work of uncovering and evaluating corporate political influence in various areas, but the work has only just begun.
- Social investors and SRI research firms should strengthen their dialogue with organized labour. The FirstGroup case described in Box 7 shows the potential for cross-country, cross-sector (SRI and labour) collaboration on shareholder activism around ILS. In the area of research and analysis, better communication between unions and SRI researchers could help address regional differences in indicators such as labour-management relations. For example, the Ethibel survey reflects extensive and detailed questions on freedom of association by one ratings agency.<sup>200</sup> These data are probably best gathered by both unions and companies. But in countries where unionisation rates are low, or unionised workers are intimidated, or where there is no dialogue between unions and SRI, these questions remain aspirational, and ratings agencies can gather very little information on labour relations.
- When looking at emerging markets, investors and their research providers must strive to partner with local researchers in those markets, both because the latter can provide better information than non-local sources, and because such a process is more likely to build local capacity to conduct ESG research.

#### Labour Unions

- Unions can strengthen the take-up of ILS in investment through the education of pension fund trustees, union representation on pension fund boards, and building relationships with investment managers.<sup>201</sup> Section I noted some examples of shareholder collaboration between trade unions and other investors. There is potential for much more, given labour’s major role, for example, in filing shareholder resolutions in the U.S., albeit mostly around corporate governance issues.<sup>202</sup>
- Unions can also explore enhanced collaboration with other investors, including information or research exchange with SRI researchers and

<sup>199</sup> Rob Lake, “Henderson Global Investors: Engagement and Activism”, in Sullivan and MacKenzie, *op. cit.*, pp. 182-3.

<sup>200</sup> Association for Independent Corporate Sustainability & Responsibility Research, “Labour Indicators...”, *op. cit.*, p. 16.

<sup>201</sup> These points are drawn from Robinson, “Workers’ Capital...”, *op. cit.*, p. 72.

<sup>202</sup> Joshua Humphreys, Director, Center for Social Philanthropy, Harvard University, emphasized this point about the potential for “forging alliances” in an email communication, December 12, 2007.

open dialogue on what constitutes good or bad corporate performance on labour rights. Where unions are actively engaged with investors – SRI or otherwise – the latter will more likely better understand the meaning of “mature industrial relations” and the importance of ILS.<sup>203</sup>

## Governments

Governments clearly have the primary responsibility to protect labour rights. Outside of the obvious recommendation that governments should improve enforcement of their national laws and ensure that those laws are consistent with ILS, they should also consider:

- Redefining or clarifying fiduciary duty to include ESG criteria<sup>204</sup>
- Making ESG disclosure mandatory for companies and stock exchanges<sup>205</sup>
- Working with investors and others to think creatively about how to provide incentives for companies to improve their ESG performance<sup>206</sup>
- Providing support – directly and through membership in intergovernmental organizations – to underfunded areas such as emerging markets SRI research, at least to get the ball rolling until a market can be created for such research

## International Organizations

- International organizations should ensure, through their convening role, the inclusion of organized labour in multi-stakeholder initiatives that specifically address labour issues, and thus the inclusion of the workers’ rights perspective<sup>207</sup>
- As with governments, international organizations can also provide technical and financial support to underfunded areas of research
- A robust integration of ILS into the social criteria of the UN Principles for Responsible Investment (PRI) would extend the reach of these standards<sup>208</sup>
- International organizations could have a role – as convener or facilitator – in fostering a stronger relationship between investors and labour.

<sup>203</sup> Interview of Schilling, op. cit.

<sup>204</sup> UNEP-FI, “The Materiality of Social, Environmental and Corporate Governance Issues to Equity Pricing”, June 2004, p. 5.

<sup>205</sup> Ibid.

<sup>206</sup> For an interesting example from the UK in the area of employee health and safety, see Waygood et al., “Harnessing Investors...”, op. cit, pp. 322-330.

<sup>207</sup> Interview of Schilling, op. cit.

<sup>208</sup> Ibid.

## Corporations

The focus of this paper has not been on companies. However, in the realm of policy prescriptions on ILS, companies have a role to play. In addition to the recommendation that they establish – and implement – robust labour rights policies and programs, recommendations to corporations include the following:

Use their lobbying power in favour of strengthening ILS: SRI has increasingly turned a spotlight on corporate political involvement – including lobbying – and how it can have a negative effect on environmental and social protections, and on the flipside, the potential for corporations to use this influence to strengthen such protections.<sup>209</sup>

Increase efforts to examine the root causes of violation of labour rights, which could include rethinking entire business models. Social investors and civil society organizations have increasingly pushed on this point, but only a handful of companies seem to be addressing it seriously.

## Researchers

More comprehensive research is needed on the impact of investment practices on corporate behaviour, the impact of corporate behaviour on working conditions and, by extension, the impact of investment practices on workers' rights.

<sup>209</sup> See Business for Social Responsibility, “Beyond Monitoring...”, op.cit., pp. 14-15, for more on the role of corporations in public policy.



## APPENDIX I

### Select Mechanisms and Platforms: Information-Sharing, Dialogue and Initiatives in Support of Labour-Related SRI

These mechanisms fall into several different categories: networks and consortia, working groups or committees, and key reports and studies.

#### Networks and Consortia

**ICCR:** the Interfaith Center on Corporate Responsibility, based in New York, represents 275 faith-based institutional investors, including religious orders, pension funds, asset managers, unions and foundations. Members are primarily from North America, but also from Europe. ICCR coordinates the filing of shareholder resolutions; each year, its members sponsor over 200 resolutions on social and environmental issues<sup>210</sup> and are involved in long-term dialogues with many companies on issues of concern to investors. Founded in 1971, ICCR has been a major force in the global SRI community, and it has been at the forefront of identifying emerging issues for social investors. The ICCR model of active engagement, while “not necessarily a model for other investors”, has been particularly influential in the US SRI community.<sup>211</sup>

**SIRAN:** over 150 research analysts in North America belong to the Social Investment Research Analyst Network (SIRAN). They represent 30 investment firms and research providers in the U.S. and Canada. In addition to conducting research and facilitating meetings between analysts and companies to discuss corporate performance on ESG issues, SIRAN aims to “provide a forum through which analysts can share best practices, thoughts on emerging issues, and resources” ([www.siran.org](http://www.siran.org)) While the network has not done much work specifically on labour-related issues since its establishment in 2004, its members include those working directly on these issues, and SIRAN’s structure is such that any member can suggest more work in this area.

**SIFs:** There is a number of Social Investment Forums around the world, including in Canada (Social Investment Organization), the U.S. (US SIF), Europe (Eurosif), Asia (AsRIA) and Australia (Responsible Investment Association Australasia). Below are a few examples:

**US Social Investment Forum (SIF):** a national membership network promoting SRI, its members are SRI practitioners such as analysts and portfolio managers, and institutions such as banks, mutual funds and foundations. SIF provides tools such as *biennial research reports on trends in SRI*, industry reports, and SRI mutual fund performance charts. Its Advocacy and Public Policy program coordinates advocacy among members and allows them to share information and collaborate on shareholder proposals. SIF carries out its programs primarily through working groups such as the Indigenous Peoples Working Group, Community Investing Working Group and International Working Group. SIF tracks labour-friendly investment funds, SRI funds that screen on labour- and employee-related issues, and trade union plan sponsors that screen or file resolutions on environmental and social issues. It has recently increased its outreach to organized labour.<sup>212</sup> [www.socialinvest.org](http://www.socialinvest.org)

**European Social Investment Forum (Eurosif):** founded in 2001, the not-for-profit Eurosif’s stated goal is to “address sustainability through financial markets”. Its members are the European national SIFs (Belgium, France, German, Italy, Netherlands, Sweden, UK), and its member affiliates

<sup>210</sup> [www.iccr.org](http://www.iccr.org)

<sup>211</sup> Interview of Schilling, op. cit.

<sup>212</sup> Email communication from Joshua Humphreys, Director, Center for Social Philanthropy, Harvard University, December 12, 2007. Humphreys was speaking in his individual capacity (see footnote 95).

include pension funds, financial service providers, academia, research forums and NGOs. Its membership represents total assets of over 600 billion Euros. Activities include lobbying the EU, research, and conferences. [www.eurosif.org](http://www.eurosif.org)

**UKSIF:** a member of Eurosif, the UK Social Investment Forum has conducted a number of projects that incorporate labour-related SRI. For example, in 2005 UKSIF's *Just Pensions* program produced a brief assessing SRI engagement on supply chain labour standards (see section II). The report highlighted how SRI engagement could be effective in changing corporate behaviour, and made recommendations on best practices for investment managers. Members of the Forum used the report as a catalyst to develop their own work on supply chain labour standards.<sup>213</sup> UKSIF has also begun a new initiative around investor concern about supply chain labour standards. According to a recent update from the Ethical Trading Initiative (ETI), UKSIF "has formed a small group of investment analysts to develop and review the standards and key indicators that they would like to see" in relation to supply chain labour standards.<sup>214</sup> ETI, which brings together companies, NGOs and unions, is also involved. [http://www.eurosif.org/about\\_eurosif/sifs/uk](http://www.eurosif.org/about_eurosif/sifs/uk)

**UNPRI Engagement Clearinghouse:** this is a private, online forum, open only to signatories of the Principles for Responsible Investment (PRI). The forum, created in late 2006, provides signatories with a network within which to share information about engagement on various issues. It is meant to help investors harness collective power in influencing corporate behaviour, and to address the "tragedy of the commons" problem that reduces incentives for individual actors to take action. In 2007, the Clearinghouse had proposals for work around various ESG issues, including forced labour in the steel supply chain in Brazil. In addition, the New York City Employee Retirement System (NYCERS) reported that it used the Clearinghouse to notify other signatories about its planned shareholder proposal to Wal-Mart on the company's noncompliance with ILO standards, and as a result several signatories joined as co-sponsors of the proposal.<sup>215</sup> As of 2008, the Clearinghouse had held at least one webinar for signatories specifically on ILS-related issues.

## Working Groups or Committees

While more informal in nature than some of the longer-term MSIs described above, several working groups or committees focused in part or wholly on labour-related SRI have proven to be useful mechanisms for dialogue around raising the bar for labour standards in corporate operations. Below are two examples.

**ICCR Working Groups:** ICCR (see above) has several working groups that advance the organization's over-arching goal of changing corporate behaviour. ICCR working groups offer an opportunity for members to deepen their work on certain key issues, and to build and implement long-term, targeted action plans to achieve change. A specific priority of ICCR members is "eliminating sweatshops" ([www.iccr.org](http://www.iccr.org)), and its Contractor Supplier Working Group (CSWG) focuses on this goal.

In 2007, social investors and SRI researchers in ICCR's CSWG formed the **Purchasing Practices sub-group**.<sup>216</sup> The sub-group is focused on improving working conditions in manufacturing facilities by motivating U.S. brands and retailers to integrate effective purchasing practices into their daily business. It formed in response to a growing realization that corporate purchasing practices are among the root causes of ILS violations in global supply chains. The group's strategy includes research, interviews with experts, direct contact with companies, and the collection of management tools and best practices in the apparel industry, and ideally will be extended eventually to other industries

<sup>213</sup> Telephone interview of Ognall, op. cit.

<sup>214</sup> Ethical Trading Initiative, *Update*, No. 35, Autumn 2007

<sup>215</sup> UNEP-FI and Global Compact, "PRI Report On Progress 2007", op.cit., pp. 8 and 30.

<sup>216</sup> The author was a member of the group in 2007.

**Report Review Committees (RRCs):** as described in section III, a few companies have started to use voluntary review committees to provide feedback on their CSR reports. While most of these groups look at a wide range of ESG issues (environment, labour, diversity, governance), some of the companies using these committees have had major ILS-related controversies – viz. Gap and Nike – and their reports and thus their RRCs have therefore focused special attention on labour issues. Gap’s RRC consists wholly of social investors. Nike’s RRC is comprised of representatives of trade unions, SRI, environmental NGOs, other corporations, academia, and independent consultants.<sup>217</sup> RRCs serve as useful platforms for dialogue and information-sharing both for companies (by helping raise the bar on reporting about ILS and indicating what kind of information social investors and others are seeking from company reports) and for RRC members themselves (by providing them with an in-depth look at how companies report on complex topics such as supply chain labour standards). RRCs are also increasingly used as a form of report “assurance”: not in the sense of data verification, which RRCs generally cannot undertake (nor are they given the mandate to do so), but in the sense of a third-party review of the reporting process and evaluation of at least some aspects of a report.

## Key Reports and Studies

While reports are somewhat less dynamic as platforms for sharing information, they are important for spreading information and triggering dialogue, including between investors and companies. Below are a few examples.

1) In 2004, Insight Investment, a UK-based asset manager, and Acona, a UK-based consultancy, produced a report entitled “Buying Your Way Into Trouble? The Challenge of Responsible Supply Chain Management”. The report was launched at about the same time as an Oxfam International report that also looked at responsible supply chain management.<sup>218</sup> It was a very public sign that SRI was aware of the structural or “root” causes of ILS violations, and that it was paying attention to on-the-ground accounts. While there have been many reports by NGOs and unions on ILS violations in the global supply chains of public companies, when a report comes from within the investment world, it often resonates with investors and asset managers.

2) Also in 2004, Insight and AccountAbility, a non-profit institute based in the UK, published a report entitled, “Gradient: Promoting Best Practice Management of Supply Chain Labour Standards”. The report compared 35 UK companies in several sectors on their management of supply chain labour standards. A UKSIF official interviewed listed the report – and the fact that the authors made the benchmark publicly available – as an example of a key mechanism for sharing information on the issue of ILS.<sup>219</sup>

3) As detailed in section II, in 2002 UKSIF’s *Just Pensions* program and the ETI collaborated on a brief, “Assessing Company Approaches to Labour Standards: Labour Standards for Investors”. The brief served as an early set of guidelines to investors on what to look for in corporate performance on ILS.

4) The 2007 Moskowitz Prize for Socially Responsible Investing, an annual award for research, was given to a Wharton study that found that companies on the *100 Best Places Companies to Work For* list outperformed industry benchmarks.<sup>220</sup>

<sup>217</sup> The author sat on Nike’s RRC in 2005-2007.

<sup>218</sup> Oxfam International, “Trading Away Our Rights”, 2004.

<sup>219</sup> Interview of Ognall, op. cit. In its 2007 progress report, PRI cites the importance of this kind of report, and mentions specifically the Insight/AccountAbility report. UNEP-FI and Global Compact, “PRI Report on Progress 2007”, op.cit., p. 29.

<sup>220</sup> The author is grateful to Joshua Humphreys, Director of the Center for Social Philanthropy, Harvard University, for pointing this out in an email communication, December 12, 2007.

## Appendix II:

### A closer look at Council on Ethics for the Norwegian Government Pension Fund – Global

Ms. Pia Goyer, Senior Advisor, Council on Ethics

The Norwegian Government Pension Fund – Global is one of the world's largest single owner funds. As at February 2008, the fund had invested in approximately 7 400 listed companies and has a value of about USD 425 billion (2 200 billion NOK).

The fund is owned by the Ministry of Finance and is managed by the Norwegian Central Bank (Norges Bank). In 2004, the Norwegian Parliament adopted ethical guidelines for the fund which are based on two ethical obligations. The first one is that future generations should derive benefits from the fund, meaning that the fund should achieve a sound return in the long run. The second obligation is to respect basic rights of persons affected by the business activities that the fund has invested in. This means that the fund should not be invested in companies representing an unacceptable risk that the fund will be complicit in grossly unethical activities.

The guidelines build on a three-track strategy which is:

- Exercise of ownership rights (Norwegian Central Bank)
- Negative screening (Council on Ethics)
- Ad-hoc exclusion (Council on Ethics)

The Council on Ethics was also established in 2004. It was decided that the members of the Council should be selected and appointed by the Ministry of Finance and that the members should be chosen so that their professional background would correspond to the criteria in the guidelines. Being responsible for the negative screening and the ad-hoc exclusion mechanisms, the Council on Ethics gives advice to the Ministry of Finance on the exclusion of companies from the investment universe. The Council has its own secretariat that conducts fact-finding and information gathering, reports to the Council and drafts the recommendations on exclusion. The secretariat evaluates about 80 cases each year and considers in brief some 500 additional cases. The Council on Ethics meets for a one-day meeting every month. In 2007, the secretariat had 6 full time researchers and three screening agencies to help with the screening of the fund's investment universe in relation to the criteria in the guidelines. The budget of the Council on Ethics and its secretariat in 2007 was about USD 1.2 million (NOK 6 million). This covers the entire operation such as salaries, compensation to the members of the Council, commissioning of studies, travel expenses and office rental etc.

In the mandate of the Council it is stated that:

“the Council shall issue recommendations on:

1. negative screening of companies on the basis of production of weapons that through normal use may violate fundamental humanitarian principles
2. exclusion of companies from the investment universe because of acts or omissions that constitute an unacceptable risk of contributing to, inter alia:
  - -serious or systematic human rights violations, such as murder, torture,
  - deprivation of liberty, forced labour, the worst forms of child labour and other forms of child exploitation
  - -grave breaches of individual rights in situation of war or conflict
  - -severe environmental damage, gross corruption, other particularly serious violations of fundamental ethical norms”.

It should be emphasized that the guidelines state that previous conduct constituting breaches of the guidelines is not sufficient in itself for an exclusion to come into question, there also has to exist an

unacceptable risk for breaches in the future. As the main focus of this publication is labour rights issues, the other criteria will be not be presented further here.

The assessment of a case starts by the secretariat receiving information about allegations claiming that a company is involved in activities that might be in contravention of the guidelines. This information is received by way of information providers, meetings with civil society and ad-hoc inquiries by the secretariat. Having obtained relevant information, the first step is for the secretariat to make an introductory examination of the facts and allegations of the case which is presented to the Council. The Council then decides whether the secretariat should go deeper into the case and prepare a background report building on available and relevant information. The Council can also decide to engage its secretariat in conducting research to verify the allegations at hand and to obtain additional information through, inter alia, commissioning external studies and expert assessments, meeting with key stakeholders, or conducting field work.

The background report, which often is very much the same as the final recommendation, is then sent to the company for comments. This principle of contradiction is explicitly stated in point 4.5 of the guidelines. The company's comments are then considered thoroughly by the Council. If the Council finds that there still exists (despite of the reply from the company) an unacceptable risk that the fund through its investment will contribute to unethical activities, the final recommendation on exclusion is prepared. This document also reflects the reply that has been given by the company in question. The recommendation is then sent to the Ministry of Finance which takes the final decision on exclusion. If the Ministry decides to follow the recommendation, the Norwegian Central Bank is instructed to sell the shares in the company (this usually takes two to three months). When this has been conducted, the recommendation is published in its entirety. If the Ministry decides *not* to act in accordance with the Council's recommendation, it can then be published immediately.

In the Council's recommendations that deal with human rights and labour rights, there is a reference to the guidelines' preparatory works concerning the status of international conventions in the work of the council. There it is stated that:

“Since international law expresses a balancing of interests between states it is difficult to derive norms of action for market actors from international law. On the other hand, international conventions give concrete form to the content of an international consensus on minimum requirements which should be imposed regarding respect for basic rights worldwide”.

Among the conventions that are mentioned in the preparatory works representing such minimum requirements are the eight core ILO conventions together with the Convention 169 concerning the rights of indigenous and tribal peoples.

The Council's evaluations are discretionary. The aim of the Council's work is not to establish a formula that can fit all future cases covering the same criteria, but to make a thorough evaluation of the merits of each case individually. This means that the Council does not consider itself bound by past recommendations, but can chose to put emphasis on different elements in different cases making a comprehensible evaluation in each case. The Council's work has however resulted in the establishment of certain conditions for the evaluation of the link between a company's activities and the violations in question, which are presented below.

At present, the Council has issued recommendations on the exclusion of companies because of violations of labour standards twice. In a recommendation on exclusion published in 2006, where a company was excluded from the fund because of complicity in serious or systematic human rights violations (labour rights), the Council referred to the ILO Convention 182 on the Worst Forms of Child Labour, the ILO Convention 29 on Forced Labour, the ILO Convention 87 on Freedom of Association and the ILO Convention 100 on Equal Remuneration. One peculiarity is that this case did not only assess the working conditions of the company's own employees, but also those of the company's subcontractors. The size of the company and its possibilities to influence the working environment in its suppliers' activities was an important element of the Council's assessment. The Council stated in the recommendation that the company:

“wields substantial influence in regard to working environment, wages etc., particularly in relation to the manufacturers which the company itself describes as direct suppliers. This is due not least to the company's size and widespread presence in many countries, and thus to its engagement in a large number of suppliers”.

It was also stated in the recommendation that:

“It seems clear that a number of the violations reported, particularly in the supply chain, are very serious. They include violations of fundamental international standards with regard to child labour, working conditions bordering on forced labour, serious violations of work hour provisions,

wages below the local legal minimum, health-hazardous working conditions, and unreasonable punishment. Isolated occurrences of this type, even if serious, would probably not suffice to exclude a company since such events would not constitute sufficient grounds for establishing a risk of violation in the future”.

The Council noted the total sum of violations and concluded by stating that:

“It appears to be a systematic and planned practice on the part of the company to operate on, or below, the threshold of what are accepted standards for the work environment. Many of the violations are serious, most appear to be systematic, and altogether they form a picture of a company whose overall activity displays a lack of willingness to countervail violations of standards in its business operations”.

In human rights (and labour rights) cases, the Council operates with four conditions that have to be met in order to conclude that a company is complicit in the breaches and that there therefore exists an unacceptable risk that also the fund through its investment can be considered complicit in these breaches in the future. The conditions are as follows:

- there must be some kind of linkage between the company’s operations and the existing breaches of the guidelines, which must be visible to the Fund,
- the breaches must have been carried out with a view to serving the company’s interests and to facilitate conditions for the company,
- the company must either have contributed actively to the breaches, or had knowledge of the breaches, but without seeking to prevent them, and
- the norm breaches must either be ongoing, or there must exist an unacceptable risk that norm breaches will occur in the future. Earlier norm breaches might indicate future patterns of conduct.

In a recommendation published in 2006, the Council assessed allegations against a company because of violations of human rights (labour rights) in its activities in Burma. The main allegations in that case concerned forced labour. The Council emphasized in its recommendation that both the UN Commission on Human Rights and the ILO, on several occasions, had reported on and condemned the Burmese regime’s systematic violations of human rights and use of forced labour. The Council found that the company had been involved in forced labour and several other grave violations and concluded that the company therefore had been involved in serious or systematic human rights violations as stated in the guidelines. For an exclusion to come into question, there has to exist an unacceptable risk for future breaches. The fact that the actual construction of the pipeline was finished, and that the company seemed to have changed its human rights policy, made the Council conclude that there was no "unacceptable risk" of future breaches. The Council thus concluded by not recommending an exclusion of the company in question.

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