RESEARCH REPORT

DO AUSTRALIAN INSTITUTIONAL INVESTORS AIM TO INFLUENCE THE HUMAN RESOURCE PRACTICES OF INVESTEE COMPANIES?

Kirsten Anderson
Research Fellow
Corporate Governance and Workplace Partnerships Project
Faculty of Law
The University of Melbourne

Shelley Marshall
Research Fellow
Corporate Governance and Workplace Partnerships Project
Faculty of Law
The University of Melbourne

Ian Ramsay
Harold Ford Professor of Commercial Law and
Director, Centre for Corporate Law and Securities Regulation
The University of Melbourne

Centre for Corporate Law and Securities Regulation
The University of Melbourne
and
Centre for Employment and Labour Relations Law
The University of Melbourne
2007

Published in Melbourne by the Centre for Corporate Law and Securities Regulation and the Centre for Employment and Labour Relations Law

Centre for Corporate Law and Securities Regulation
Faculty of Law
The University of Melbourne
Victoria
Australia 3010
Phone: + 61 3 8344 5281
Fax: + 61 3 8344 5285
Email: cclsr@law.unimelb.edu.au
Website: http://cclsr.law.unimelb.edu.au

Centre for Employment and Labour Relations Law
Faculty of Law
The University of Melbourne
Victoria
Australia 3010
Phone: + 61 3 8344 8924
Fax: + 61 3 8344 4623
Email: celrl@law.unimelb.edu.au
Website: http://www.law.unimelb.edu.au/celrl

ISBN 978-0-7340-3703-9

© 2007 K Anderson, S Marshall and I Ramsay

This publication is copyright. Except as permitted under the Copyright Act 1968 (Cth), no part of this publication may in any form or by any means (electronic, mechanical, microcopying, photocopying, recording or otherwise) be reproduced, stored in a retrieval system or transmitted without the specific written permission of the publisher.

Table of Contents

1. Introduction……………………………………….……...................4
2. Methodology……………………………………………..……....7
3. Context: The growth of institutional investors……………….…….11
4. Literature review………………………………………………...14
   4.1 Is the growth of institutional investors having indirect consequences for the human resource practices of investee companies?...15
   4.2 Direct influence: Active engagement for better human resource practices…………………………..…....22
   4.3 Barriers to investment selection or engagement concerning human resource practices……………..……......26
   4.4 Summary of the literature…………………………………......28
5. Case study findings……………………………………………......31
   5.1 Institutional investors with internally managed funds that seek to influence the human resource practices of investee companies……………………………..……..31
   5.2 Institutional investors with internally managed funds that do not seek to influence the human resource practices of investee companies………………....….41
   5.3 Superannuation funds that seek to influence the human resource practices of investee companies……….......45
   5.4 Superannuation funds that do not actively seek to influence the human resource practices of investee companies…………………………………………….55
6. Analysis……………………………….……………………….….58
   6.1 Rationale for seeking to influence the human resource practices of companies……………………………….60
   6.2 Mechanisms used by institutional investors to influence the human resource practices of companies………...67
   6.3 Do institutional investors make investment selections on the basis of human resource practices?................................71
   6.4 Observations relating to institutional investors that do not seek to influence the human resource practices of companies…………………………………………72
   6.5 Barriers to investment selection or engagement concerning human resource practices……………………………………74
7. Conclusion…………………………………………………………77

Appendix A: List of interviewees and date of interview…………………...81

Appendix B: Representative schedule of questions….……………………..82

1. INTRODUCTION*

There has been considerable speculation recently regarding the effect of the growing prevalence of institutional investors in the equity markets on investee company behaviour. Institutional investors include superannuation funds, banks, mutual funds and insurance companies. It has been posited that the growth of institutional investors may lead to the pursuit of what is generally referred to in the human resource literature as 'high commitment' employment practices in investee companies.[1] This may be because institutional investors are using 'voice' mechanisms to pressure investee companies to adopt 'high commitment' human resource practices. For the purposes of our study it is sufficient to note that these labour management practices typically involve managerial attempts to motivate and manage workers through a series of workplace practices that incorporate the interests of employees rather than through strict command and control structures.[2] These might include investment in staff training and development, employment security, flexible workplace practices and self-directed work teams, investment in occupational health and safety, equitable remuneration, incentive pay, and 'partnerships' and consultation with employees and/or their representatives.[3] In formal labour relations terms, it might also include

---

* This research report is published as part of the Corporate Governance and Workplace Partnerships Project, Law School, University of Melbourne: http://cclsr.law.unimelb.edu.au/go/centre-activities/research/corporate-governance-and-workplace-partnerships-project/index.cfm. The authors thank Geof Stapledon for preliminary advice he provided regarding the research presented in this report. The authors also thank Graham Duff, Chairman of Hostplus, upon whom we piloted the interview questions, for his helpful comments.

[1] The terms 'employment practices', 'human resource management' and 'labour management' are used inter-changeably throughout this report.

[2] The human resource literature posits that the deployment of specific work practices and human resource policies provide an organisation with the internal capability to raise employee effort and productivity, and organisational performance. See, for example, J. McDuffie, 'Human Resource Bundles and Manufacturing Performance: Organisational Logic and Flexible Production Systems in the World Auto Industry' (1995) *Industrial and Labor Relations Review* 197; P. Capelli and D. Neumark, 'Do "High Performance" Work Practices Improve Establishment Levels of Outcomes?' (2001) 54 *Industrial and Labor Relations Review* 737, C. Ichniowski, K. Shaw and G. Prennushi, 'The Effects of Human Resource Management on Productivity' (1997) *American Economic Review* 291; T. Baker, *Doing Well by Doing Good: The Bottom Line on Workplace Practices*, The Economic Policy Institute, Washington D.C; C. Erikson and S. Jacoby, 'The Effect of Employer Networks on Workplace Innovation and Training' (2003) *Industrial and Labour Relations Review* 203.

[3] For a more comprehensive list of high commitment labour management practices, see J. Pfeffer, 'Producing Sustainable Competitive Advantage Through Effective Management of People' (1995) *Academy of Management Executive* 55.

respect for freedom of association, the right to bargain collectively and other core labour standards.[4]

The purpose of this study is to discover whether it is the intention of institutional investors to encourage investee companies to adopt 'high commitment' employment practices through case studies of twelve prominent institutional investors with funds invested in the Australian equities market and the Australian Council of Superannuation Investors (an industry body representing 39 superannuation funds). In the event that the institutional investor did seek to influence investee companies, we asked (i) why they seek to influence the companies, and (ii) what mechanisms they use to exert this influence. In the event that they did not seek to influence investee companies in this way, we asked (iii) why they did not and what barriers exist to taking into account companies' employment practices. We also sought to discover (iv) whether institutional investors take into account the employment practices of companies when making investment decisions, and if so, (v) what kinds of practices they take into account. In addition, we enquired into (vi) whether there are any differences between institutional investors, based on type, in relation to whether or not they have an intention to influence investee company employment practices, or the ability to do so.

We are particularly interested in the difference between industry superannuation funds and other types of institutional investors. This difference is significant, firstly, because under the *Superannuation Industry (Supervision) Act 1993 (Cth)*, Part 9, industry superannuation funds are required to have equal representation of employers and members on their boards. [5] In the case of industry superannuation funds, which are operated by parties to industrial awards, these representatives are usually employer associations and unions. Secondly, industry superannuation funds often manage their funds via external fund managers, whereas other institutional investors generally manage their funds internally. (This distinction is explained further in the Methodology part of this report.) It is possible that these two characteristics of

---

[4] Respect for core labour standards is generally expressed in terms of respect for human rights, rather than links with productivity increases.

[5] Industry superannuation funds primarily offer superannuation services to employees in one or several industries, though some major industry funds now offer superannuation to retail investors which enables them to compete as retail funds in particular markets.

industry superannuation funds might result in different attitudes and responses concerning the human resource practices of investee companies compared with other types of institutional investors.

A survey of the literature in the area informs us that this is a novel study. Whilst some empirical studies have attempted to establish a link between the growth in institutional investors and the social performance of investee companies, no studies have focussed exclusively or predominantly on human resource management or industrial relations. Social performance has typically been measured by assessing company performance against criteria including community relations, environmental impact, and treatment of minorities. Our research reveals new findings about the attitudes and practices of institutional investors regarding the human resource practices of investee companies.

The remainder of the report is structured as follows: first, the methodology used in our study is set out in relation to the questions posited in this introduction. Second, the context for this study is outlined. That is, the growth of institutional investors in Australia is sketched in brief terms and compared with other countries in order to establish the importance of this phenomenon. Third, we report the results of a literature survey. Fourth, we describe the practices of each case-study investor. Fifth, we carry out our analysis: discussing the themes that emerged through the study, and comparing our findings with the questions posited in this introduction and issues put forward in the literature. In the final part, we conclude.

2. METHODOLOGY

Our study was conducted via case-studies of institutional investors. The chief method used to gather information about our subject's attitudes and practices was through semi-structured interviews. A list of interviewees is included as an appendix to this report (Appendix A). Interviews with institutional investors were secured with the assistance of the two major umbrella bodies in Australia. The Investment and Financial Services Association Limited (IFSA) asked its members to participate.[6] Letters were also sent to all members of the Australian Council of Superannuation Investors (ACSI).[7] We followed up this initial contact from the umbrella organisations with telephone calls in order to secure interviews. In addition, two of the interviews were secured through the authors' personal contacts; one investor was contacted due their explicit interest in human resource practices in investee companies and their perceived likelihood of agreeing to be involved in the interview process. An attempt was made to secure interviews with a mixture of investors which manage funds internally and other investors which generally engage external fund managers. Some institutional investors manage funds internally on behalf of their clients/beneficiaries. They have in-house analysts who make investment decisions on behalf of the clients/beneficiaries. Other institutions, typically superannuation funds, have contracts with investment managers (often up to 40 different investment managers) who make investment decisions on behalf of the clients/beneficiaries.

We did not aim for a representative sample by selecting a mix of investors. Rather, we hoped to carry out our investigation in the different contexts of investments which are managed internally and investments which are managed externally.[8]

---

[6] IFSA is a national not-for-profit organisation which represents the retail and wholesale funds management, superannuation and life insurance industries in Australia. IFSA has over 120 members who are responsible for investing over $920 billion on behalf of more than nine million Australians. See <http://www.ifsa.com.au> for more information.

[7] ACSI is a not for profit organisation which provides independent research and education services to superannuation funds in relation to the corporate governance practices of companies in which they invest. See <http://www.acsi.org.au/dsp_about.cfm> for more information.

[8] This concern to disaggregate institutional investors was based on findings by Johnson and Greening that pension funds and other funds have different investment strategies regarding corporate social performance, as discussed in the literature survey part of this report: Richard A. Johnson and Daniel W. Greening, 'The Effects of Corporate Governance and Institutional Ownership Types on Corporate Social Responsibility' (1999) 42 *Academy of Management Journal* 564, 564.

Our method of selection of case study investors may have particular implications in relation to our conclusions on the extent to which institutional investors in Australia seek to influence the human resource practices of companies. In addition to contacting and securing an interview with one institutional investor on the basis of their perceived interest in human resource management issues, our method of selection may have attracted a high proportion of investors interested in human resource management issues in investee companies. Restricting the selection of superannuation funds to those which are members of ACSI, an organisation which has an active interest in governance matters in Australian companies, may have further impacted on our conclusions in this regard.

After the interviews were secured, profiles of the institutional investors were constructed using information contained on the public record about the investors. We examined this information in order to ascertain whether and in what manner human resource management issues were taken into account in making investment decisions. We sought information concerning company engagement policies and whether human resource management forms part of these strategies. This information was subsequently used to inform the semi-structured interviews. Interviews were conducted face-to-face, using a schedule of questions.[9] A representative schedule of questions is included in the appendix to this report (Appendix B). The choice of answers to the questions was open ended. Follow up questions were asked where further clarification was required or where it was useful to do so. On the basis of information provided in some of these interviews, further interviews were secured with representatives of ACSI and Monash Sustainability Enterprises, a company research enterprise based at Monash University. A face-to-face semi-structured interview was conducted with the ACSI representative and an informal telephone interview was conducted with the Monash Sustainability Enterprises representative.

The use of semi-structured interviews allowed us to ensure that each interviewee was presented with largely the same questions, allowing for direct comparison between subject responses. However, it also provided the flexibility to ask specific questions regarding the investor's practices, based on our research of the public record, and

[9] The schedule of questions was developed from a list of questions contained in G.P Stapledon, *Institutional Shareholders and Corporate Governance* (1996), Appendix D.

therefore gain a more thorough knowledge of these practices than had we asked closed or structured questions.

The methodology shaped the nature of our findings in a number of respects. Case-study methodology is designed to study a phenomenon or set of interacting phenomena in context 'when the boundaries between phenomenon and context are not clearly evident.'[10] The lack of distinction between phenomenon and context make case-studies ideal for conducting exploratory research designed to stand alone or to guide the formulation of further quantitative research. In this study we are concerned with the consequences of growth both in the number of institutional investors and the proportion of funds under management by institutional investors on the human resource practices of investee companies. Given the dearth of prior research into this phenomenon, case study methodology was the ideal means to gain a preliminary understanding of this phenomenon. The method allows us to make theoretical generalisations in a way that is deeply contextualised.[11] However, quantitative generalisations cannot be made from a small number of cases.

Further limitations on our ability to make broad findings concerning the questions listed in the introduction to this report arise from the fact that our study was restricted to the attitudes and practices of institutional investors. As a result, we are unable to draw wider conclusions concerning whether the practices of institutional investors have their intended effect, where these investors intend to influence investee companies. This would be an extremely complex empirical study to conduct. It may be possible to study institutional complementarities;[12] that is, whether the functionality of 'high-commitment' human resource practices in a company is conditioned by a high proportion of share ownership in that company by institutional investors. It is more difficult to find a causal connection between the practices of institutional investors and the employment practices of investee companies given the number of variables which are likely to affect employment practices including industrial relations laws, competitive pressures, union strength, and industry/product

---

[10] Robert K. Yin, *Case Study Research Design and Methods* (3rd edition), Sage, London, 13.
[11] *Ibid*., at 10. See also Gregory Mitchell, 'Case Studies, Counterfactuals and Causal Explanations' (2004) 152 *University of Pennsylvania Law Review* 1517.
[12] Martin Höpner, 'What Connects Industrial Relations and Corporate Governance? Explaining Institutional Complementarity' (2005) *Socio-Economic Review* 331.

type and so on.[13] Nevertheless, as the review of existing literature in the area shows, various authors speculate that such a causal connection may exist, and our findings may have implications concerning the likelihood that the behaviour of investee companies is influenced by a concern by investors for 'high commitment' human resources practices.

In two studies related to this one, which are also part of the Corporate Governance and Workplace Partnerships Project, we are seeking to test company experiences of institutional investor attitudes to human resource management.[14] First, in a large survey of Australian company directors, we have asked directors whether shareholders have raised human resource matters with the company, and if so, whether changes followed from that engagement. We have also sought to find a correlation between those companies in which employees were rated highly amongst stakeholders by directors and those in which institutional investors had large holdings. Second, in detailed case studies of several Australian companies we have obtained more detailed and context based information about senior manager's perceptions of the influence of institutional investors regarding human resource management.

[13] Shelley Marshall, 'Hedging around the Question of the Relationship Between Corporate Governance and Labour Regulation' (2005) 18 *Australian Journal of Labour Law* 97.
[14] The findings from these studies, once completed, will be published at <http://cclsr.law.unimelb.edu.au/index.cfm?objectid=E3D38F25-B0D0-AB80-E2F1BF648C87997F>

3. CONTEXT: THE GROWTH OF INSTITUTIONAL INVESTORS

Many authors have speculated on the consequences of the growth both in the number of institutional investors and the proportion of funds under management by institutional investors. This growth represents a significant development in the corporate landscape of market economies in recent years. Worldwide, institutional investors have come to own a very significant proportion of equities markets; a development which is particularly pronounced in liberal market economies, including Australia.[15]

If Australia is following trends experienced in the United States, the growth of institutional investors is likely to continue. In the United States, over 50 per cent of the equities market is held by institutional investors,[16] and registered investment companies hold around US$8.6 trillion of funds under management: an increase of around US$800 billion since 2003.[17] Mutual funds manage 95 per cent of total investment company assets: a total of US$8.1 trillion.[18] The institutional investor market is heavily concentrated in the US, with 74 per cent of mutual fund assets held by the top 25 mutual fund groups, and 51 per cent held by the top 10.[19]

From the available data, it appears these trends are largely mirrored in the Australian equities market, in which institutional investors have 'enjoyed a long period of sustained growth in the value of funds under management.'[20] The total consolidated assets of managed funds institutions was $1010.2 billion at 31 March 2006, an increase of $56.8 billion (6.0%) on the revised December quarter 2005 figure of $953.4 billion. The increase was mainly driven by new investments and changes in asset values during the quarter.

---

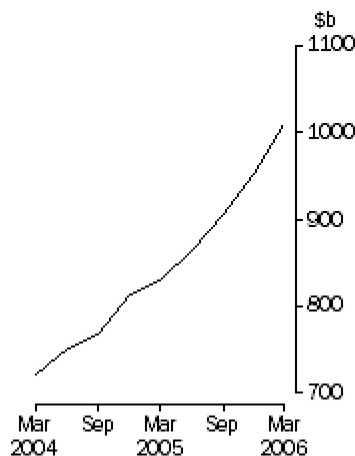
[15] Peter Waring, 'Institutional Investors and Contemporary Corporate Governance: Prospects for Enhanced Protection of Employee Interests in Liberal Market Economies' (2005) paper presented at the *26th Conference of the International Working Party on Segmentation Theory on 'The Dynamics of National Models of Employment'*, 8 – 11 September 2005, Berlin Germany, 3.
[16] Philip C. English, Thomas I. Smythe and Chris R. McNeil, 'The 'CalPERS Effect' Revisited' (2004) 10 *Journal of Corporate Finance* 157, 157.
[17] Investment Company Institute, *Investment Company Fact Book* (2005) (45th edition) 3, available at <http://www.ici.org/stats/latest/2005_factbook.pdf>
[18] Ibid.
[19] Ibid, 8.
[20] Paul Ali, Geof Stapledon and Martin Gold, *Corporate Governance and Investment Fiduciaries* (2003) 3.

Figure 1a: Total consolidated assets held by managed funds (figures)[21]

	Mar Qtr 2005	Dec Qtr 2005	Mar Qtr 2006
Consolidated Assets	$m	$m	$m
Superannuation funds	425 140	497 793	536 978
Life insurance offices*	183 332	194 664	201 887
Other managed funds	220 694	260 959	271 352
Total	829 166	953 416	1 010 217

* Investments by superannuation funds which are held and administered by life insurance offices are included under life insurance offices.

Figure 1b: Total consolidated assets held by managed funds (graph)[22]



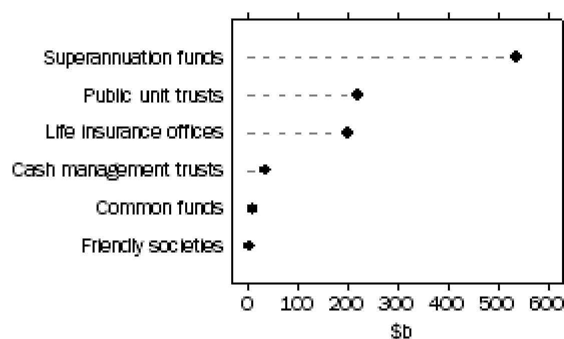
Fund managers in Australia hold a significant proportion of total funds under management in the Australian equities market. As at March 2006, Australian fund managers held approximately $343 billion (27.9%) of total assets under management in Australian equities.[23]

As in the United States, funds under the management of institutional investors are highly concentrated in Australia, with the 'top 10' equities investment managers holding 51.5 per cent and the 'top 20' holding 73.5 per cent of market share as at

[21] Australian Bureau of Statistics, *Managed Funds*, Cat. No. 5655.0, released March 2006.
[22] Ibid.
[23] Data obtained from *Rainmaker Roundup*, March Quarter 2006. This information is based on data derived from unconsolidated assets.

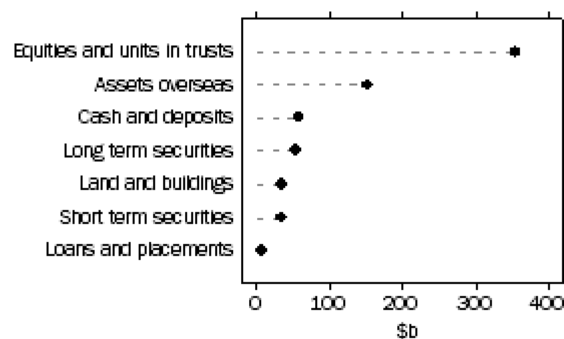
March 2006.[24] The rise in institutional share-holdings has been driven, in part, by the growing size of superannuation funds in Australia, which was triggered by the enactment of the compulsory superannuation contribution scheme in 1991, which mandated employer superannuation contributions. At 31 March 2006, according to the Australian Bureau of Statistics, consolidated assets of superannuation funds were $537.0 billion, up $39.2 billion (7.9%) on the December 2005 figure. It is projected that the value of superannuation fund assets in Australia will reach around $1,699 billion in 2020.[25]

Figure 2: Consolidated assets by type of institution[26]



Superannuation funds have far more investments in equities than other asset types, making the management of equities more crucial to their risk assessment.

Figure 3: Type of assets held by superannuation funds[27]



---

[24] Ibid.
[25] Association of Superannuation Funds of Australia, *Superannuation Statistics – April 2006.*
[26] Australian Bureau of Statistics, above n. 21.
[27] Ibid.

4. LITERATURE REVIEW

What are the consequences of growth both in the number of institutional investors and the proportion of funds under management by institutional investors? Little is known concerning the effects of this phenomenon on the social practices or employment practices of investee companies. In this part of the report we consider the existing evidence concerning either the direct or indirect effects of the growing market power of institutional investors on the employment practices of investee companies.

Our review of the literature suggests there are three distinct ways of thinking about the relationship between the growth of institutional investors and changes in the employment practices of companies. The first is to posit that the longer term investment horizons of institutional investors reduce the pressure on investee companies to produce short-term results. As the proportion of equities held by institutional investors grows, investee companies enjoy greater freedom to manage diverse stakeholder interests in a more balanced way, entailing the pursuit of strategies which develop employee skills and welfare in the long term. The second is that as a consequence of being long-term and universal investors (with funds invested across a broad spectrum of companies in the Australian equities market), institutional investors prefer investments which will produce long term, and sustained returns. Institutional investors believe that investee companies that utilize ‘high commitment’ employee management strategies are more likely to produce returns of this nature. As the proportion of funds under management by institutional investors grows, this produces a powerful market for investments in which human resources are managed in accordance with ‘high commitment’ techniques.

Both of these first two views are based on an understanding that the relationship between the growth of institutional investors and the pursuit of high commitment employee practices is *indirect*. Some authors understand the relationship to be causal, whilst others are of the view that there are institutional complementarities between the two phenomena which are the result of other historical and institutional influences. The third view found in the literature, in contrast, posits a far more *direct*, causal relationship. According to this perspective, because institutional investors prefer

investments which will produce long term and sustained returns, they will actively engage with investee companies to encourage them to adopt high commitment employee practices.

This part of the report is organised around the distinction between the direct and indirect potential influence of institutional investors on the pursuit of high commitment human resource practices of investee companies.

4.1 Is the Growth of Institutional Investors Having Indirect Consequences for the Human Resource Practices of Investee Companies?

Various theories have been developed concerning the consequences of the growth of equity investments held by institutional investors. It has been speculated that the size of individual institutional holdings in companies may make it difficult for institutional investors to enter and exit a company quickly without affecting the share price,[28] and can lock them into a particular company for the long term. Simon Deakin observes that at the same time as having large holdings in individual companies, by virtue of their size institutional investors must diversify holdings across a broad portfolio. They thereby become 'universal owners', with an interest in the economy as a whole and are 'locked in both to the market and to the individual firms in which they hold stakes.'[29] This lock-in increases the incentive to have a long-term view of investment, as these investors may not gain financially from exiting a company by selling their shares.[30]

Superannuation funds, in particular, are often thought of as long-term investors as they have predictable cash flows and, owing to the nature of their members (who are investing for their retirement), typically invest funds for a long period. This, in theory, makes them more able than other investors to ride out short term dips in the market in order to secure returns in the long term. Confirming this theory, a recent survey, conducted by Institutional Shareholder Services (ISS) of 320 institutional investors from 19 developed countries, found that some superannuation funds tend to have

---

[28] Johnson and Greening, above n. 8.
[29] Simon Deakin, 'The Coming Transformation of Shareholder Value' (2005) 13 *Corporate Governance: An International Review* 11, 19.
[30] Ibid.

long-term investment horizons.[31] The CEO of an Australian superannuation fund interviewed for the ISS study stated that: 'in the next 10 years, we will own all the top 100 if not 200 companies in Australia. It is in our direct interest to have all companies performing well in the long term.'[32]

However, institutional investors can encounter problems communicating their need to ensure a company's value over the long-term in markets, like Australia, that have traditionally favoured short-termism.[33] A 2001 empirical study of the views of 60 Australian institutional investors (including superannuation funds) found that '[m]any (superannuation fund) trustees say they feel pressure from their members for high returns year by year and that they in turn put pressure on fund managers to deliver. This ultimately leads to fund managers and institutions putting pressure on companies for short-term gains.'[34] As a consequence, while many institutional investors may generally favour long-term investment horizons, this may not always be easy to implement in practice. These contradictory empirical findings suggest that further research is required in order to establish whether institutional investors are, in fact, 'patient' investors.

Based on the assumption that institutional investors are able to be more patient than smaller retail investors, some authors, such as Waring, have speculated that the growth of institutional investors may act as a counterpoint to the 'market-outsider' system of corporate governance, which places primacy on maximising shareholder returns, at the expense of other stakeholders, such as employees. This emphasis on short-term shareholder returns promotes, in Legge's conceptualisation, a 'hard' human resource management model, in which employees are viewed as 'a resource to be used like any other, at management's discretion'[35] in order to achieve immediate financial gains.[36] This, it has been argued, can create an environment that is hostile to

---

[31] Institutional Shareholder Services, Inc., *Global Institutional Investor Study* (2006) 46 – 7.
[32] Ibid, 46.
[33] Ibid, 47.
[34] Irving Saulwick and Associates, Shareholders Project, Report No. 2, *A Qualitative Study of Superannuation Trustees and General Financial Investment Managers' Attitudes to Investment-Related Issues* (2001) 24.
[35] Karen Legge, *Human Resource Management: Rhetorics and Realities* (1995) 247.
[36] Peter Waring and John Lewer, 'The Impact of Socially Responsible Investment on Human Resource Management: A Conceptual Framework' (2004) 52 *Journal of Business Ethics* 99, 102. See also Richard Mitchell, Anthony O'Donnell and Ian Ramsay, 'Shareholder Value and Employee Interests:

internal labour markets and the provision of job security, human resource training and skills development, as it sits in opposition to the notion that employees are 'resourceful human beings to be developed and nurtured' in order to ensure their loyalty to the company.[37]

The growth of institutional investment may transform the 'market-outsider' system, which is based on short-term investment pressure: Waring states that '[a] longer term investment orientation reduces pressure and may create an environment less hostile to the investment in skills, training and internal labour markets.'[38] It is speculated that shareholder valuation of a company's financial performance according to a long term investment horizon may empower managers to pursue strategies which develop employee skills and welfare in the long term, rather than imposing pressure to focus simply on 'the head count and cost minimisation.'[39] The rising prominence of institutional investors may thus be more consistent with better employment practices, as companies are given more freedom to balance stakeholder interests with the purpose of producing long-term, sustainable returns to investors. By investing in staff training and development, flexible workplace practices, occupational health and safety and equitable remuneration, 'partnerships' with employees and the implementation of high performance workplace systems, companies can reap financial rewards in the long term.

Is there any empirical support for this thesis that the rising prominence of institutional investors is consistent with high commitment employment practices? Whilst it is very difficult to identify the causes of a company's economic performance given the range of variables at play including managerial discretion, employment and labour relations laws, the requirements of product development, the strength of the labour market, and so on,[40] some studies have found a link between superior human capital management and increased long–term financial success. Royal, Daneshgar and O'Donnell's

---

Intersections of Corporate Governance, Corporate Law and Labour Law' (2005) 23 *Wisconsin International Law Journal* 417, 430.

[37] Waring and Lewer, ibid, 102.

[38] Waring, above n. 15, 7.

[39] Waring and Lewer, above n. 36, 102.

[40] Carol Royal, Farhad Daneshgar and Loretta O'Donnell, 'Facilitating Organisational Sustainability Through Expert Investment Systems' (2003) 1(2) *Electronic Journal on Knowledge Management* 167, 170.

review of relevant studies conducted in various regions internationally found evidence that sustainable human capital management is an indicator of a company's future financial success, and that company investment in creating sustainable workplace practices can create financial benefits in the long term.[41] There may be institutional complementarities between increasing proportions of company shares being held by institutional investors and the pursuit of 'high commitment' human resource practices. The reasons for this complementarity are difficult to establish, as the proposition that long-term investment by institutional investors *causes* or in some way contributes to 'high commitment' labour management practices in companies is difficult to establish empirically. Several studies conducted internationally have made positive findings in support of the theory that institutional investors are more likely to invest in companies with good human resource practices, and that companies in which institutional investors have holdings are more likely to have good human resource management practices. Most of this evidence derives from studies of institutional investor concern for corporate social performance or responsibility, of which labour management is only one indicator amongst many.

A study conducted by Graves and Waddock concluded that institutional investors were taking into account information relating to corporate social performance, including employee relations, when making investment decisions.[42] The study examined a group of 430 companies drawn from the Standard and Poor's 500 and cross-referenced ownership data with a company's corporate social performance**.** Corporate social performance was measured according to data developed by Kinder, Lydenberg, Domini & Co which ranked companies according to eight attributes: these included community relations, employee relations, environment, treatment of women and minorities, and military contracts. The study drew on this data to rank companies that performed well (those having a "major strength") and poorly (those having a "major weakness") against these attributes. The study found a positive and significant relationship between corporate social performance and the number of institutions holding shares in a company, and a positive but insignificant relationship between corporate social performance and the percentage of shares held by institutional investors. This led the authors to conclude that 'institutions buy stock in companies

[41] Ibid, 168 – 9.
[42] Samuel B. Graves and Sandra A. Waddock, 'Institutional Owners and Corporate Social Performance' (1994) 37 *Academy of Management Journal* 1034.

when corporate social performance improves' and that 'improving social performance will not depress institutional stock ownership.'[43]

A later empirical study of a sample of 678 UK firms drawn from the FTSE AllShare Index matched social performance data to accounting and company ownership data.[44] Social performance data, which was drawn from the Ethical Investment Research Service included, as an indicator, 'employment',[45] which constituted occupational health and safety; training and development; equal opportunities; employee relations and job creation and security. The study found that the proportion of a company owned by long-term investors was 'significantly and positively related to company social performance.'

Given the diversity of institutional investor share ownership, disaggregation may assist in understanding the different investment strategies and concerns of different types of investors. In a study of institutional investor share ownership by Johnson and Greening, institutional investors were classified into two groups of investors: pension funds (similar to Australian superannuation funds) and mutual funds.[46] The authors found that a positive and significant relationship existed between pension fund share ownership and the "people dimension" of corporate social performance, which was evaluated against the criteria of community, women and minorities and employee relations. However, no relationship was found to exist between mutual fund ownership and the people dimension of corporate social performance.[47] Johnson and Greening suggested that the reason pension fund ownership was found to have a positive correlation with corporate social performance was the tendency for pension funds to have longer-term investment horizons. They claimed that managers of mutual funds are measured against short-term performance criteria and typically have quarterly incentive schemes. They therefore have short-term investment horizons, and are not predisposed to spending resources on dimensions of corporate social performance that tend to reap financial rewards in the longer term. Pension funds, on

---

[43] Ibid, 1044.
[44] Paul Cox, Stephen Brammer and Andrew Millington, 'An Examination of Institutional Investor Preferences for Corporate Social Performance' (2004) 52 *Journal of Business Ethics* 27.
[45] Social performance was also measured according to environment, community, human rights and supply chain management: Ibid, 35.
[46] Richard A. Johnson and Daniel W. Greening, above n. 8, 564.
[47] Ibid, 571.

the other hand, are managed by salaried employees who do not face short-term performance evaluation and bonuses based on short-term results. Also, pension funds tend to have large individual holdings, and hold shares in companies for a longer time.

Further disaggregation may be possible based on the different investment products offered by institutions. Many institutions now offer socially responsible investment products or sustainable investment products. It has been theorised that the rise in popularity of socially responsible investment products and the growth in the number of these products offered by institutional investors can contribute to the pursuit of more sustainable human resource management practices.[48] Socially responsible investment (SRI) has been defined 'as an investment management based activity that involves consideration of non-financial factors in investment and related decision-making (e.g. voting of shares').[49] Decisions are made in the management of SRI funds 'as to which investment, in a universe of investments having comparable risk/return profiles, is to be acquired, retained or realised by reference to non-financial factors', including social factors, such as the company's labour management practices.[50] SRI funds typically employ 'positive' and / or 'negative' screens in making investments, in order to construct portfolios. Negative screens filter out companies in errant industries, such as gambling or tobacco production, or companies engaging in particular unethical or socially or environmentally harmful activities.[51] Positive screens identify ethically desirable investments and factor these 'ethical' companies into investment portfolios.[52] Institutional investors do not use uniform criteria in screening companies, and may employ a range of factors in constructing screens. However, it has been argued that increasingly, investment funds are applying labour considerations to SRI screens, often in the context of human rights screens which make use of International Labour Organization (ILO) Conventions.[53]

---

[48] See Waring and Lewer, above n. 36.
[49] Philip Spathis, 'Corporate Governance and Superannuation Investors' (2001) *Corporate Citizenship: A Newsletter of the Australian Council of superannuation Investors* 1, 23.
[50] Ibid.
[51] Paul U. Ali and Martin Gold, 'Investing for Good – The Cost of Ethical Investment' (2002) 20 *Company and Securities Law Journal* 307, 307.
[52] Ibid.
[53] Waring and Lewer, above n. 36, 101.

SRI has experienced significant growth in Australia in recent years, and '[t]he status of SRI funds has shifted from being a novelty financial product to become a major force in international equities markets.'[54] As at March 2003, the total amount of funds under management in Australian equities SRI funds was estimated at just over $2.3 billion,[55] up from $1.9 billion at 31 December 2001.[56] What is the likely impact of this increase in the availability of SRI? The rise in SRI should, according to Waring and Lewer, reduce capital flows to companies with poor labour management reputations, and thereby apply pressure on these companies to alter their practices.[57] It may signal to the market that a positive human resources reputation can lead to higher shareholder demand and therefore, a higher share price.[58] In addition, the negative publicity generated when a company is excluded from an SRI fund's portfolio can signal to the market that the company is a perceived undesirable investment.[59]

In Australia, the potential influence of SRI funds in this respect is likely to be mitigated by the fact that SRI funds still only constitute a very small percentage of overall investment in the Australian equities market.[60] As at March 2003, equity funds under management in SRI funds constituted only 0.31% of total funds under management held in all managed funds.[61] Further, the pressure on companies to improve their human resource management practices in order to increase SRI is likely diluted by the multiplicity of different screens used by different SRI funds, muddling the message concerning market expectations relating to labour management practices.

Empirical research regarding the attitudes of investors towards SRI does not suggest there will be a sudden increase in the number of SRI funds offered by Australian institutional investors. For instance, the Shareholders' Project did not find widespread enthusiasm towards 'ethical investment' or 'socially responsible investment' amongst

---

[54] Ibid, 99, referring to Allens Consulting Group.
[55] Matthew Haigh and James Hazelton, 'Financial Markets: A Tool for Social Responsibility?' (2004) 52 *Journal of Business Ethics*, 59, 63, citing Rainmaker Information, March Quarter 2003.
[56] Paul Ali and Martin Gold, above n. 51, 1, citing Rainmaker Roundup, December 2001.
[57] Waring and Lewer, above n. 36, 102 – 3.
[58] Ibid, 103.
[59] Ibid.
[60] Ibid.
[61] Haigh and Hazelton, above n. 55, 63. Compiled from data drawn from Rainmaker Information, Investment Company Institute and Lipper, Avanzi SRI Research and SiRi Group.

respondent institutional investors.[62] It may be plausible to expect an amendment to the *Corporations Act* 2001 (Cth), introduced by the *Financial Services Reform Act* 2001 (Cth), to trigger greater interest by beneficiaries/clients in SRI. The amendment requires institutional investors to disclose ‘the extent, if any, to which labour standards, environmental, social or ethical considerations are taken into account in the selection, retention or realisation of the investment’.[63] This provision compels institutional investors to disclose these matters in relation to their investment and company engagement policies and practices. In an environment of increased public interest in corporate social responsibility, the amendment may draw attention to the absence of such considerations in mainstream products, making SRI products more attractive to those who wish their investments to be guided by social concerns. Alternatively, it may provide the impetus for institutional investors to include some of these considerations in non-SRI funds in an attempt to attain a competitive edge.

Despite this small legal development, it is likely to be some time before SRI funds reach a size that is sufficient to have a measurable impact on the human resource practices of investee companies. It may be that the greater impact will arise from the infiltration of the lessons learnt from the SRI context and the translation of these lessons into the management of mainstream investment policies.

4.2 Direct Influence: Active Engagement for Better Human Resource Practices

Some authors have gone beyond stating there are institutional complementarities between the universality and patience of institutional investors and the pursuit of ‘high commitment’ employment practices by investee companies. They have posited that the characteristics of institutional investors make them more likely not only to invest in companies that demonstrate good human resource management, but also to actively engage with investee companies to foster improved human resource practices. Waring, for instance, has posited that the rise in institutional investor equity holdings may facilitate more active involvement by investors in investee companies.[64] He theorises that institutional investors are more likely to be ‘insider-relational investors’:

[62] Irving Saulwick and Associates, above n. 34, 20.
[63] Section 1013D(1)(l).
[64] Waring, above n. 15.

a term developed by Gospel and Pendleton to describe investors that have active and long-term investment horizons and engage in building company wealth, including human capital, in the long-term.[65]

Waring asserts that because the ability of institutional investors to exit their investments is diminished (because their large holding may depress the share price if the holding is sold or because of their long term investment horizon), the investor is left with two options: voice or loyalty.[66] That is, they have the option to entrust ownership responsibilities to the management of companies in which they invest (the 'loyalty' strategy), or actively engage with management, to express their concerns and seek to exert influence over management (the 'voice' strategy).[67] It seems logical that the larger the size of investment in a company, the more likely an institutional investor is to opt for the 'voice' mechanism, as the costs involved in active management become less significant the larger the holding. Deakin likewise posits that universal ownership has delivered 'strong incentives to become actively involved in the affairs of individual companies.'[68] The incentive to engage is also likely to flow in the opposite direction. Investee companies are also more likely to actively engage with investors who have large and long-term holdings. In contrast to the anonymous nature of diffuse retail shareholdings, the significant amount of funds held collectively by institutional investors means that company management faces 'an identifiable group of portfolio managers', rather than a widely dispersed shareholder group.[69] They may therefore be more likely to discuss changes in business strategy with large investors before making major decisions.

Because good human resource practices can impact favourably on 'long-run risk and return',[70] it is suggested in the literature that investors will actively engage with companies to encourage the pursuit of 'high commitment' labour management. However, there have been no empirical studies conducted in Australia specifically on this point, to our knowledge. Most studies are focused on the manner in which investors engage with companies concerning either corporate governance or corporate

[65] Gospel and Pendledon in Waring, ibid, 2.
[66] Ibid, 6, referring to Hirschman.
[67] Ibid, 7.
[68] Deakin, above n. 29, 16.
[69] Ibid, 5.
[70] Cox, Brammer and Millington, above n. 44, 29.

social performance. In 2001, The Shareholders' Project examined the views of 60 institutional investors, including 39 superannuation fund trustees, in relation to their willingness and ability to influence corporate behaviour and their opinions concerning socially and ethically responsible investment.[71] The study found that large superannuation funds and other investment funds felt they were able to exert influence on the 'policies and operations' of individual investee companies.[72] These investors tended to exert influence through face-to-face interventions, utilising personal industry contacts.[73] Smaller funds felt unable to exert influence.[74] The study also sensed a move toward greater collective action among institutional investors, although this kind of action was found to be minimal and limited to smaller funds at the time of the survey.[75]

This study found that some institutional investors reported attempts to exert influence in relation to ethical or social issues, including industrial relations. One superannuation fund manager mentioned intervening in a company in relation to its 'treatment of workers.' Another mentioned exercising its AGM votes in favour of a union-sponsored resolution relating to Rio Tinto's adherence to ILO Conventions.[76] One institutional investor also mentioned that it attempted to exert indirect influence through its selection criteria for the appointment of fund managers, which included consideration of 'their attitude to ILO Conventions.'[77] There were also some indications, from both superannuation funds and other institutional investors, that issues such as labour management would become more important to their investment and company engagement policies and practices in the future.[78]

Other studies of Australian institutional investors have provided support for the thesis that these investors employ 'voice' mechanisms, but generally with regards to corporate governance issues. A 1998 study of 12 Australian institutional investors by Ramsay, Stapledon and Fong found that institutional investors use proxy voting as

[71] Irving Saulwick and Associates, above n. 34.
[72] Ibid, 7.
[73] Ibid, 30.
[74] Ibid, 7.
[75] Ibid, 33.
[76] Ibid, 11.
[77] Ibid, 12.
[78] Ibid, 13 – 15.

well as ‘behind the scenes’ actions to influence the corporate governance practices of investee companies.[79] Ten investors said they preferred to resolve contentious issues behind the scenes with companies before an issue was put to the vote. Nine institutions maintained frequent communications with companies (usually with senior managers) in relation to issues such as financial and economic conditions, strategic planning and management issues. A 1999 study by Fabris and Greinke, based on a series of interviews with 27 representatives from nine Australian institutional investors made similar findings. It found that these investors sought, at times, to actively engage with company management in relation to corporate governance issues; however, they were generally not considered as being significantly active.[80] Proxy voting was found to be the ‘clearest indication of institutional investor activism’. Also, interviewees were found to express the general view that cooperative and constructive relationships between investors and companies were valuable and provided a form of company monitoring.[81]

The 2006 ISS survey, cited earlier in this report, found collective action among institutional investors to be an emerging global trend. In the Australian-New Zealand market, the study found that investors rely most on engagement by third parties, especially industry associations representing institutional investors. Almost one in five investors interviewed in these markets stated that a third party engages with companies on their behalf (in comparison to a global average of around 5 percent).[82] Superannuation funds were found to be particularly involved and interested in collective engagement, while other institutions were not as heavily involved in collective engagement practices.[83]

All three studies provide support for the hypothesis that Australian institutional investors are increasingly engaging in ‘voice’ mechanisms in their relations with investee companies. They thus provide partial support for the theories developed by both Deakin and Waring in the context of the emerging prominence of institutional

---

[79] Ian Ramsay, Geof Stapledon and Kenneth Fong, ‘Corporate Governance: The Perspective of Australian Institutional Shareholders’ (2000) 18 *Company and Securities Law Journal* 110.
[80] Paul Fabris and Andrew Greinke, ‘Institutional Activism: Attitudes of Australian Fund Managers’ (1999) 7 *Corporate Governance: An International Review* 379.
[81] Ibid, 381.
[82] Institutional Shareholder Services, Inc., above n. 31, 35.
[83] Ibid, 36.

investors in the Australian equities market. However, because these studies were not specifically focused on the extent to which institutional investors exercise ‘voice’ mechanisms with regard to the industrial relations or human resource management of investee companies, they do not provide us with evidence to draw any conclusions on this point.

4.3 Barriers to Investment Selection or Engagement Concerning Human Resource Practices

Whilst there may be an emergent trend in Australia towards active engagement by institutional investors in investee companies, it has been argued that Australian institutional investors face various barriers to active engagement and monitoring. The ability to monitor company practices is a precondition to making investment selections (buying, retaining, selling) on the basis of non-financial data, and utilising informed ‘voice mechanisms’. Several legal barriers are imposed by corporations law. These include the provisions on insider trading,[84] takeover and substantial shareholding provisions[85] and ‘shadow director’ provisions.[86]

[84] It is possible that the prohibition on insider trading contained in Part 7.10 Division 3 of the *Corporations Act* 2001, may act as a disincentive to company monitoring by institutional investors. Where an institutional investor comes into contact with “inside” (price-sensitive) information during the course of monitoring, it must not trade on this information, communicate it to another party or procure another party to trade in the shares. One author argues that insider trading provisions may serve as a disincentive to acquire information about a company, particularly in the “pre marketing” stage of a proposed large transaction: see Geof Stapledon, ‘Disincentives to Activism by Institutional Investors in Listed Australian Companies’ (1996) 18 *Sydney Law Review* 152, 158 – 175.

[85] Stapledon argues that, where several institutional investors act collectively to some extent in relation to a company in which each has a shareholding, they may potentially be in breach of the takeover and substantial shareholding provisions which were previously contained in Part 6.7 and s. 615 of the *Corporations Law* (now contained in Part 6C.1 and s. 606 of the *Corporations Act* 2001). Former Part 6.7 (now Part 6C.1) requires any person who becomes, or ceases to become, a “substantial shareholder”, or whose substantial shareholding changes to notify the company and the Australian Securities Exchange of certain particulars. A person is a “substantial shareholder” where they or their associates have a “relevant interest” in 5% or more of votes attached to voting shares in a company (s.9 *Corporations Act* 2001). Section 615 (now s. 606) prohibits a person from acquiring a “relevant interest” in a company where this increases this person’s or someone else’s voting power in a company from 20% or below to above 20% or from a starting point that is between 20% and 90%. “Relevant interest” includes not only the power to vote but also the power to dispose of shares in a company (s.608 *Corporations Act* 2001), which would include nearly all institutional investors. Institutional investors may breach these provisions not only in relation to shares in which they have a “relevant interest”, but also in relation to “associates” which have a “relevant interest” in a company. An associate is defined, for these purposes, in s. 12(2) as a person acting in concert with the primary person (through a formal or informal arrangement, agreement or understanding). Using Stapledon’s example, where four institutional investors each with a “relevant interest” in a company, decide independently to take shareholder action against the company where, for example, the actions of a director are damaging the company’s profitability, they could activate Part 6C.1 or contravene s.606.

Institutional investors also face economic and practical barriers to engagement. Economic disincentives to actively engaging with and monitoring company management include collective-action and free-rider problems; limitations in procedures used to assess the performance of external fund managers, which reduces incentives to monitor and engage with companies;[87] and conflicts of interests, as many institutional investors also provide services to companies (e.g. banking services).

The costs inherent in monitoring, in addition to imperfect information problems, may further inhibit monitoring and engagement concerning labour management. Investors may find it difficult to obtain adequate information on human resource practices in order to effectively monitor human resource management.[88] In the absence of standardised reporting regarding employment practices, company managers can largely control which information flows to investors and therefore "may be able to astutely 'manage' investor relations.[89] Furthermore, whilst it has become reasonably acceptable for institutional investors to monitor and show concern regarding corporate governance, there may be reluctance to 'second guess' the management of a company in relation to human resource matters: something best left to managers. [90] Institutional investors may exclude monitoring employment issues as part of their company engagement practices on this basis.

Any dialogue between these shareholders relating to the shareholder action may cause them to become 'associates', as they could be construed as acting in concert with one another. They may therefore be obliged to either give a substantial shareholder notice to the company and the ASX (where collectively they hold more than 5% of voting shares) or, where they collectively hold over 20% of voting shares, an institutional investor may contravene s. 606 should it subsequently make an 'acquisition of shares.' See ibid, 158 – 170.

[86] Where appointed company directors 'are accustomed to act in accordance' with 'the wishes' of an institutional investor, pursuant to the definition of 'director' in the *Corporations Act* 2001, the institutional investor will be deemed to be a director of the company. Stapledon argues that this may act as a disincentive to activism by institutional investors, as, if deemed a director, the institution will be subject to various provisions in *the Corporations Act* including insolvent trading and directors' duties provisions. See ibid, 158 – 175.

[87] Stapledon argues that in Australia, as in the UK and US, the performance of fund managers is measured through 'league tables' prepared by asset-management consultants, which assess a fund manager's performance comparatively (that is, performance is 'measured *relatively* rather than *absolutely*'). This means that 'it may be irrational for any one fund manager to provide the collective good (monitoring)': see ibid, 179.

[88] Ibid, 188.

[89] Waring, above n. 15, 8.

[90] Stapledon, above n. 84, 175 – 188.

A related issue is whether the disincentives to 'exit', arising from the problems associated with investors that have a large stake of a company such that they may depress the share price should they opt to sell, may be exaggerated. The 'Wall Street walk' is still thought to be 'a major option' for investors where problems are identified in company management, [91] although it may be an action of last resort. [92] On the one hand, the threat of exit may bolster the strength of engagement strategies. On the other hand, it may make institutional investors more likely to restrict monitoring and engagement to strictly financial or governance-based topics and use exit as a safety mechanism in the event of company mismanagement.

Putting aside these barriers to engagement, it is our view that there remains a larger problem. Whilst some evidence may exist to support the proposition that institutional investors may attempt to influence company labour management, it does not follow that companies act upon the stated desires of investors. Even where institutional investors are interested in human resource management practices in an investee company and seek to influence management in this regard, the system of corporate governance in place in Australian results in managers retaining the prerogative to determine their preferred management strategies. Where holdings amongst institutional investors are small, numerous investors may send different messages to company managers regarding the preferred human resource strategies, thereby allowing managers to adopt the strategy which best suits their interests. Thus, even where incentives to monitor and engage with management in relation to labour management practices are present, institutional investors may face barriers in translating this interest into tangible influence in the labour management of companies.

4.4 Summary of the Literature

Our survey of the literature shows that some authors have speculated that there is a link between the growth in the proportion of equities held by institutional investors and a propensity to adopt 'high commitment' human resource practices by investee

[91] Ibid, 177.
[92] Ramsay, Stapledon and Fong, above n. 79.

companies. To sum up this literature, we might say that the *context and rationale* of the link is posited variously as follows:

i. The proportion of equities held by institutional investors has grown significantly in recent years. Institutional investors now often have the largest share holdings in individual Australian companies.
ii. The clients of institutional investors, especially those of superannuation funds, are often employees who will realise the returns on their investments when they retire. This means that their investments are long-term, rather than short-term, investments.
iii. As employees, the clients of institutional investors may have a natural concern to ensure that investments are made in companies with good human resource practices. Further, as industry superannuation funds have sometimes been created at the instigation of labour unions, and are required to have boards constituted by half employee representatives and half employer representatives it might be expected that the employee representatives would pursue labour issues in the course of their stewardship of the funds.
iv. Because of the large, concentrated and relatively illiquid nature of institutional investor investments, institutional investors have less ability to exit from investments compared with smaller retail investors.
v. Reduced ability to exit means that institutional investors have a heightened concern to reduce the risks associated with investments. Good human resource management and fair industrial relations strategies are risk reduction strategies.

The *nature* of the influence exerted by institutional investors, and the *mechanisms used* are posited as being both *direct* and *indirect* and may be summarised as follows:

vi. As a consequence of the long term investment time frames of some institutional investors, investee companies may be given more scope to invest in human capital when a higher proportion of their shares is held by these institutional investors rather than investors with short term investment horizons; or
vii. Long-term investment in human capital may be more likely to produce returns for investors in a sustained manner, thus institutional investors may wish to invest in companies that exhibit this kind of behaviour. This may, in turn, have an indirect influence on company practices. Because companies know that

institutional investors determine their investment strategies, at least in part, based on information about human capital management, they may wish to demonstrate high commitment human resource practices.

viii. Alternatively, the influence may be direct. Where institutional investors are unable to use exit as a mechanism to reduce their exposure to risky investments, they may be more likely to use 'voice' mechanisms. That is, they may actively engage with investee companies in order to influence human resource and industrial relations strategies.

However:

ix. Some authors have proposed that there may be significant barriers to either taking into account the human resource management practices of investee companies, or engaging with companies using 'voice mechanisms' regarding labour management.

Whilst our literature review shows there has been speculation by some authors concerning the impact of the growth of institutional investment on the labour management of companies, it also indicates there has been very little empirical research conducted in Australia. That empirical research which has been conducted has mainly tested for a 'social performance' or 'CSR' affect, rather than studying the behaviour of institutional investors regarding labour relations specifically. Thus, very little is known in this regard.

The literature review presents a number of possible hypotheses which might be tested in the Australian context. However, as noted in the methodology part of this report, the choice of a case-study methodology limits our study to the behaviour and attitudes of institutional investors, and does not allow us to study the impact of their behaviour and attitudes. As a result, we test whether institutional investors engage with investee companies in order to encourage 'high commitment' human resource practices. These findings have implications regarding the possible *direct* influence of institutional investors. The methodology also allows us to test whether investors take into account human resource management in their investment decisions, which would be a precondition to any *indirect*, market effect on investee or potential investee companies.

5. CASE-STUDY FINDINGS

In this part of the report we outline the empirical findings from our case studies of twelve Australian institutional investors and the Australian Council of Superannuation Investors (an industry body representing 39 superannuation funds). We provide a description of the investment strategies of each investor, as well as an outline of the practices of each investor with regards to the employment practices of investee companies. We have grouped the institutional investors into two categories: those that seek to influence the employment practices of investee companies and those that do not. We have further categorised the investors on the basis of whether they manage their investment funds internally or whether they manage their funds externally (ie, use external investment managers). Superannuation funds typically manage funds externally.

The case studies elicited a range of views as to whether, the extent to which, and how institutional investors intend to influence the employment practices of companies in which they hold shares, regardless of whether their investments are managed internally or externally. There is a marked difference in the systems employed by the superannuation funds interviewed, as compared to other institutional investors, in the way in which they seek to influence companies in relation to employee management. This is partly due to the fact that the Australian equities investments of the superannuation funds studied are largely managed externally by a range of fund managers, in contrast to other institutional investors interviewed, which predominantly manage funds internally. Thus, different systems are employed by the superannuation funds and other institutional investors interviewed whereby they seek to influence the employment practices of investee companies.

5.1 Institutional Investors with Internally Managed Funds that Seek to Influence the Human Resource Practices of Investee Companies

Contrary to the argument in some of the literature that superannuation funds would be more concerned than other institutional investors to monitor and influence the human

resource practices of investee companies,[93] a number of the non-superannuation institutional investors that we studied have demonstrated some activity in relation to this issue. We found that those institutional investors that internally manage funds which evinced concern for employment practices as a risk management strategy have a greater aptitude to modify their investment and engagement strategies accordingly. This is because they manage funds in-house rather than outsourcing the management of funds, as in the case of many superannuation funds studied. Three out of five non-superannuation institutional investors studied monitor and seek to influence the labour management practices of investee companies to varying extents and using a variety of methods. Whilst these processes are in an embryonic stage, they are growing in sophistication.

BT Financial Group ('BT')

BT is the investment arm of the Westpac Banking Corporation. Its core business is investment, margin lending, superannuation and retirement income streams,[94] and it manages funds internally and through external, pooled investment managers.[95] BT is a large institution and has around $73 billion of funds under management.[96] It has large individual holdings in numerous Australian companies (large holdings are defined as being 3% or more of total equities of an individual company), including a holding of 13% in one company.[97] BT has long-term investment horizons, but performance is measured in 'shortish term increments.'[98] Whether BT can easily or quickly exit out of investments will depend on the specific holding, and the liquidity of each of BT's equities holdings is carefully monitored such that analysts are able to calculate how many days it would take to exit out of an investment. This can vary from 'a couple of minutes to…a hundred days' depending on each particular investment.[99]

---

[93] See Johnson and Greening, above n. 8.
[94] BT Financial Group, 'About Us', available at <http://www.btonline.com.au/content/general/about.htm>
[95] Ibid.
[96] As at September 2005: BT Financial Group, 'BT Investment Funds', available at <http://www.btonline.com.au/content/information/mf_glance.htm>
[97] Interview with Head of BT Governance Advisory Service, BT Financial Group, 13 February 2006.
[98] Ibid.
[99] Ibid.

In general, there is no systematic analysis of human resource issues by BT analysts over the majority of equity investments. BT analysts routinely hold several meetings with company representatives each year in order to maintain an active dialogue with board members and senior executives and make non-data-based, intuitive assessments of risks involved in investments:

> *You will usually have one or two meetings each year, at Board or senior executive level, outside of the formal briefings just in order to sort of touch base and refresh on your relationship and make sure that you're keeping abreast on any issues, but obviously at the same time you're looking to read the body language of the professionals involved just to make sure that there's not something that you might be missing in your research.*[100]

Human resource issues may be discussed at these routine meetings, but only if initiated by the management of that company or if the analyst has questions regarding a particular, current industrial relations matter, for example, an ongoing industrial dispute.

When a BT analyst has a concern about the governance of a company, he or she is likely to utilise 'voice' mechanisms before other mechanisms such as proxy voting at AGMs.[101] The analyst will typically raise the issue with the board or senior executives, depending on the issue. Analysts will 'pick up the phone or have a meeting with directors, raise the issue and seek out their view point and concerns and they either address that or otherwise we encourage them to modify what they're doing.'[102] In companies in which BT has a large holding, 'selling pressure' is sometimes used and this pressure is, at times, perceived as having the capacity to influence company

[100] Ibid.

[101] The BT Financial Group (BTFG) does have a policy on proxy voting in which it stipulates that it 'regards corporate governance and the exercise of voting power as simply another aspect of the investment decision. BTFG will not become involved in day-to-day management issues but recognises that it can influence company policy on matters of corporate governance by virtue of shareholdings under our management. In accordance with industry practices, and the IFSA guidelines in particular, BTFG uses that influence for the benefit of its clients': BT Financial Group, *Proxy Voting Policy*, 30 November 2005, available at <www.btonline.com.au/downloads/flyers/proxyvoting.pdf>

[102] Interview with Head of BT Governance Advisory Service, BT Financial Group, 13 February 2006.

behaviour: it is thought that, at times, it forces the company 'to be very careful before they decide to proceed [with] a particular strategy.'[103]

BT will attempt to directly engage with a company in relation to human resource issues where there is a particular perceived problem in relation to a company:

> *Typically it will be done as a measure when there's already a concern, there would be a means to understanding the depth of that concern, it won't typically be an initial filter. Having said that, you know the experienced analyst certainly will have some knowledge of that and they will at worst subconsciously incorporate those issues because they know their companies quite well.*[104]

Also, BT provides the BT Governance Advisory Service (BT GAS), which is 'a sustainability and corporate governance risk management service designed to enhance the performance of S&P/ASX200 companies,'[105] by directly engaging with individual companies. The service is utilised by five Australian superannuation funds, and is discussed in more detail below.[106]

BT also considers human resource issues in selecting and retaining investments in its conventional funds, but not in a systematic manner: 'such issues may financially affect an investment and any such financial effect would influence our investment decisions.'[107] BT analysts take into account human resource issues, but not as an 'initial filter'. Human resource issues will be considered as an indicator of how well a company is being managed, and as a potential governance risk, but only after financial indicators are considered.[108]

In relation to its SRI products, which constitute a total of $260 million (less than 0.5%) of BT's total funds under management, BT expressly 'take into account

---

[103] Ibid.
[104] Ibid.
[105] BT Financial Group, 'BT Governance Advisory Service: A Pro-Active Approach to Managing Long Term Risks', April 2005 (on file with authors).
[106] See section 5.3.
[107] BT Financial Group, *BT Investor Choice Funds: Product Disclosure Statement* 35.
[108] Interview with Head of BT Governance Advisory Service, above n. 97.

environmental, social and ethical considerations, as well as financial criteria, when selecting, retaining or realising investments.'[109] One of its SRI products, for example, the 'Australian Sustainability Share Fund', explicitly takes into account workplace management issues.[110] In constructing the Australian Sustainability Share Fund portfolio, BT adopts a 'best of sector' approach and engages Monash Sustainability Enterprises, a research organisation, to conduct research into companies in relation to environmental, social and ethical criteria and rank them on a scale of 1 to 5 (1 being the highest ranking).[111] The rankings take into account 'the nature of the company's exposures, drawing upon materiality principles to focus the assessment on aspects relevant to the protection and enhancement of long term shareholder value.'[112] BT will then accord the companies a financial ranking on a scale of 1 to 5. Both of these rankings will be taken into account in the selection and retention of investments.[113] If an investee company's ranking in relation to any of these criteria drops to 4 or 5, BT will normally sell the investment 'within a reasonable time.'[114] Monash Sustainability Enterprises researches various issues under the rubric of 'environmental' or 'social' considerations. It considers 'workplace management' issues within its assessment of social considerations (other social considerations are 'human rights and business ethics' and 'community relations').[115] It uses the following list of workplace management issues when researching companies:

- *Occupational health and safety practices*
- *Management of contractors and suppliers*
- *Staff incentives, development, and training policies*
- *Equal opportunity and anti-discrimination policies*
- *Industrial relations practices*
- *Employee entitlement practices.* [116]

---

[109] BT Financial Group, above n. 107, 35.
[110] BTFG also offer a range of 'ethical' SRI products, which 'apply negative and positive screens to the investment selection process' in ASX 300 companies. These screens incorporate a range of issues, such as uranium mining, and alcohol and tobacco and weapons manufacture, but do not explicitly include labour management issues: see BT Financial Group, 'Socially Responsible Investments', available at <http://www.btinstitutional.com.au/content/investments/social_invest.htm>
[111] BT Financial Group, above n. 107, 35 – 36.
[112] Ibid.
[113] Ibid, 36.
[114] Ibid.
[115] Ibid.
[116] Ibid.

The weighting of workplace management issues (along with other social and environmental issues) varies across companies according to their relative exposure to these issues.[117]

Portfolio Partners

Portfolio Partners, established in 1994, is owned by Morley Fund Management, one of the UK's largest fund management firms,[118] and currently has around $9 billion in funds under management.[119] It offers a range of investment products for both individuals and institutions,[120] and has recently launched an SRI product: the Long/Short Sustainability Fund.[121] Portfolio Partners has many large holdings in individual companies: in approximately 20 companies, holdings are 5% or over.[122] Portfolio Partners has what it terms 'longer-term' investment horizons, although this is not due to the size of the fund or the size of individual investments. Rather, as it is a 'bottom up' manager, Portfolio Partners will assess company fundamentals and secure investments in light of what they could yield over a longer time frame (typically '12 plus months').[123] Shares trading below their underlying valuation in the short term are identified and Portfolio Partners, by taking a long-term view, trades off the short-term undervaluation to attempt to secure value in the long term.[124] Although

---

[117] A Senior Research Fellow at Monash Sustainability Enterprises states that "the weighting applied to HCM (Human Capital Management) issues varies across individual companies depending on their relative exposures to HCM, community, or business ethics risks. For example, where a company/industry is experiencing critical skills shortages, HCM would tend to be weighted more heavily in the framework. Similarly, a company that has very little direct engagement with the community (say a software company) would not be assessed to any significant degree on human rights or community relations factors. The same applies to environmental issues": Email correspondence with Senior Research Fellow, Monash Sustainability Enterprises, 8 November 2006.

[118] Portfolio Partners, 'About Us', available at <http://www.portfolio partners.com.au/Default.aspx?tabid=28>

[119] Ibid.

[120] See Portfolio Partners, 'Individuals: Investment Trusts' available at <http://www.portfolio partners.com.au/Default.aspx?tabid=83> and Portfolio Partners, 'Institutions: Investment Trusts', available at <http://www.portfolio partners.com.au/Default.aspx?tabid=46>

[121] Leng Yeow, 'Portfolio Partners Launches New Long/Short Fund' *Investment and Technology*, 1 February 2006, 11, available for download at <http://www.portfoliopartners.com.au/Default.aspx?tabid=87>

[122] Interview with Managing Director, Portfolio Partners, 24 February 2006.

[123] Ibid.

[124] Portfolio Partners, 'Investment Approach', available at <http://www.portfoliopartners.com.au/Default.aspx?tabid=31>: 'the pricing of individual stocks and sectors on the Australian sharemarket is at times inefficient. As a consequence, stocks sometimes trade away from their underlying valuation in the short term…(Portfolio Partners) seek to identify these opportunities by taking a longer term view, and through detailed, systematic research of stocks from a bottom-up perspective.'

Portfolio Partners is careful to maintain liquidity in individual investments, according to the Managing Director, selling shares is typically a last resort measure and will only occur after attempts to influence perceived problematic management practices through a dialogue have failed to yield favourable results.[125] Where it is to sell shares, Portfolio Partners will normally notify the company beforehand.[126]

Portfolio Partners uses the principle of sustainability in monitoring and engaging with companies in its conventional funds, and sustainability assessment is a 'core part' of its research in relation to all investment products.[127] Portfolio Partners has developed a position paper on "human capital"[128] and has, for the past two years, been reviewing the human capital management policies and practices of Australian companies, through the distribution of a survey to ASX 300 companies, although the response rate to the survey has not been very high.[129] The survey attempts to elicit information from companies and evaluate their human resource practices 'based on the types of indicators found to be present in high performing organisations' in relation to 'culture and people management practices.'[130] In particular, the survey attempts to elicit information about the presence and nature of a company's Code of Conduct or Guiding Principles; the collection of staff feedback and the results of recent feedback; whether information, such as company financial performance, goals, progress, staff achievements and initiatives are regularly communicated to staff; the presence and types of flexible work practices, such as flexible hours, availability of part time work, work from home options and paid parental leave; staff turnover rates and typical reasons for departure (as communicated through exit interviews); recruitment processes; representation and consideration of human resource interests at board level and staff participation in developing business strategy; remuneration, in particular the presence and nature of incentive-based payment schemes; and allocation of budget for staff training and development.[131]

[125] Interview with Managing Director, Portfolio Partners, above n. 122.
[126] Ibid.
[127] Ibid.
[128] Portfolio Partners, *Human Capital Research Paper*, November 2003.
[129] Ibid.
[130] Ibid, 6.
[131] Portfolio Partners, *Survey: Research on Human Capital* (on file with authors).

According to the Managing Director, it is hoped that analysis of human resource practices of companies will move human resource management 'into a new area whereby it wasn't just payroll' and other quantitative indicators, but is 'strategically involved in identifying the analysis of a company and the way they use their staff.'[132] Portfolio Partners attempts to analyse company policies and statistics related to employee management. It aims to assess company performance against various human resource indicators including staff recruitment and retention, development, morale, exit strategies, and so on.[133] Analysts also try to access information as to how these policies are implemented 'on the ground':

> *I suppose our job then is to say are they walking the talk? So we're getting lots of sustainability reports out there and OH&S numbers coming through and that really doesn't excite us...we want to get down and sort of say, okay well you said you were going to do this and the guys on the shopfloor are about to go on strike because of workplace practices because you're cutting costs on safety. That would be of interest to us and…means then we have a dialogue with them.*[134]

Portfolio Partners employs 'sustainable investment themes' in its SRI funds management selection (which currently has $50 million in funds under management) in order to research companies.[135] One of these themes is 'employee management.'[136] Portfolio Partners professes to 'favour companies with excellent corporate governance practices and superior human capital management', as it believes that 'companies with good human capital management will outperform because of their ability to attract and retain good employees.'[137] Portfolio Partners has recently employed a specialist manager (Manager, Sustainability) to 'analyse companies against sustainability filters.'[138]

---

[132] Interview with Managing Director, Portfolio Partners, above n. 122.
[133] Interview with Managing Director, Portfolio Partners, above n. 122.
[134] Ibid.
[135] Ibid.
[136] Portfolio Partners, *Portfolio Partners Long-Short Sustainability Trust: Information Memorandum*, 30 January 2006, 5, available for download at <http://www.portfolio partners.com.au>
[137] Ibid.
[138] Portfolio Partners, *News Release: Portfolio Partners Appoints New Manager, Sustainability*, 7 February 2006, available for download at <http://www.portfolio partners.com.au>

Portfolio Partners is an active investor.[139] In practice, this means it will 'make considered use of votes; enter into dialogue with companies based on mutual understanding of objectives; and give due weight to all relevant factors drawn to (their) attention.'[140] Portfolio Partners analysts generally conduct face-to-face meetings with managers of investee companies between two and five times a year. Meetings are normally conducted with Chief Executive Officers, Chief Finance Officers, and sometimes with other levels of management. Meetings are sometimes but 'not usually' held with Human Resources Managers. They then aim to verify this information through other information channels including competitors, suppliers and clients.[141]

Human resource issues are not currently routinely discussed at these meetings. This is expected to change, however, following the recent appointment of Portfolio Partners' Manager, Sustainability, who will conduct human resource management research into companies:

> *It will be routinely done going forward. It hasn't been routine enough because it's sort of been a new area for us to get in and try and find some science behind it...And now that I've got a person dedicated to it, I…want it to be a more integral part of every stock analysis. But we're really only just building up our database, so it will happen, it's a new trend but it's nowhere near what I want it to be.*[142]

Queensland Investment Corporation ('QIC')

QIC is a Queensland statutory government-owned corporation that operates as a commercial organisation.[143] It has around $32 billion of funds under management, and is Australia's fourth largest wholesale funds manager, and one of the ten largest investment managers in Australia.[144] It also has numerous large individual

---

[139] Portfolio Partners, above n. 124.
[140] Portfolio Partners, 'Corporate Governance', available at <http://www.portfolio partners.com.au/Default.aspx?tabid=48>
[141] Ibid.
[142] Interview with Managing Director, Portfolio Partners, above n. 122.
[143] As at 2004: QIC, 'About Us' (2004) available at <http://www.qic.com.au/qicnet/default.jsp?id=about_us> It was established in 1991 under the *Government Owned Corporations Act* 1993 and the *Queensland Investment Corporation Act* 1991.
[144] QIC, *QIC Corporate Profile*, available for download at <http://www.qic.com.au/qicnet/default.jsp?id=about_us>

investments in companies: 38 over 3%, and its largest individual investment is 17.4%.[145] QIC cannot easily exit smaller companies in which it has large investments without affecting the share price. However, in larger companies, for instance the ASX 100, QIC is able to retain liquidity.

QIC's clients are predominantly superannuation funds.[146] Other clients are government and statutory bodies; charitable funds; research, estates and other funds; insurance funds; and university and school funds.[147] It does not manage personal investments.[148] It has an SRI fund, which constitutes a very small percentage of QIC's overall funds under management ($8 million), and is managed externally by AMP.[149] QIC has a long-term investment horizon, due to the nature of its clients:

> *Most of our clients are superannuation funds…they tend to be longer term funds…99% of the money that we manage, is managed for people with a longer term horizon so it's appropriate to manage those investments over the long term, not over the short term. So it's not somebody who's coming in and saying I want to double my money in one year. It's somebody who comes and says I'm starting work at 19 and I'm going to retire when I'm 60. When I retire, I want a lot of money to live on so it will be done to invest it for tomorrow; you've got a 40 year time horizon.*[150]

As a result, QIC has the 'luxury' of being able to focus on long-term results, and, according to the General Manager, 'the focus of the organisation is less about profits and more about doing the job properly'.[151]

QIC maintains a close relationship with managers of investee companies, and conducts meetings with these managers 4 to 6 times a year.[152] It also actively

---

[145] As at 9 February 2006. Information provided by QIC (on file with authors).
[146] Information provided by QIC (on file with authors).
[147] QIC, 'Our Clients' (2004) available at <http://www.qic.com.au/qicnet/default.jsp?id=our_clients>
[148] QIC, 'Investing With Us' (2004) available at <http://www.qic.com.au/qicnet/default.jsp?id=investing_with_us>
[149] Information provided by QIC to authors (by email).
[150] Interview with General Manager, Queensland Investment Corporation, 10 February 2006.
[151] Ibid.
[152] Ibid.

considers and votes all AGM proxies.[153] According to the General Manager, QIC analysts assess a company's employee management practices as a matter of course when carrying out analyses of companies, although not in a systematic manner.[154] Although employee turnover figures may be used as a potential indicator of a problem within a company,[155] research into human resource practices seems mainly to be anecdotal in nature. In particular, analysts will attempt to ascertain whether human resource management policies permeate all ranks within a company, and lead to 'motivated and positive' employees:[156]

> *We go out there and visit the companies and actually do more than just go and sit in the boardroom with the Chairman and CEO, we actually go out and see the operations as well... you can get that from the people that work there. Surprisingly enough, you get a lot of it anecdotally…When you visited BHP say three years ago after Paul Anderson had taken over, [a] different perspective [was evident] from all the people including the cleaners and the cooks out on the mine site – this guy's fantastic, he's got an open policy about email, he talks to us, he's concerned and very different from what BHP was…all those things are useful.*[157]

5.2 Institutional Investment with Internally Managed Funds that do not Seek to Influence the Human Resource Practices of Investee Companies

Two of the non-superannuation institutional investors studied do not generally seek to influence the human resource practices of investee companies. One of these investors (Vanguard) is a wholly indexed, rather than actively managed, fund.

Barclays Global Investors (Australia) (BGIA)

BGIA is a major investor in Australia, with around A$41 billion of assets under management.[158] It is part of Barclays Global Investors: one of the world's largest

---

[153] Ibid.
[154] Ibid.
[155] Ibid.
[156] Ibid.
[157] Ibid.
[158] At June 2006: Barclays Global Investors (Australia), 'About BGI', available at <http://www.barclaysglobal.com/about/index.jhtml>

investment managers, with around A$2.2 trillion of assets under management.[159] It was established in 1971, having introduced the world's first index investment strategy.[160] BGIA serves a range of clients including Australian corporations; industry, public sector and endowment funds; master funds; and wrap account distributors.[161] BGIA holds 24% of its funds under management in indexed strategies, while the remaining 76% of its funds is in active strategies. In relation to Australian equities, BGIA holds only 4% of equities in indexed strategies and the remaining 96% in active strategies.[162] It has numerous large holdings in individual Australian companies: 47 over 3%, with its largest holding at 9.3%.[163] Whilst BGIA has a substantial number of large individual share holdings, this generally does not limit exiting as an option, as BGIA actively works to ensure the liquidity of individual holdings and retain exiting as a viable option. It conducts considerable research in order to ascertain what the optimum level of share ownership is in individual companies before it will encounter problems exiting.[164] In relation to its indexed strategies, BGIA simply invests in those companies which remain in the ASX 300. In relation to active funds, investment horizons will vary according to the particular investments, although generally it will have a medium to long-term view (12 months – 3 years).[165]

Because BGIA employs a mathematical or 'quantitative' investment process, it is difficult to factor employee management issues into share selection or retention decisions. As a result, BGIA does not actively monitor, or seek to engage companies in relation to human resource management issues. Indeed, BGIA does not generally engage with companies except via proxy voting. Corporate governance issues are considered as part of the proxy voting process, and in companies in which BGIA has a substantial holding, investee company management may be notified where there are perceived problems in relation to a company's governance practices. According to Barclay's Proxy Voting Policy, it 'aim[s] to vote on all resolutions at annual general

[159] At June 2006: Barclays Global Investors (Australia), 'Top of the Class: Assets Under Management and Industry Rankings', available at <http://www.barclaysglobal.com/about/who_we_are/assets_rankings.jhtml>
[160] Barclays Global Investors (Australia), above n. 158.
[161] Ibid.
[162] Information provided by Barclays to authors (on file with authors).
[163] As at January 2005: Information provided by Barclays to authors (on file with authors).
[164] Interview with Corporate Governance Manager, Barclays Global Investors (Australia), 10 March 2006.
[165] Ibid.

meetings and extraordinary general meetings held by all companies in the…ASX 300.'[166] However, BGIA generally does not form and maintain close relationships with managers of investee companies, even in companies in which BGIA is a substantial shareholder.

Despite this reticence to engage with companies, the Corporate Governance Manager of BGIA stated that companies are beginning to actively court BGIA as a major shareholder before significant decisions are made:

> *We don't…go out and have meetings with companies way beforehand to discuss…issues. Companies have just started to realise we're here and they've just started to come to us to request meetings to sit down and go through things with us and I think that will pick up…but we're just a little bit different because we are quantitatively based rather than qualitative.*[167]

Vanguard Investments Australia Ltd (Vanguard)

Vanguard was established in 1996, as a wholly owned subsidiary of The Vanguard Group, based in the United States,[168] which is one of the world's largest investment management companies, with around A$1.25 trillion of assets under management.[169] Vanguard Australia has approximately A$36 billion of assets under management, primarily for large institutional investors.[170] It manages client's portfolios as either separate accounts or in pooled investments, across all major asset classes.[171]

Vanguard's investments are 100% indexed, which precludes the consideration of 'social issues' when choosing to buy or sell investments in its mainstream products.[172] Vanguard uses a variety of indexes (for instance, the ASX 300) and uses a mathematical model to weigh up investments in the index so holdings are maintained

[166] Barclays Global Investors Australia Limited, 'Proxy Voting Policy – Australian Stocks', February 2005, available for download at <http//www.barclaysglobal.com>
[167] Interview with Corporate Governance Manager, Barclays Global Investors (Australia), above n. 164.
[168] Vanguard Investments Australia Ltd., 'Vanguard in Australia', available at <http://www.vanguard.com.au/About_Vanguard/>
[169] Vanguard Investments Australia Ltd., 'The Vanguard Group', available at <http://www.vanguard.com.au/About_Vanguard/The_Vanguard_Group/>
[170] Vanguard Investments Australia Ltd., above n. 168.
[171] Vanguard Investments Australia Ltd., 'Investment Philosophy', available at <http://www.vanguard.com.au/Institutional_Investors/Investment/Philosophy/>
[172] Vanguard Investments Australia Ltd., 'Fast Facts on Vanguard as at 31/12/2005', available at <http://www.vanguard.com.au/About_Vanguard/Fast_Facts/>

at the same weightings by industry and sector.[173] Vanguard does not have large holdings in Australian equities other than listed property trusts.[174] Vanguard does not enter and exit companies quickly; rather, investments will be held and topped up.[175] The use of indexing also means that Vanguard has long-term investment horizons, as it does not generally exit companies, but holds investments for a long period.[176] Its Product Disclosure Statements disclose that it 'does not take into account labour standards or environmental, social or ethical considerations when choosing, retaining or realising investments.'[177]

Although its investments are 100% indexed, Vanguard engages in a limited form of 'active investment'. It does this in order to secure long-term economic value in investee companies because it does not generally exit companies:[178]

> *The reason we're acting in corporate governance issues is because we are holding, so…our view is we have a greater responsibility. If anything, because we won't sell, we want companies to behave.*[179]

This 'active investment' is limited to the active consideration of AGM proxy votes, and does not generally involve any action beyond this, such as out-of-AGM meetings with board members.[180] Occasionally Vanguard will write a letter to the management of an investee company in which there are perceived governance problems.[181]

Vanguard Australia's general proxy voting policy is to 'abstain from voting on proposals concerning social policy issues as the fund's primary concern is shareholder

---

[173] Interview with General Counsel / Company Secretary, Vanguard Investments Ltd. Australia, 21 March 2006.
[174] Ibid.
[175] Ibid.
[176] Vanguard Investments Australia Ltd., 'Strategy and Techniques', available at <http://www.vanguard.com.au/Institutional_Investors/Investment_Philosophy/Strategy/>
[177] Vanguard Investments Australia Ltd., *Vanguard Investor Funds: Product Disclosure Statement* (2004) 67; Vanguard Investments Australia Ltd., *Vanguard Personal Superannuation Plan: Product Disclosure Statement* (2005) 51; Vanguard Investments Australia Ltd., *Vanguard Index Funds: Product Disclosure Statement* (2005) 54, all available for download at <http://www.vanguard.com.au>
[178] Vanguard Investments Australia Ltd., above n. 176.
[179] Interview with General Counsel / Company Secretary, Vanguard Investments Ltd. Australia, above n. 173.
[180] Ibid.
[181] Ibid.

value.'[182] Nevertheless, there may be occasions when Vanguard votes on social issues, 'recognising that social responsibility issues sometimes do impact the value of a shareholder's investments.'[183] Vanguard has, in the past, actively considered and cast proxy votes in relation to executive remuneration, and has voted against the board in relation to these resolutions at times.

The indexing of Vanguard's investments largely precludes more active engagement in relation to broader governance issues.[184] Vanguard does not employ research analysts to research the performance of individual companies and engage with companies where there is a perceived governance problem.[185] In addition, Vanguard is not considered large enough to engage with companies on an individual level, as holdings in individual companies are not large:

> *We don't engage yet. As we get bigger in Australia we may do so, but it would be likely that we would collaborate with others in these activities as our holdings are not significant enough for companies to take the time to speak with us, and we do not have the resources to engage with them.*[186]

5.3 Superannuation Funds that Seek to Influence the Human Resource Practices of Investee Companies

The superannuation funds studied for this project generally enunciated concern for the human resource practices of investee companies, both as a risk management strategy and also due to straightforward interest in fair industrial relations. This concern for human resource practices did not necessarily lead to engagement strategies. Because the superannuation funds studied generally outsource the management of investments, those funds that wish to engage with companies have developed complex processes to make their views known to investee companies. One such voice mechanism is through involvement in collective action in relation to perceived corporate governance

---

[182] Vanguard Investments Australia Ltd., 'Proxy Voting Policy', available at <http://www.vanguard.com.au/About_Vanguard/Proxy_Voting_Policy/>
[183] Ibid.
[184] Interview with General Counsel / Company Secretary, Vanguard Investments Ltd. Australia, above n. 173.
[185] Ibid.
[186] Ibid.

risks in companies through the umbrella organisation of ACSI. In addition, three of the superannuation funds that we studied outsource this role to BT Governance Advisory Service (BT GAS).

The three funds that use BT GAS are considered together in the description of fund practices in this section of the report. We then provide a profile of UniSuper and, finally, a discussion of ACSI's activities.

Catholic Super Fund (CSF), Public Sector / Commonwealth Sector Superannuation Schemes (PSS/CSS) and VicSuper: Utilisation of the BT Governance Advisory Service

The employment of BT GAS to engage with investee companies represents an attempt by Australian superannuation funds to influence the industrial relations and employee management practices of investee companies. BT GAS operates on behalf of five superannuation funds,[187] representing around $7 billion in Australian equities,[188] with a mandate to undertake 'constructive engagement' with S&P/ASX 200 companies in order to 'attain improved governance behaviour by investee companies leading to better and more sustainable performance for the benefit of long term shareowners.'[189] According to BT, BT GAS 'aims to fill the dialogue gap between investors and their investee companies in relation to sustainability and corporate governance. Engaging companies to improve governance behaviour and risk management enhances long term performance.'[190]

BT GAS was established in December 2001 to provide services to PSS/CSS with regards to risk assessment and engagement to reduce those risks. Its mandate on behalf of PSS/CSS is to 'actively research governance risks in the Fund's Australian equities investments and make recommendations to the Board on constructive means of diminishing or eliminating such risks.'[191] These risks include 'potential environmental, social and corporate governance risks to long-term shareholder

[187] In addition to the three funds interviewed, the Northern Territory Public Authorities Super and Emergency Services Super also engage BT GAS: see BT Financial Group, above n. 105.
[188] Interview with Senior Research Fellow, Monash Sustainability Enterprises, 23 May 2006.
[189] BT Financial Group, above n. 105.
[190] Ibid.
[191] PSS, 'Governance of Your Scheme', available at <http://www.pss.gov.au/pss/governance/governance.htm>

value.'[192] Social risks include: workplace health and safety; product stewardship (including 'managing outsourced production'); and workplace and industrial relations.[193] Four other superannuation funds, including CSF[194] and VicSuper,[195] have also engaged BT GAS.

The profile of the case study superannuation funds that engage BT GAS is as follows: The PSS/CSS has approximately $10 billion of funds under management;[196] VicSuper has $3.1 billion[197] and CSF around $2 billion.[198] None of the funds have large individual holdings (holdings over 3%) in investee companies;[199] however, all of the funds have long-term investment horizons by virtue of the nature of their members and / or their inability or unwillingness to exit.[200] The PSS/CSS, for example, does not seek to exit companies, due to difficulties associated with the fund's size.[201] For VicSuper, it is the fact that the 'vast majority' of the fund's equities investments are invested on a passive basis (in indexed strategies) that makes exiting a non-option.[202] For the Catholic Super Fund, the long-term view of investment reduces the necessity for exiting in response to perceived governance problems in the short term.[203] All

[192] PSS, 'More About the PSS/CSS Investment Governance Advisory Service', available at <http://www.pss.gov.au/pss/governance/advisory_service.htm>
[193] PSS, 'How the Investment Governance Advisory Process Works', available at <http://www.pss.gov.au/pss/governance/process.htm>
[194] In 2002, the CSF appointed BT Financial Group's Governance Advisory Service 'to act on CSF's behalf to research social, environmental and corporate governance risks and engage with ASX200 companies to encourage management of those risks.' In doing so, the CSF seeks to 'minimise exposure to future governance risks and thus maximise potential share valuations': see Catholic Superannuation Fund, 'Investing Responsibly', available at <http://www.csf.com.au/investments/investing_responsibly.htm>
[195] VicSuper, 'Sustainability Investing', available at <www.vicsuper.com.au/www/html/73-sustainability-investing.asp?intSiteID=1>
[196] PSS, 'Media Release', 18 December 2001, available at <http://www.pss.gov.au/pss/news/westpac.html>
[197] As at 31 December 2005: VicSuper, 'About VicSuper', available at <www.vicsuper.com.au/www/html/170-about-vicsuper.asp>
[198] Interview with Chief Executive Officer, Catholic Superannuation Fund, 14 February 2006.
[199] Interview with Chief Executive Officer, Catholic Superannuation Fund, ibid; Interview with Chief Executive Officer, Public Sector / Commonwealth Sector Superannuation Schemes, 6 April 2006; Interview with Chief Executive Officer, VicSuper, 28 February 2006.
[200] VicSuper, 'VicSuper's Investment Options', available at <www.vicsuper.com.au/www/html/142-investment-options.asp?intSiteID=1> See also PSS, *The Facts About the PSS: Our Product Disclosure Statement*, 11 March 2004, 6, available for download at <http://www.pss.gov.au> Interview with Chief Executive Officer, Catholic Superannuation Fund, above n. 198.
[201] Interview with Chief Executive Officer, Catholic Superannuation Fund, above n. 198; Interview with Chief Executive Officer, Public Sector / Commonwealth Sector Superannuation Schemes, above n. 199; Interview with Chief Executive Officer, VicSuper, above n. 199.
[202] VicSuper, *VicSuper Scheme: Combined Financial Service Guide and Product Disclosure Statement* (2005) 21.
[203] Interview with Chief Executive Officer, Catholic Superannuation Fund, above n. 198.

three funds profess to prefer active engagement with investee companies.[204] The PSS/CSS and the CSF do not manage any equities investments internally. External fund managers manage all funds.[205] VicSuper, on the other hand, predominantly manages funds internally.[206]

BT GAS's engagement strategy on behalf of these superannuation funds is based on research conducted by Monash Sustainability Enterprises on ASX 200 companies. Monash Sustainability Enterprises employs a complex monitoring system in order to give companies a risk rating based on company exposure to risk associated with particular issues and company performance in managing those risks. These issues might include labour management issues, including occupational health and safety; performance management; talent retention; remuneration; training and skills development; gender equity at management level; discrimination and harassment.[207] Monash Sustainability Enterprises investigates whether the issue will create a governance problem over the short term (the next couple of months) and longer term (the next couple of years).[208] Company performance is then benchmarked by assessing whether there is a gap between exposure to the issue and management of the issue. In order to obtain information to assess a company's management of an identified risk issue, Monash Sustainability Enterprises consults information provided by the company, in addition to information provided by a range of stakeholders, including unions. Where there are gaps in the information (as there often is), Monash Sustainability Enterprises devises a list of questions and meets face to face with a company manager in an attempt to obtain additional information.[209]

Once a company has been identified as having exposure to a targeted issue, Monash Sustainability Enterprises will develop a 'dialogue action plan'. The plan recommends various engagement actions, typically including one-on-one meetings in which research outcome briefings are presented to a company's management, with

[204] Interview with Chief Executive Officer, Catholic Superannuation Fund, above n. 198; Interview with Chief Executive Officer, Public Sector / Commonwealth Sector Superannuation Schemes, above n. 199; Interview with Chief Executive Officer, VicSuper, above n. 199.
[205] Interview with Chief Executive Officer, Catholic Superannuation Fund, above n. 198; Interview with Chief Executive Officer, Public Sector / Commonwealth Sector Superannuation Schemes, above n. 199.
[206] Interview with Chief Executive Officer, VicSuper, above n. 199.
[207] Interview with Senior Research Fellow, Monash Sustainability Enterprises, above n. 188.
[208] Ibid.
[209] Ibid.

opportunities provided to the company to supply additional information on how the risk issue is being managed.[210] BT GAS is responsible for implementing the plan.[211] Managers of the superannuation funds interviewed, which engage BT GAS, attend company visits with BT GAS from time to time.[212] Monash Sustainability Enterprises conducts follow-up monitoring 6 – 12 months later, and, if unsatisfied with a company's treatment of the issue, it will conduct further monitoring 2 – 3 years later, including another complete round of benchmarking.[213]

In addition to seeking to exert influence over human resource management issues in Australian companies directly by engaging BT GAS, the three superannuation funds all employ methods which expressly seek to indirectly influence human resource management practices in some investee companies. VicSuper applies a 'sustainability approach' to 10% of all listed Australian and international equities in its mainstream products. VicSuper adopted this approach following a survey of its members, and subsequent studies and research based on the survey outcomes.[214] According to VicSuper '[s]ustainability is a way of operating and investing that recognises the dependence of the overall health of the economy on the long-term availability of natural resources, a healthy environment, a productive workforce and cohesive societies.'[215]

VicSuper employs Vanguard to manage these equities in accordance with its sustainability approach. Vanguard in turn engages the Sustainability Asset Management (SAM) index to rate companies and select investments from the ASX 200 index that rate well in terms not only of financial performance, but also based on assessment of company strategies 'to create long-term shareholder value by embracing opportunities and managing risks deriving from economic, environmental

---

210 Ibid.
211 PSS, above n. 193.
212 Follow-up Telephone Interview with Chief Executive Officer, Catholic Superannuation Fund, 19 May 2006; Interview with Chief Executive Officer, Public Sector / Commonwealth Sector Superannuation Schemes, above n. 199; Interview with Chief Executive Officer, VicSuper, above n. 199: 'we've got a person whose title is Manager, Sustainability Investments and…he attends every now and again the company visits by BT. The purpose of that is so that BT can point to our representative and say here is the owner, so we represent this person and a few other people in asking these questions and we're asking these questions…because we're interested in…value creation over the long term.'
213 Interview with Senior Research Fellow, Monash Sustainability Enterprises, above n. 188.
214 Interview with Chief Executive Officer, VicSuper, above n. 199.
215 VicSuper, 'Purpose and Core Values', available at <www.vicsuper.com.au/www/html/28-purpose-and-core-values.asp?intSiteID=1>

and social developments.'[216] SAM indexing takes into account labour management issues, based on standards of the International Labour Organisation in rating and selecting investments, and companies are identified as 'sustainability leaders' based on various indicators, including: labour practice indicators (grievance resolution, diversity and non-discrimination, freedom of association, and layoffs); human capital development (human resource skill mapping and development processes, human capital performance indicators, and personal and organisational learning and development); talent attraction and retention (coverage of employees through performance appraisal processes, performance related compensation, employee satisfaction and additional benefits); and other industry specific indicators, which may include, for example, occupational health and safety.[217]

Other superannuation funds employ a social filter in a less systematic manner to VicSuper's sustainability approach. Some superannuation funds require or expect their fund managers to consider industrial relations or labour management issues when selecting and retaining investments. The PSS/CSS, for instance, stipulates that appointed fund managers must, in managing the fund's assets, keep within its strategy and governance guidelines.[218] The PSS/CSS's 'Investment Governance' guidelines recognise that 'poor environmental, corporate and social practices can lead to a decline in investment values as much as financial risks' and emphasise the importance, inter alia, of human resource management as being relevant to risk management.[219] In addition to this policy guidance, the Board 'may discuss their concerns about a company with their investment managers,' although it stops short of instructing appointed fund managers specifically on which shares to buy and sell.[220]

---

[216] VicSuper, *VicSuper Scheme: Combined Financial Service Guide and Product Disclosure Statement* 24.
[217] SAM, *The Australian SAM Sustainability Index Guide*, November 2000, 10, available at <www.aussi.net.au/aussi_pdf/AuSSI_publications/ Guidebook/AuSSI_Guidebook_20_051101.pdf>
[218] PSS, above n. 200.
[219] PSS, 'Governance of your Scheme', above n. 191; and PSS, above 192.
[220] PSS, above n. 192.

UniSuper

UniSuper, founded in October 2000 as a result of a merger between two existing funds,[221] is an industry superannuation fund, 'dedicated exclusively to all who work in Australia's higher education and research sector.'[222] It is one of Australia's largest superannuation funds, with over $15 billion in assets under management.[223] UniSuper holds 90% of all funds / assets under management in externally managed mandates (including all Australian equities investments).[224] UniSuper likes to retain influence over the activities of external fund managers, and for that reason externally managed funds are predominantly contained in directly held mandates, not in pooled funds.[225] Its 'investment strategies' are assessed according to long time horizons; however, a short term view of investment will be taken where appropriate.[226] UniSuper does not hold any individual equities investments over 3% and is prepared to exit companies and actively sell holdings where this is considered appropriate.[227] However, exiting after the identification of a governance problem in an investee company is generally considered a last resort option, and UniSuper prefers to maintain a constructive dialogue with companies:

> *If you sell, well, it's not necessarily a very useful form of action because you don't actually change behaviour in doing that. Sometimes it's better to persist with the company and change their behaviour that way…We don't want to unnecessarily constrain your investment universe which at an extreme you would do if you kept on excluding companies from your investment universe. So selling can be a particularly short sighted solution to the problem.*[228]

UniSuper has a number of practices to ensure investments are managed in a way that is consistent with its Corporate Governance Policy as part of a commitment to its 'responsibilities as a shareholder and as a fiduciary'.[229] UniSuper requires all fund

---

[221] The two funds were the Superannuation Scheme for Australian Universities and the Tertiary Education Superannuation Scheme: UniSuper, 'Fund Profile', available at <http://www.unisuper.com.au/aboutunisuper/fund_profile.cfm>

[222] UniSuper, 'About Us', available at <http://www.unisuper.com.au/AboutUniSuper/index.cfm>

[223] Ibid.

[224] Interview with Chief Executive Officer and Chief Investment Officer, UniSuper, 14 March 2006.

[225] Ibid.

[226] Ibid.

[227] Ibid.

[228] Ibid (statement by Chief Investment Officer).

[229] UniSuper, 'Corporate Governance', available at <http://www.unisuper.com.au/aboutunisuper/corporate_governance.cfm>

managers to vote on company resolutions, based on ACSI's Corporate Governance Guidelines and research conducted by the Sustainable Investment Research Institute (SIRIS).[230] It also runs training sessions for fund managers on UniSuper's expectations relating to governance. UniSuper 'closely monitors managers' voting activity and may override both the managers' vote and SIRIS's recommendations in instances where this is deemed appropriate';[231] although it will stop short of removing governance responsibilities from fund managers.[232]

According to UniSuper, fund managers are expected to look at human resource issues in making investment decisions to the extent that human resource practices are an indicator of good company management. The Chief Investment Officer of UniSuper states that 'it obviously depends on the nature of the business but human resources are very important, and in some particular situations…it's all about the people.' UniSuper's Chief Executive Officer states with respect to the fund managers UniSuper engages that:

> *I imagine they would look at turnover, they would look at health and safety, they would look at all those sorts of things…I think they're trying essentially to find out whether one company has an edge over another.*[233]

UniSuper offers an SRI product (the 'socially responsible shares strategy'), which accounts for 0.6% of total funds under management.[234] The socially responsible shares strategy invests in the BT Institutional Australian Sustainability Share Fund, the AMP Sustainable Future Australian Share Fund and the Dexia Sustainable Global Equity Fund, and uses a 'best of sector' approach: shares are selected and retained 'in companies that rate higher – relative to other companies in the same industry or sector – according to certain sustainability criteria.'[235] Among these criteria are social considerations, including 'labour standards and occupational health and safety

---

[230] UniSuper, 'Voting Guidelines' available at <http://www.unisuper.com.au/aboutunisuper/voting_guidelines.cfm>
[231] Ibid.
[232] Interview with Chief Executive Officer and Chief Investment Officer, UniSuper, above n. 224.
[233] Ibid.
[234] Ibid.
[235] UniSuper, *Investing for the Future: Your Guide to Investment Choices in UniSuper* (2005) 20, available for download at <http://www.unisuper.com.au> UniSuper, *Product Disclosure Statement for Accumulation Super (1)*, 16, available for download at <http://www.unisuper.com.au>

practices.'[236] Research is conducted by Monash Sustainability Enterprises and investment managers use various guidelines when setting relevant standards, including the Social Accountability 8000 Standard, which 'measures health and safety, child labour, forced labour, trade union rights, pay and work hours'.[237] UniSuper has expressed commitment generally to sustainable investing, and 'is currently working towards developing a broader socially responsible investment strategy that will include more asset classes.'[238]

In addition to these strategies, UniSuper engages with company managers through ACSI. Collective action, through ACSI, is UniSuper's preferred method for undertaking company engagement:

> *We're a very active participant in the Australian Council of Superannuation Investors. We believe that managers should get one voice which is why we're an active member in ACSI rather than getting a number of voices. So we try and actually do most of our discussions with companies through ACSI so that companies don't get fed up with people coming to speak to them about governance. If they have every super fund coming to speak to them it's not very beneficial.*[239]

However, at times where a governance problem is identified in an investee company, UniSuper may directly engage with the company's management by, most commonly, writing a letter to the company's management. In 2005, UniSuper wrote to two or three different companies – in one instance, in relation to occupational health and safety concerns.[240] In these direct interventions, where companies reply with an unacceptable response to its concerns, UniSuper will meet with company managers.[241]

---

[236] Ibid, 16.
[237] Ibid, 16.
[238] Ibid, 20.
[239] Interview with Chief Executive Officer and Chief Investment Officer, UniSuper, above n. 224 (statement by Chief Executive Officer).
[240] Ibid.
[241] Ibid.

Collective Action through ACSI

ACSI, a not-for-profit organisation, was formed in April 2001 in order to 'provide independent research and education services to superannuation funds, in relation to the corporate governance practices of companies in which they invest.'[242] It is an umbrella organisation representing 39 superannuation funds, which collectively hold around $160 billion of funds under management.[243] ACSI's main objective is 'to ensure that trustees are properly equipped to deal with corporate governance issues, in a practical way and that is consistent with the general duty to protect and advance the investments of superannuation fund members'.[244]

ACSI aims to foster active corporate engagement with its members' investee companies, through the provision of research and its proxy voting alert service. ACSI also makes recommendations to companies in relation to corporate governance issues on behalf of its members. Corporate governance is defined by ACSI to include corporate social responsibility issues, including labour management. ACSI's President states that it is:

> *. . . difficult to distinguish between what is called corporate governance and what is called CSR. In our way of looking at things they kind of overlap…a company…can't be well governed if it doesn't pay attention to the CSR range of issues…certainly one of them is the way they deal with their employees.* [245]

In order to provide greater direction concerning an issue which many members find complex, in September 2005, ACSI commissioned a discussion paper, prepared by the Monash Governance Unit, titled 'Corporate Social Responsibility: Guidance for Investors.'[246] The paper reviews company managers' common perceptions of CSR and aims to 'give superannuation trustees a guide to the tools used to assess how well a company is practising CSR.'[247] The paper also justifies active engagement with companies regarding CSR issues on the basis that '[w]here CSR issues can be

---

[242] ACSI, 'About ACSI', available at <http://www.acsi.org.au/dsp_about.cfm>
[243] Interview with President, ACSI, 7 April 2006.
[244] ACSI, above n. 242.
[245] Interview with President, ACSI, above n. 243.
[246] ACSI, *Corporate Social Responsibility: Guidance for Investors: Executive Summary* (2005), available for download at <http://www.acsi.org.au> Full report not available online.
[247] Ibid.

demonstrated as material investment risks, it can be argued that failure to identify and manage such risks would be a breach of fiduciary duty.'[248] Thus, 'the availability of robust information on material CSR risks and rewards is a critical requirement to provide investment decision-makers with the confidence to integrate CSR criteria into investment, engagement and analytic strategies.'[249] CSR risks are thought to include human resource management issues, and it is stated in the paper that a well-managed company should:

> *Provide conditions of employment which include just remuneration and non-wage/salary entitlements and are fair and equitable according to local norms AND international minimum standards (and) provide safe and healthy work environments for both direct and indirect employment such as contractors.*[250]

At times, ACSI has engaged directly with companies in relation to the issue of company recognition of collective bargaining. In general, however, these interventions are not event-specific, but rather aim to engage with companies in relation to broader human resources policies and practices as part of a broad understanding of corporate governance.[251]

5.4 Superannuation Funds that do not Actively Seek to Influence the Human Resource Practices of Investee Companies

Three of the superannuation funds interviewed – the Construction and Building Industry Super Fund (CBus); Health Super; and the TWU Superannuation Fund (TWU) – are more reticent in their company engagement strategies than the four funds discussed in the previous section of this report. They engage in proxy voting, but are less likely to use other, more active, 'voice' mechanisms. Nevertheless, interviewees from all funds, to differing extents, professed to be interested in human resource issues in investee companies. All three funds indicated that 'high commitment' workplace practices could be an indicator of a well functioning

[248] Ibid.
[249] Ibid.
[250] Ibid.
[251] Interview with President, ACSI, above n. 243.

company. A comment by a Senior Investment Analyst of Health Super is representative of this attitude:

> *In a successful company…if the employees are happy usually they…are more willing to…work harder, and then obviously if the company does well…they'll be rewarded and hopefully that'll…foster a company that will produce strong returns for our members.*[252]

These three funds are unlikely to use 'voice' mechanisms beyond proxy voting. All three are members of ACSI. They therefore engage with companies indirectly through their membership and support of ACSI. CBus and TWU actively exercise proxy votes where shares are held in direct mandates.[253] For CBus, the exercise of proxy votes includes consideration of human resource issues: they 'comb the press' for 'any evidence of malpractice' in relation to a company's labour management practices.[254] Beyond these actions, the three superannuation funds appear to have not actively sought to engage with companies in relation to human resource issues.

The main reason given for this lack of active engagement is the fact that their equities investments are externally managed (and in the case of the TWU, predominantly in pooled funds) and the superannuation funds are not directly involved in the operations and decisions of the fund managers they engage.[255] Interviewees from the three superannuation funds stated that this arms length relationship is the rationale for not engaging with companies concerning their human resource practices. The funds perceive that they do not have the ability to effectively monitor external fund managers' analysis of human resource issues in making and retaining investments. A Senior Investments Analyst at Health Super stated:

---

[252] Interview with Senior Investment Analyst, Health Super, 6 March 2006. Also, Interview with Chief Finance Manager, TWU Superannuation Fund, 7 March 2006; Interview with Chief Executive Officer, CBus, 17 March 2006.
[253] Interview with Chief Finance Manager, TWU Superannuation Fund; Interview with Chief Executive Officer, CBus, ibid.
[254] Interview with Chief Executive Officer, CBus, above n. 252.
[255] Interview with Senior Investment Analyst, Health Super, above n. 252. Also, Interview with Chief Finance Manager, TWU Superannuation Fund; Interview with Chief Executive Officer, CBus, above n. 252.

> *If the manager bought say ABC Learning Centres today and it went up 100% tomorrow, if he wanted to sell it tomorrow, he can sell it tomorrow. And obviously we don't have any control over that, because we're looking at it more from…the overall portfolio point of view…as long as they're…sticking to what they said they were going to do…we're not that interested in whether they've bought one company one day and sold it three weeks later or they've bought it and they've held it for 10 years, as long as they're sticking to the process that they said they were going to use.*[256]

Whilst there may be an absence of oversight of fund managers in relation to human resource issues, the interviewees from these superannuation funds expressed an expectation that human resource practices are, nevertheless, taken into account. The interviewee from CBus, for example, stated that given that CBus is a long term and patient investor, 'most of the fund managers…if they're doing a company visit and the company's got a long track record of…bad labour relations then it's a matter that they pick up on.' However, he stressed the inability of the fund to monitor this analysis: 'it's nearly impossible [to monitor this] because we don't get involved in the day to day mechanics, we simply give a clear indication that we have a view about that.'[257]

The only instance where there is an explicit policy of screening for employee management issues amongst these three superannuation funds is in SRI products. Health Super, for example, offers an SRI product to members. It engages Perennial Growth Management to manage its Australian equities, which uses both negative and positive screening: companies are screened out for being involved in 'negative activities' (e.g. alcohol, tobacco, child labour, oppressive regimes, etc.), and are 'screened in' if they have 'positive policies' in relation to a variety of factors, including 'good workplace practices.'[258] Health Super's SRI product has only attracted 0.3% of its total funds under management.[259]

---

[256] Interview with Senior Investment Analyst, Health Super, above n. 252.
[257] Interview with Chief Executive Officer, CBus, above n. 252.
[258] Health Super, 'Invest in Socially Responsible Investments', available at <http://www.healthsuper.com.au/SRIs_4.htm>
[259] Interview with Senior Investment Analyst, Health Super, above n. 252.

6. ANALYSIS

Our study revealed an intention, on the part of seven of the institutional investors interviewed, to directly influence the human resource practices of investee companies to adopt 'high commitment' practices through a variety of mechanisms. It might be expected that some superannuation funds would have a particularly strong interest in the human resource management of investee companies. Under Part 9 of the *Superannuation Industry (Supervision) Act 1993* (Cth) there is a requirement that 'employer sponsored funds' have boards with equal representation of employers and members.[260] Both industry superannuation funds and corporate superannuation funds fall into this category.[261] Most of the superannuation funds we studied, including CBus, TWU, Catholic Super, Health Super and Uni Super, are industry superannuation funds.[262] Because industry superannuation funds are generally created by parties to an industrial award, the employer representatives are normally nominated by employer associations and the member representatives are generally nominated by unions. CBus, for instance, has member directors appointed by the Australian Council of Trade Unions and sponsoring unions, whereas the employer representatives are appointed by Master Builders of Australia.[263] Unisuper has a particularly complicated method of appointment which includes two directors nominated by the national unions who represent a significant number of members of

[260] Part 9 applies to 'employer-sponsored funds'. Under s 16(3) of the Act an employer-sponsored fund is a regulated superannuation fund that has at least one employer-sponsor. Under s16(2), if an employer so contributes, or would contribute, wholly or partly pursuant to an arrangement between the employer and a trustee of the regulated superannuation fund concerned, the employer is a standard employer-sponsor of the fund.

[261] Corporate superannuation funds are funds operated by an employer sponsor on a "stand-alone" basis, meaning the company which employs the members is also the sponsor of the superannuation fund.

[262] See earlier definition, above, n. 5. Some of the superannuation funds studied were created under separate Acts: for example, PSS. VicSuper was originally a Victorian public sector fund administered by the Victorian Superannuation Board (VSB), a Government organisation set up to administer the superannuation benefits of many Victorian public servants. It also has equal numbers of employer and member representatives on its board. All of the other superannuation funds studied for this report are industry superannuation funds.

[263] These include the Construction, Forestry, Mining and Energy Union, the Australian Workers Union, the Australian Manufacturing Workers Union, and the Communications Electrical Plumbing Union: http://www.cbussuper.com.au/Industry-Super/General-Information/About-Cbus-Super/Our-Team/index.cfm, accessed 6 November 2006.

UniSuper.[264] In the case of the PSS, two of the trustees are nominated by the Australian Council of Trade Unions, in consultation with relevant organisations.[265]

It might be expected that directors who are appointed by trade unions to the boards of industry superannuation funds would have a strong interest in labour standards at investee companies and seek to establish mechanisms to influence the human resource management practices in the same way that some pension funds in the US, for in instance, have done.[266] Some of the unions represented on the CBus Board, for example, have been involved in union shareholder campaigns which focussed on core labour standards.

Despite the presence of employee representatives on the boards of some superannuation funds, we did not find that these superannuation funds were particularly active in engaging companies in relation to human resource issues. In addition, we found that non-superannuation funds were no less likely to become engaged with companies in relation to human resource issues than superannuation funds.

Although seven of the institutional investors interviewed indicated an intention to directly influence the human resource practices of investee companies to adopt ‘high commitment’ practices, we did not reach the view that this engagement is a highly significant aspect of institutional investor activities. For most institutional investors, both engagement and monitoring regarding labour management issues is not systematic and occurs on an ad hoc basis. Further, the expectations regarding the impact of any engagement on company practices is not generally high. There may, however, be a growing trend of activism in relation to the human resource practices of

---

[264] Other representatives on the board include two directors nominated by shareholder universities; two directors elected by Consultative Committee members who represent employers; one director elected by Consultative Committee members who represent academic staff; one director elected by Consultative Committee members who represent general staff; and two independent directors appointed by the other directors for their specific expertise and knowledge: http://www.unisuper.com.au/aboutunisuper/board_of_directors.cfm, accessed 7 November 2006.

[265] PSS/CSS is governed by the *Superannuation Act 1990 (Cth)*. Power to appoint board members is vested in the Minister for Finance and Administration under s 4 of the Trust Deed formed under the Act.

[266] For an early account of US pension fund activism and its limitations, see Roberta Romano, ‘Public Pension Fund Activism in Corporate Governance Reconsidered’ (1993) *Columbia Law Review* 795. For a more recent account of US pension fund’s international activism, see S Jacoby, ‘Convergence by Design: The Case of CalPERS in Japan’ forthcoming in (2007) *American Journal of Comparative Law*.

investee companies by some institutional investors. The remaining five institutional investors studied do not aim to directly influence human resource practices of companies, although we found that this is not necessarily a consequence of lack of concern for the human resource management practices in investee companies.

6.1 Rationale for Seeking to Influence the Human Resource Practices of Companies

Why are some institutional investors attempting to influence the human resource practices of investee companies in the course of their company engagement strategies? Consistent with hypotheses proposed in the relevant literature, our research found that the common rationale provided by the institutional investors studied for seeking to influence human resource practices in investee companies is to promote long-term value for members. We found that these institutional investors believe that companies that pursue 'high commitment' human resource practices are more likely to produce long-term value for members than those that adopt poor human resource practices. This was the predominant reason provided by interviewees for active engagement with investee companies regarding their industrial relations and human resource management.

Concern for the employment practices of investee companies was generally conceived of in economic terms in relation to the broader risk management strategies of institutional investors. It was not conceived of in ethical terms. Poor human resource practices are believed to present risks in relation to the realisation of investments in mainstream (i.e. non-SRI) products. Institutional investors thus seek to directly influence human resource practices in companies in the interests of mitigating risk in (usually long term) investments. We found that this desire to reduce risk may result in some 'screening out' of companies with poor human resource management practices in mainstream portfolios. However, this is generally on an informal basis and not based on formal guidelines or oversight of analysts. UniSuper, for instance, expects that its fund managers will consider human resource issues such as staff turnover and regard for occupational health and safety in 'screening' companies and making

investment decisions, although not in a rigorous systematic manner.[267] Interviewees sometimes voiced the view that 'screening' on social issues both in SRI products and mainstream products might have a flow on effect in terms of influencing companies to improve their human resource practices in order to attract investment from large institutional investors. This is not the primary purpose of 'screening', however. Where screening occurs in mainstream products, in particular, it is predominantly in the interests of reducing exposure to risks.

Often, the use of engagement strategies is conceived of as an alternative to screening. For superannuation funds, this is frequently because the fund is unable or unwilling to intervene in the investment strategies of its external fund managers, where its investments are managed externally. The pursuit of engagement strategies using governance service providers such as BT GAS is seen as an alternative to requiring fund managers to monitor and screen on the basis of labour management issues. More often, it is due to a desire not to limit investment options. We thus find partial support for the 'universal owners' hypothesis offered by Deakin: that is, that institutional investors engage with companies to create a global pursuit of 'high commitment' labour management practices in Australian companies because their size means that they are effectively locked in to investing across a widespread portfolio for the long term.[268] Support for this thesis is mitigated by the fact that whilst the investors studied are widely invested across the Australian equities market, they typically limit the size of their investments in individual companies in order to retain the ability to exit. This desire for liquidity, by restricting the size of investments in individual companies, limits the degree of potential influence the institutional investor has over the management of investee companies.

These broad observations are now further developed.

Long-term Investment Horizons: The Pursuit of 'High Commitment' Employment Practices for Long-Term Financial Value Creation and Risk Mitigation

As expected, the most common reason given by the institutional investors studied for this project for seeking to influence the human resource management practices of

[267] Interview with Chief Executive Officer and Chief Investment Officer, UniSuper, above n. 224.
[268] Simon Deakin, above n. 29, 11.

companies is the perception that 'high commitment' employment practices leads to long term value creation in individual companies and, conversely, unsound or poor employment practices can create a governance risk. All the institutional investors studied stressed their central obligation to create financial value for their members. Encouragement of investee companies to pursue 'high commitment' employment practices is generally considered to be consistent with this obligation, particularly where financial value is measured against a long-term time horizon.

A broad understanding of the risks associated with investments adds to the incentive to engage with companies with regards to 'social issues', including human resource issues, for some of the superannuation funds studied. The CEO of the PSS/CSS explained the willingness on behalf of some superannuation funds to engage with companies, compared with others that do not, in the following terms:

> *If everyone's got the same fiduciary duty why does everyone have a slightly or even radically different investment strategy? Everyone's got the duty to make money in the long term; there must be one strategy which someone can show over a period of time is bound to give you the best chance…the real difference is of course risk because some people have a different risk tolerance. And that made us start thinking about what really is risk. And…when we thought about risk we thought well, there's a whole lot of things that companies may or may not do which are as important from a risk perspective as what traditionally investors would look at.*[269]

The CEO of VicSuper situated this broad notion of 'risk' within an understanding of a superannuation fund trustee's fiduciary duty to act in the best financial interests of beneficiaries:

> *My view is that fiduciary responsibility sort of conjures up in my mind acting in the best interests of people…in a responsible way taking due care and diligence. And to do that properly you must take into consideration*

[269] Interview with Chief Executive Officer, Public Sector / Commonwealth Sector Superannuation Schemes, above n. 199.

> *environmental and social issues because they have an impact on your risk profile and they're opportunities.*[270]

The superannuation funds studied conceived of the risks which arise from poor employment practices in a multifaceted manner, including the risks of lowered performance by workers, increased insurance premiums, litigation risks, brand reputation effects and recruitment difficulties. The CEO of the PSS/CSS illustrated this with reference to occupational health and safety risks:

> *The risk that a company has an appalling health and safety record, that it's injuring its workers, not only is there a risk in terms of direct financial and workers compensation premiums, not only is there a risk in terms of litigation, there's a real risk of reputation and again losing customers. Or a real risk that it just won't be able to recruit and retain the labour force it needs if it gets a reputation as a company that injures its workforce.*[271]

Interviewees from superannuation funds also viewed the standard of labour management as an indicator of broader management standards, and thus, likely associated risks. The CEO and CIO of UniSuper maintain that human resource issues can be a 'very important' indicator of good management or business strategy of companies. As a result, UniSuper requests that its fund managers examine staff turnover and occupational health and safety as indicators of governance risks.[272]

As a consequence of this view by superannuation funds of investee company labour management as a risk factor, ACSI, the peak body representing superannuation funds concerning governance issues, has begun to focus more on CSR issues, including labour management.[273] ACSI's President argues that superannuation funds have a particular interest in CSR as they have long-term investment horizons; large passive equity investments; cannot disinvest in any way adverse to the interests of

---

[270] Interview with Chief Executive Officer, VicSuper, above n. 199.
[271] Interview with Chief Executive Officer, Public Sector / Commonwealth Sector Superannuation Schemes, above n. 199.
[272] Interview with Chief Executive Officer and Chief Investment Officer, UniSuper, above n. 224.
[273] Michael O'Sullivan, President of ACSI, Presentation on 16 March 2005, 'The Social Responsibility of Company Directors Workshop' (2005) 19 *Corporate Citizenship Newsletter* 8 – 10.

beneficiaries; and mitigating risk is a key responsibility of superannuation fund trustees.[274] In relation to the role of CSR in risk management, he states:

> *If CSR is mismanaged there are clear risks to shareholder value that arise including…poor treatment of workers…As shareholders we want to be clear that companies have sought to properly apply good management of these risks. Concerned investors will increasingly be discerning about these issues when selecting portfolios. Ultimately companies that do not engage in this process will incur a higher cost of capital…Today an increasing part of a corporation's value is related to its reputation, image, projection of goodwill and its brand…Protecting 'intangible' assets of a corporation (reputation risk management) is therefore a critical and central driver.*[275]

Contrary to the evidence collected in the US by Johnson and Greening, [276] a number of the Australian non-superannuation institutional investors studied for this project also seek to influence human resource practices in investee companies. Corresponding to our findings concerning superannuation institutional investors, respondents from the non-superannuation institutional investors perceived that 'high commitment' labour management practices amongst investee companies is consistent with long term valuation. The Managing Director of Portfolio Partners was particularly insistent regarding the complementarity between 'high commitment' labour practices in investee companies and long term performance:

> *It is our view that there is a direct link between a company's culture and values, people management practices, and company profitability and long term performance…With an increasing amount of external pressure placed on companies (eg compliance legislation, a push for good corporate governance, and economic pressures of tight margins and competition) companies must become more effective and efficient in their quest to reach their bottom line goals. In order to do this, and gain competitive advantage, we believe a*

[274] Ibid, 9.
[275] Ibid, 10.
[276] Johnson and Greening, above n. 8, 564.

> *company's approach to positive and strategic people management is not only the best, but perhaps the only way in which to achieve these goals.*[277]

This concern regarding the labour management of investee companies is predominantly framed in terms of risk management. Poor labour management practices are perceived as a significant risk to long-term profits, and in turn, realisation of investments,[278] and not related purely to ethical considerations. As the Head of BT Governance Advisory Service stated: 'I want to make clear that we're not an NGO and so therefore ethics and moral issues are determined in relation to those that give rise to a risk.'[279]

<u>Universal Owners Theory</u>

Partial support for the 'universal owners' theory put forward by Simon Deakin is found through our case studies of institutional investors. Further empirical evidence is required to support the proposition that institutional investors are 'locked in' to a wide range of investments in Australian companies. As outlined in the literature review part of this report, it is thought by some that institutional investors might be locked into investments because their investments in individual companies are such that selling shares would affect the share price of the company, and reduce returns on the investment. This is, in turn, believed to result in attitudes amongst investors which are more favourable to 'high commitment' labour relations in investee companies.

It is our finding, however, that many of the institutional investors studied for this project employ investment strategies aimed at maintaining investment levels in an individual company at a level that allows for easy exit. Further, some of the institutional investors studied are not large enough to have investments of over 3% in the largest individual companies.[280] Consistent with Simon Deakin's view, however, the maintenance of low-level holdings has achieved diversified holdings across a broad portfolio of companies. As a result, despite the absence of a 'lock in' our case-

---

[277] Portfolio Partners, above n. 128.
[278] Interview with General Manager, Queensland Investment Corporation, above n. 150.
[279] Interview with Head of BT Governance Advisory Service, BT Financial Group, above n. 97.
[280] Funds are required to disclose any investments they have which exceed 5% of overall shares: pursuant to s. 671B of the *Corporations Act* 2001 (Cth), an investor must declare that they have (and where they cease to have) a 'substantial shareholding' in a company. A 'substantial shareholding' is defined in s. 9 as a holding of '5% or more of the total number of votes attached to voting shares' in a company.

studies found that institutional investors are near universal owners of the ASX 200 and exit is understood as an option of last resort (one of the interviewees even described the fund he represented as a universal owner).[281] This is for a number of reasons: some simply prefer not to limit the diversity of their investments by 'screening out' investments. In some cases this is linked to an indexed investment strategy.[282] Nevertheless, reluctance to exit should not be exaggerated.[283] Whilst most institutional investors may consider themselves to be invested for the 'long-term', and are not likely to sell all their stock in an ASX 200 company, the reason they employ fund managers is to constantly adjust the extent of their investments in companies. This 'trading at the margins' can send strong signals to company managers.

Despite these caveats on the 'universal investor' theory, the near universal and long term nature of the investment strategies does appear to have promoted, on the part of some of the case study institutional investors, an interest in seeking to influence the human resource practices of investee companies by directly engaging with these companies. The establishment of BT GAS, which is engaged by three of the superannuation funds studied to conduct engagement strategies, for example, is said to reflect 'the near-permanent share ownership of S&P/ASX200 companies by Australian superannuation funds and other long term institutional investors.'[284] The CEO of the PSS/CSS likewise stated that:

> *We're so big in the Australian market that we know that we will own something of almost every company in the top 200, no matter what... If one of our fund managers doesn't like a company they might underweight it but we still own it….and we'll have money in it next week and we'll have money in it next year and we'll have money in it in 10 years time, so we're interested in long term performance…we don't want to pick the two or three cows that are*

[281] Interview with Chief Executive Officer, VicSuper, above n. 199.
[282] This was the case with Vanguard, which indexes all of its funds under management.
[283] See Stapledon, above n. 84, 177.
[284] BT Financial Group, above n. 105.

at the head of the herd running the fastest; we want to make the whole herd run faster.[285]

This idea of 'making the whole herd run faster' was repeated in many of the interviews we conducted with representatives of institutional investors.

6.2 Mechanisms Used by Institutional Investors to Influence the Human Resource Practices of Companies

The institutional investors studied use a range of mechanisms to influence the human resource practices of investee companies that might broadly be referred to as 'voice' mechanisms.[286] These include proxy voting, writing letters to companies both individually and collectively, and raising labour management issues in meetings with management.

Whilst proxy voting is the most commonly used 'voice' mechanism amongst investors, it is rare for proxy voting to concern human resource management issues. This is primarily because proxy voting generally occurs on matters raised by the board of directors of companies at annual general meetings, and these infrequently concern the labour management of non-executive level employees.[287] All interviewees who engage in proxy voting said they had voted on executive remuneration issues, however, and they considered this matter to be of the utmost importance. The General Counsel / Company Secretary at Vanguard commented that executive remuneration has 'been a huge issue this year.' The General Manager of Portfolio Partners also remarked that non-performance based executive remuneration is an important issue and they are 'very active in that regard.' Interviewees also said that proxy voting advisory services, such as Corporate Governance International and ISS Proxy Australia do not provide advice regarding non-executive level employee

[285] Interview with Chief Executive Officer, Public Sector / Commonwealth Sector Superannuation Schemes, above n. 199.
[286] Hirschman, referred to in Waring, above, n.15.
[287] However, see Kirsten Anderson and Ian Ramsay, 'From the Picket Line to the Board Room: Union Shareholder Activism in Australia' (2006) 24 *Company and Securities Law Journal* 279, which examines a number of case studies in which Australian unions have initiated shareholder activist campaigns against companies by putting forward resolutions to be voted on at company AGMs.

management issues, as they do not have the expertise to do so. Such issues are beyond the mandate of these organisations.

As a consequence, direct 'voice mechanisms', such as meetings with company management, are much more likely to be used by institutional investors regarding labour management issues than proxy voting. However, interviewees stated that the raising of concerns over labour management issues is by no means as frequent or as systematic as the raising of traditional corporate governance issues such as the number of independent directors or remuneration of company executives. The reasons for this are discussed in section 6.5.

Perhaps the most systematic of the direct engagement mechanisms is the use, by the PSS/CSS, VicSuper and the CSF of BT GAS to routinely research and engage with companies in relation to a list of governance risks. BT GAS provides a systematic mechanism by which to research and seek to engage ASX 200 companies in relation to human resource management issues in circumstances in which the member superannuation funds may not directly be able to engage with investee companies on a one-to-one basis, due to the 'arms length' nature of their investments or the use of indexed investment strategies.

Other institutional investors studied engage directly with companies in relation to human resource management issues on a far more ad hoc basis. Thus, it cannot be said that human resource issues have reached anywhere near the same significance of other indicators in the management of risk. BT engages with companies in relation to labour management issues only where a concern has already been identified or is raised in a routine meeting with company managers. UniSuper engages directly with company management where a governance risk is identified, and this has, in the past, been defined to include human resource management issues, such as occupational health and safety. UniSuper will initially write a letter to company management and, if satisfied with the response, will not pursue the matter further. However, if the company's response is perceived to be inadequate, UniSuper will meet face-to-face with management. The interviewee from QIC stated that human resource management issues are considered as a matter of course when conducting analyses of companies. However, research on human resource management issues is not systematic, as in the

case of BT GAS. QIC relies mainly on anecdotal information uncovered by analysts during routine workplace visits of investee companies.

Portfolio Partners is working toward integrating human resource concerns into more routine company engagement practices. Portfolio Partners has been attempting to research human resource management practices in Australian ASX 300 companies through the distribution of a survey. Portfolio Partners is moving toward further incorporation of labour management considerations into its routine engagement processes through the appointment of a Manager, Sustainability, who is expected to research and engage with companies more routinely in the future, and further integrate the operating principle of 'sustainability' throughout its investment selection and retention processes.

Reflecting this shift towards greater engagement regarding labour management issues amongst some superannuation funds, ACSI, which represents superannuation funds in relation to corporate governance issues, is also developing more sophisticated policies concerning engagement over human resource issues. To date, ACSI has directly engaged with companies five or six times on behalf of members in relation to human resource issues. These issues have been defined as broad governance risks, and instances in which ACSI has determined that it is important to engage with companies have typically involved a company refusing to engage in collective bargaining. ACSI has also commissioned research into corporate social responsibility (which includes consideration of human resource management issues), thus attempting to promote the integration of human resource management issues into the investment, engagement and analysis practices of member superannuation funds.

Perceived success of engagement strategies

Whilst we were unable to establish whether efforts to influence investee company labour management practices were successful, we were able to gather interviewees' views about the success or otherwise of their engagement strategies. Many of the observations of the interviewees were in relation to the process of engagement. In most cases interviewees commented that the process of engagement with companies over human resource management issues had been positive. In general, they did not expect the company to change its practices immediately. It was more likely that the

investor would engage in a process of discussion and clarification with company management explaining why it had chosen to pursue a particular strategy. In some cases, interviewees were of the view that this was sufficient. Where interviewees were dissatisfied with the explanation given by management, 'selling pressure' was only very rarely applied. Comments made by the Chief Executive Officer and Chief Investment Officer of UniSuper provide an illustration of this:

> *We wrote to two or three companies last year about issues to do with their governance. They would then write back to us and we also had discussions with one of these companies…(one issue) was to do with work practices…If they gave us a response we thought was acceptable…we would have not done anything else…one of them…wrote back to us and we thought that was fine…But if we think the issue's unresolved we'll persist with it…(selling) is always an alternative available to us and we can always do that but if you sell…it's not necessarily a very useful form of action because you don't actually change behaviour in doing that.*

The only data which was kept by interviewees to our study concerning the effectiveness of engagement was held by Monash Sustainability Enterprises. An interviewee from Monash Sustainability Enterprises was of the view that the results of engagement strategies have been mixed. Monash Sustainability Enterprises advises institutional investors with $7 billion in Australian equities, which ought to be persuasive for company management regarding targeted issues. Monash Sustainability Enterprises maintains that, in relation to the various social and environmental issues it has researched, some companies have clearly modified their behaviour following engagement and instances of this are increasing. However, according to their assessment as at the end of 2005, 25 companies in the ASX 200 had refused to engage with Monash Sustainability Enterprises.[288] Most companies have been open to ongoing engagement.

[288] Interview with Senior Research Fellow, Monash Sustainability Enterprises, above n. 188. This comment refers to the refusal of companies to engage with Monash Sustainability Enterprises in relation to the various issues that Monash Sustainability Enterprises has engaged with, not human resource management issues exclusively.

6.3 Do Institutional Investors Make Investment Selections on the Basis of Human Resource Practices?

We expected that were institutional investors to carry out investment stock selection (i.e. buying, retaining, or selling shares) on the basis of information concerning labour management in companies, this might produce an incentive for companies to demonstrate high commitment labour relations in order to attract investment. To find support for this thesis, we looked for evidence of selection on the basis of human resource management practices. Our research found that in mainstream products (that is, non-SRI products), any 'screening out' of companies which adopt poor labour management practices occurs on an informal and not a systematic basis. Six of the institutional investors studied said that some consideration of human resource management issues is made in the selection of investments.

BT may look at labour management issues as an indicator of how well a company is being run in selecting and retaining investments within conventional (non-SRI) funds. Portfolio Partners is intending to mainstream the principle of 'sustainability' into its conventional funds, including the increasing use of 'high commitment' human resource management criteria in selecting and retaining investments in its conventional products. UniSuper expects external fund managers to consider 'high commitment' human resource management practices as an indicator of sound company management in selecting and retaining investments. Its fund managers are also expected to consider such issues as staff turnover and occupational health and safety as potential governance risks. However, this expectation is not driven by policy guidance which would indicate to fund managers exactly how they are to meet this expectation. Other inteviewees said they imagined that analysts would take into account human resource management issues in selecting or retaining shares, however, they were not aware of any specific system for making such decisions.

As might be expected, the active consideration of human resource practices of companies in selecting and retaining equities is most systematic within SRI products. Three of the superannuation funds studied– VicSuper, UniSuper and Health Super – offer SRI products, as do three of the non-superannuation institutions - BT, Portfolio Partners and QIC. In selecting and retaining investments for SRI products, most case

study institutional investors use a 'best of sector' or 'sustainability' approach, in which companies are rated according to various 'high commitment' labour management practices. Leaders in this and other criteria are identified and selected / retained on this basis. The only exception to this process is the SRI Australian equities product provided by Health Super, which uses a screening process to 'screen out' companies involved in 'negative activities' (e.g. child labour) and 'screen in' companies with 'positive policies', including policies in relation to human resource management.

The likely influence of SRI funds in Australia is limited by their small market power. Investments contained in SRI funds as a proportion of total funds under management are generally small in case study institutions. As noted above, of the six investors with SRI products only one of these has attracted over 1% of funds under management. VicSuper has 10% of its funds under management in a 'sustainability fund', and this fund does not rely on member choice to allocate funds to this product.

6.4 Observations Relating to Institutional Investors that do not Seek to Influence the Human Resource Practices of Companies

Those institutional investors interviewed that stated they do not seek to influence the human resource management of companies provided diverse rationales for the absence of such engagement. The two non-superannuation institutional investors that do not seek to influence human resource practices in investee companies both utilise mathematical models in selecting and retaining investments. These methods appear to preclude the institutions from taking into account human resource management issues in their stock selection or retention methods.

Both BGIA and Vanguard use quantitative investment selection and retention processes. BGIA uses a highly mathematical / quantitative stock selection and retention process and the Corporate Governance Manager from BGIA stated that a significant barrier to taking labour management issues into account is the fact that it is difficult to place more 'qualitative' measures, such as CSR / human resource management considerations into this process. BGIA ensures that it retains liquidity in the small proportion of investments which it manages actively and conducts

considerable research to do so. In relation to the indexed investments, however, it holds those investments that remain in the ASX 300. It was the view of the BGIA interviewee that this, in principle, increases incentives to be actively engaged with investee companies in relation to governance risks. However, BGIA is only just beginning to develop its engagement policies, beyond proxy voting.

Vanguard uses the process of indexing to select and retain equities investments. Indexing is a mathematical model that weighs up investments in an index (for example, the ASX 300) and ensures that holdings are maintained at the same weightings by industry and sector. Vanguard does not employ analysts to research the performance of companies and engage with these companies, and human resource management considerations cannot factor into its mathematical investment selection and retention process. Vanguard's company engagement practices are largely limited to actively considering and exercising proxy votes. The interviewee from Vanguard stated that there had been occasions in which it had considered social responsibility issues when voting due to the propensity for these issues to at times impact on the financial performance of companies.

The rationale provided by those superannuation funds that do not actively seek to influence the human resource management practices of investee companies was quite different from the non-superannuation funds. All of the superannuation funds that do not seek to influence the labour management practices of investee companies are of the view that labour management could be an indicator of a well functioning company. However, interviewees explained that they are unable to directly engage with companies or consider human resource management issues in selecting investments as the institutions maintain an 'arms length' relationship with their external fund managers.

Another reason provided for the absence of engagement is the costs involved in researching, monitoring and engaging companies in relation to human resource management issues. For instance, the Chief Investment Officer of the TWU Superannuation Fund stated:

It's a lack of resources…Having said that, if the board were to set a policy…to be more aggressive in that area, well we would have to follow, but I would think we would end up needing new staff as a matter of justifying it [which would be]…more expensive.[289]

Low costs are seen as a competitive advantage by superannuation funds in an environment in which consumers have a wide choice of funds. These funds are reluctant to risk this advantage by adding to the costs involved in managing investments.

6.5 Barriers to Investment Selection or Engagement Concerning Human Resource Practices

Whilst our study found that the majority of case-study institutional investors are engaging with investee companies in some manner concerning their labour management practices, most institutional investors are at the embryonic stages of developing engagement strategies concerning these issues. The idea that engagement regarding labour relations issues is desirable is a recent one for most institutional investors. There is a perception that significant obstacles stand in the way of engagement. These obstacles predominantly include imperfect information and reluctance to micro-manage companies.

Almost all interviewees cited the lack of access to information in relation to human resource management practices of companies as a barrier to engagement concerning these issues. The major reason for this problem of imperfect information is the fact that companies are not required to disclose information regarding labour management. A respondent from PSS/CSS, which has an active company engagement strategy, stated:

There's no information about what they're doing…to make sure that their people are good, happy, well trained, well rewarded, looked after in the workplace, all those sorts of things. By and large the disclosure on companies human resource policies and practices is pretty pathetic.

[289] Interview with Chief Investment Officer, TWU Superannuation Fund, above n. 252.

Institutional investors, on the main, base their investment decisions on quantitative data. Because information about human resource management is not presented in these terms, and is largely qualitative in nature, investors have difficulty assessing its likely impact upon returns. For instance, in spite of an explicit policy decision to develop an engagement strategy regarding labour management, the President of ACSI said that labour relations information is 'difficult to discover or measure'. The interviewee from QIC likewise stated that information gathered from management is largely anecdotal and often 'hard to find out.'

As a means of overcoming information barriers, interviewees noted with approval the increasing propensity by investee companies to release sustainability reports.[290] This reduces the transaction costs involved in gathering information of this nature. However, companies are not required to disclose this information and there is no broadly accepted or standard method of doing so. As such, comparison of sustainability reports is difficult. Schemes such as the Global Reporting Initiative, sponsored by the UN, are seen to be helpful in this respect. The Global Reporting Initiative includes various indicators relating to labour practices, in the following categories: employment (type and turnover); labour / management relations (collective bargaining etc); occupational health and safety; training and education; and diversity and equal opportunity.[291]

Some interviewees also voiced concerns regarding second guessing management. The interviewee from BT, for example, said that whilst BT does actively engage with companies in relation to their human resource management practices, they are 'very sensitive to micromanagement.' Except in the most egregious of situations, the particular human resource strategies adopted by companies are seen as a management issue, and on the whole investors are reluctant to 'second guess management.'[292] The President of ACSI summed up this attitude: 'companies have extremely specific

[290] Interview with Head of BT Governance Advisory Service, BT Financial Group, above n. 97.
[291] See Global Reporting Initiative, 'Performance Indicators', available at <www.globalreporting.org>
[292] Interview with Head of BT Governance Advisory Service, BT Financial Group, above n. 97.

knowledge about their situation and you don't.'[293] This fact of knowledge asymmetries was repeated in interviews with other institutional investors.

Reluctance to engage with investee companies on the basis that they might be meddling in management issues has been overcome by some institutional investors by conceiving of labour management issues as broad governance risks. The interviewee from PPS/CSS, for example, said 'we're not telling them how to run their business, we're just telling them as one of their owners that we think that there's a risk here that we can't discern…we don't go and tell them what to do.' The CEO of the Catholic Superannuation Fund put his fund's position in similar terms: 'It's not about managing the companies; it's about saying to the company we have certain principles we believe . . . that if you don't follow you have a long term risk to the sustainability of that business.'

Nevertheless, the concern not to second-guess management does shape the nature of engagement. This was explained in the following terms by the President of ACSI:

> *What we would never do is take a position on a particular industrial relations situation or dispute, even though sometimes people think we should or want us to, we just don't. We're really trying to talk about the long-term governance pattern of a company rather than the resolution of a dispute which is the province of the management and the unions and whoever else, the Government…whatever other parties are around.*

As noted above, institutional investors face a number of barriers to engagement with companies in relation to corporate governance issues, including information constraints.[294] We conclude that the barriers to engagement regarding human resource issues are far higher than with regards to corporate governance issues. Companies listed on the ASX are now required to report on certain corporate governance practices, but no such requirement is made concerning social issues.[295] There is now broad acceptance by both company managers and institutional investors

---

[293] Interview with President, ACSI, above n. 243.
[294] See Stapledon, above n. 84, 158 – 175.
[295] ASX Listing Rule 4.10.3

of the importance of good corporate governance in mitigating risk.[296] Whilst our study indicates that there may be growing acceptance of the importance of good human resource management in mitigating risk, information is scarce, methods for assessing the extent of the risk are underdeveloped, and engagement to reduce it is at the embryonic stage.

7. CONCLUSION

Our study sought to discover whether institutional investors in Australia seek to influence investee companies regarding their human resources management strategies. We found some evidence that investors are engaging with companies in order to foster 'high commitment' human resource practices. They do so using a variety of mechanisms; including proxy voting, letter writing and meetings with management, but with varying frequency. Whilst evidence that institutional investors are engaging with investee companies regarding labour management may be limited in the sense that engagement strategies are embryonic and often ad hoc, this is nevertheless a significant finding that suggests further research ought to be conducted to discover the extent of this phenomena. As our study was limited to a small number of investors who opted to participate in our study, it is likely that we studied investors with a particular propensity to engage with companies concerning human resource management. Despite these methodological limitations, the case study methodology allowed us to gain detailed information about the rationale and nature of institutional investor engagement with investee companies regarding human resource management.

It was expected, based on work by Waring[297] and Deakin,[298] that institutional investors may actively seek to influence the human resource management of investee companies because they have an interest in the long-term sustainability of investments due to the difficulty of exiting. This was partly confirmed by our study. Interviewees representing those institutional investors that do claim to seek to influence the human

[296] The 2006 study of 320 institutional investors by Institutional Shareholder Services Inc., above n. 31, 9 – 10, found that 44% of respondents named 'improved risk management' as an advantage of monitoring corporate governance in portfolio companies, and 20% of respondents rated this as the most significant advantage.
[297] Waring, above n. 15.
[298] Deakin, above, n. 29.

resource practices of investee companies generally cited the size, length and breadth of their investments as the primary rationale for engagement with companies regarding labour management issues. They generally believe there is a link between 'good' human resource management and company performance. Labour management issues are commonly conceived of as a risk factor, rather than in ethical terms. Because institutional investors use exit only as a 'last resort', they are concerned to reduce the risks associated with investment. Poor human resource management is understood to be a risk to long-term returns.
Research conducted outside Australia suggests that superannuation funds are more likely to be concerned than non-superannuation funds to monitor and influence the human resource management and industrial relations practices of investee companies.[299] Given the presence of member representatives, often appointed by unions, on the boards of industry superannuation funds, we might have expected these funds to have been particularly active. However, our research did not confirm this expectation. Several of the non-superannuation funds that we studied demonstrated some activity in relation to this issue. Indeed, the non-superannuation funds that directly manage investments have a greater aptitude to act upon their concern regarding human resource management than superannuation funds that outsource the management of investments. Because superannuation funds generally engage external fund managers to manage their investment portfolios, they do not generally intervene in the specific share selection strategies of these external fund managers. This use of external fund managers was the primary rationale provided by superannuation funds for why they do not seek to influence the human resource management of investee companies. As a result of this structural difficulty, those superannuation funds that do seek to influence investee companies regarding these issues often use complex methods of engagement, which are employed parallel to and separate from their investment selection strategies.

The monitoring and engagement strategies regarding human resource management exercised by the institutional investors studied vary greatly in sophistication. Engagement concerning labour issues amongst all funds studied has only begun in the last five years and investors are generally in the process of developing their

[299] See Johnson and Greening, above n. 8.

engagement policies and practices. For some investors, particularly those that engage BT GAS to conduct 'voice' strategies, engagement is on the basis of a complex rating of investment risks following research. For most, however, both monitoring and engagement occurs on an ad hoc and unsystematic basis. Human resource issues might arise during routine meetings with investee company management, but only when the investor is already aware of the existence of a human resource issue or where management raises a matter relating to this topic. Enquiries regarding labour management issues are not generally conducted routinely. Institutional investors only set up meetings with management or write letters when they believe a human resource issue poses significant risks to their investment, either because it is a threat to the reputation of the company or because it may expose the company to legal or financial liabilities. Proxy voting on human resource issues is rare because such issues are not generally raised at an AGM by the board of directors. At the most, engagement entails writing a letter or seeking a meeting to gain an explanation for the company's actions.

Whilst our research suggests that there may be a growing propensity amongst some institutional investors to seek to engage with companies concerning their employee relations strategies, we found that significant barriers exist. These barriers affect the ability to engage, the subject matters about which engagement is likely to occur, and thus the frequency of engagement. The most important of these is imperfect information. The ability to monitor the human resource management of investee companies is a precondition to engagement on that basis and institutional investors have difficulty collecting or comparing information on this issue. In the absence of routine and standardised reports on human resource management, institutional investors rely on newspaper reports of labour relations problems or anecdotal evidence. Both newspaper reports and anecdotal evidence are generally 'incident' based and do not provide a good picture of the overall human resource management strategies of a company, including important employment matters such as the use of consultative mechanisms, and training and retention policies.

Interviewees generally drew a distinction between those matters that are 'management issues' and those that are 'corporate governance risks'. Institutional investors are often hesitant to engage with companies regarding human resource management on the basis that they would be meddling in 'management issues'. As a result, they are

only likely to actively engage where labour relations are particularly egregious, and pose a risk to investment, such as a prolonged industrial dispute.

Despite these barriers to engagement over human resource management issues, our study found that engagement has increased over the last few years amongst some case study institutional investors. The peak body representing superannuation funds, ACSI, has begun engaging with companies in relation to labour management, and is developing a CSR policy that includes labour issues. This suggests that engagement concerning human resource management may increase in years to come, at least amongst superannuation funds.

Our primary aim was to discover whether institutional investors *aim* to influence the human resource practices of investee companies in a particular manner. Because of the nature of the research we were unable to test whether engagement by institutional investors *in fact* influences the behaviour of investee companies. Such a finding can only be reached by studying investee company behaviour. However, the finding that most of the institutional investors studied seek to influence the human resource management practices of investee companies has some potential implications with regards to the likely effect on companies. It is plausible that these actions by investors have some effect on the behaviour of companies, although this effect may be mitigated by a lack of consistency concerning the type of 'high commitment' human resource management practices which are valued by institutional investors as well as the often ad hoc process of engagement on human resource issues by institutions. Our findings concerning the growing propensity of some institutional investors to take into account information about employment practices when acquiring or retaining investments might also logically point to the possibility that investee companies will seek to appeal to this powerful market for investment by demonstrating 'high commitment' employment practices. It remains to be seen whether Australian companies will capitalise on this potential mechanism through which to distinguish themselves and attract investment from institutional investors.

APPENDIX A: LIST OF INTERVIEWEES AND DATE OF INTERVIEW

1. President, Australian Council of Superannuation Investors
   7 April 2006
2. Corporate Governance Manager, Barclays Global Investors (Australia)
   10 March 2006
3. Head of BT Governance Advisory Service, BT Financial Group
   13 February 2006
4. Chief Executive Officer, Construction and Building Industry Super Fund
   17 March 2006
5. Chief Executive Officer, Catholic Superannuation Fund
   14 February 2006
6. Senior Investment Analyst, Health Super
   6 March 2006
7. Managing Director, Portfolio Partners
   24 February 2006
8. Chief Executive Officer, Public Sector / Commonwealth Sector Superannuation Schemes, 6 April 2006
9. General Manager, Queensland Investment Corporation
   10 February 2006
10. Chief Investment Officer, TWU Superannuation Fund
    7 March 2006
11. Chief Executive Officer and Chief Investment Officer, UniSuper
    14 March 2006
12. General Council / Company Secretary, Vanguard Investments Australia Ltd.
    21 March 2006
13. Chief Executive Officer, VicSuper
    28 February 2006

APPENDIX B: REPRESENTATIVE SCHEDULE OF QUESTIONS

1. Does your institution have any large holdings in listed Australian companies (ie large in relation to the particular company's issued capital)? For instance, holdings of 3% and above, or 5% and above?

2. Do you consider your investments to be long term or short term?

   2.1. Do the size of your investments affect whether you consider them to be short or long term?

   2.2. Can you exit easily from your investments (ie without affecting the sale price of the shares)?

   2.3. If not, does this increase the need for you to be more actively engaged with investee companies to ensure a high standard of corporate governance practices?

3. We are interested in the way that your institution might exercise influence over the corporate cultures, business strategies or performance of Australian companies that your institution invests in via pooled funds. Can you identify any mechanisms you can utilise or actions your institution can take to exert this kind of influence?

4. Is any allocation made to socially responsible investment (SRI) funds?

   4.1 If so, to what extent do human resources concerns explain the trustee's decision to allocate some funds to SRI?

   4.2 What is the size ($A and percentage of fund's assets) of investment in SRI?

5 Does your fund require any of its equity fund managers specifically to take into account issues relating to human resources, when making stock selection decisions?

6 What is the nature of your relationship with the management of the companies in which your institution has a large holding?

7 How is that relationship managed? Does your institution meet regularly with the senior management of companies in which you have a holding/a large holding?

7.1 How do those meetings take place? i.e. are they one to one, who are they with (how senior are the members of the company?

7.2 What sort of matters are discussed at those meetings?

7.3 Are human resource issues ever discussed at those meetings?

8 How might your institution influence the strategy of a company in which you have a major holding? Is your institution ever involved in 'extraordinary actions'? By this we mean 'behind the scenes' actions with problem companies. These kinds of actions might involve: (i) approaches made by the institution (alone) to a portfolio company's management, regarding specific concerns; (ii) shareholder conferences with the institution either convened or attended, for the purpose of discussing specific concerns about a specific company (but which did not reach the stage of a 'shareholder coalition'); (iii) approaches made by the institution (either alone or with the backing of other institutions) to a company's non-executive director(s) and/or a company's senior management (and which did not reach the stage of a shareholder coalition); (iv) institutional shareholder coalitions which the institution either led or joined, for the purpose of producing specific changes at a specific company (usually changes in board/senior management composition); (v) the convening of, and, if necessary, the exercise of voting rights at, an extraordinary general meeting calling for the removal of a director or directors and/or the election of new directors.

8.1 Could you give an estimate of the average number of 'extraordinary actions' concerning Australian companies in which your institution has participated, annually over the past few years?

8.2 Do you think that these 'extraordinary actions' have ever had a flow on effect on the human resource strategy of the target company?

8.3 Has this ever been the express purpose of an 'extraordinary action'?

9 How involved are you in determining the business strategy of the company?

9.1 Is it common for company managements to consult with, and/or obtain the prior approval of, your institution in relation to proposed large transactions (such as acquisitions, etc.) that do not legally require shareholder approval?

10 Are you involved in determining, influencing or assessing the human resource strategy of the company?

11 How easy or difficult is it to assess company activities in the area of human resources?

12 Do you perceive that your members have a vested interest in, or expect that human resource issues are something that you would be mindful of in influencing or keeping a check on the business strategy of the company?

13 How closely does your institution liaise with non-executive directors of companies in which you have a holding – both in 'good times' and when a company's performance is unsatisfactory?

    13.1 Would human resource management issues ever be raised in those liaisons?

14 What kind of performance evaluation do you have for your fund managers? What performance criteria are they judged against?