# ARE SUPERANNUATION FUNDS AND OTHER INSTITUTIONAL INVESTORS IN AUSTRALIA ACTING LIKE 'UNIVERSAL INVESTORS'?

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## 1. Introduction, Hypothesis and Methodology

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 in size, and as a proportion of all investments in the capital market, may have transformed them into 'universal investors' with an interest in the long-term sustainability of the entire market. This, in turn, 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 human resource practices typically involve managerial attempts to motivate and manage employees through a series of workplace practices that incorporate the interests of employees rather than through strict command and control structures. The deployment of specific work practices and human resource policies is posited to provide an organisation with the internal capability to raise employee effort and productivity, and organisational performance: see, for example, McDuffie (1995); Capelli and Neumark (2001); Ichniowski, Shaw and Prennushi (1997); Baker (1999); Erikson and Jacoby (2003). These practices might include investment in

staff training and development, employment security, flexible workplace practices, investment in occupational health and safety, equitable remuneration, incentive pay, and 'partnerships' with employees and/or their representatives (for a more comprehensive list, see Pfeffer 1995). In formal labour relations terms, it might also include respect for freedom of association, the right to bargain collectively and other core labour standards.

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 of investee companies. The size of individual holdings makes it difficult for institutional investors to enter and exit a company quickly without affecting the share price (Johnson and Greening 1999). 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' (Deakin 2005: 19). This lock-in increases the incentive to have a long-term view of investment (Deakin 2005: 19). The idea that institutional investors may be 'universal owners' has mainly developed in the United Kingdom, however, it may also be applicable in Australia where superannuation funds, in particular, are often thought of as long-term investors as they have predictable cash flows and typically invest for a long period. Superannuation funds have far more investments in equities than other asset types, making the management of equities more crucial to their risk assessment.

Universal investment may have a number of consequences for the human resource practices of investee companies. Deakin has proposed 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 (see also Waring 2005: 3). The rising prominence of institutional investors may thus be 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. This phenomenon is seen to be associated with mainstream investment portfolios, not just the much smaller proportion of Socially Responsible Investment (SRI) portfolios which have attracted a great deal of attention in recent years.

Institutional investors may believe that investee companies that utilise 'high commitment' human resource practices are more likely to produce returns of a preferred long-term and sustainable nature. For instance, a study conducted by Graves and Waddock (1994) concluded that institutional investors were taking into account information relating to corporate social performance, including employee relations, when making investment decisions, and this had flow on 'market effects'. The growing proportion of funds under management by institutional investors produces a powerful market for investments in which human resources are managed in accordance with 'high commitment' techniques. Companies wish to attract investment of this kind and thus either change their behaviour or market themselves accordingly. In addition to this generalised effect, it has been theorised that the rise in popularity of socially responsible investment (SRI) 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 (Waring and Lewer 2004).

A stronger proposition suggested is that 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 human resource practices. Waring (2005: 6) asserts that because the ability of institutional investors to exit their investments is diminished, the investor is left with two options: voice or loyalty. That is, they can either 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) (Waring 2005: 7). 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. The incentive to engage is also likely to flow in the opposite direction. Investee companies are also more likely to actively engage with investors with large and long-term holdings. The significant amount of funds held collectively by institutional investors has meant that company management faces 'an identifiable group of portfolio managers', rather than a widely dispersed shareholder group (Deakin 2005: 5). Company management may therefore be more likely to discuss changes in business strategy with large investors before making major decisions.

Institutional investors who act like ‘universal owners’ have been heralded as a potential countervailing force to ‘shareholder primacy’ which is perceived by some authors to have an injurious impact upon the interests of corporate employees (Lazonick and O’Sullivan 2000). Under a certain type of ‘market-based’ capitalism (Hall and Soskice 2001; Gospel and Pendleton 2005: 26-7), the interests of shareholders are considered paramount by directors, over and above those of other stakeholders, such as employees. At its extreme, this perspective suggests that directors will tend to favour the short-term financial interests of shareholders (shareholder value), being driven by capital markets fixed on share price and short-term returns. But even in a more balanced perspective, the shareholder primacy view would hold that the overriding goal of the corporation is to maximise shareholder wealth (Mitchell, O’Donnell and Ramsay 2005).

### *Available data regarding the extent of institutional holdings*

Data on the growth of total funds under management suggests that equity managed by institutional investors in Australia has grown substantially in recent years. Institutional investors have ‘enjoyed a long period of sustained growth in the value of funds under management’ (Ali, Stapledon and Gold 2003: 3). Fund managers in Australia now 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 percent) of total assets under management in Australian equities based on data derived from unconsolidated assets (Rainmaker Roundup 2006).

There is also data on the percentage of equity of listed companies held by institutional investors. A 1991 Industry Commission found that the average ownership of equities in listed companies was as follows: Life Offices 10 percent, Funds 22 percent, Investment Companies and Equity Trusts 2 percent, other financial institutions 2 percent, individuals 28 percent, other companies 7 percent and overseas investors 29 percent (Industry Commission 1991: 140), putting Australian institutions' combined beneficial holding of equities at 36 percent. Australian Stock Exchange data from 1999 (ASX) showed that governments owned 0.1 percent of shares, other companies owned 8.3 percent, banks 3.5 percent, life insurance offices and superannuation funds 24.1 percent, other financial institutions 9.3 percent, individuals 23.0 percent and overseas investors31.7 percent of shares, resulting in Australian institution's combined beneficial holding of equities of around 37 percent. In so far as the data lends itself to comparison, this suggests that the average holdings by institutional investors of listed companies in the 1990s remained reasonably stable and were not nearly as large as in the UK where, in around 1991, institutions held over 60 percent of the UK equity market (Stapledon 1996a: 25)..

Other research also shows that funds under the management of institutional investors are highly concentrated in Australia, with the 'top 10' equities investment managers holding 51.5 percent and the 'top 20' holding 73.5 percent of market share as at March 2006 (Rainmaker Group 2006).

### *Methodology*

The evidence just outlined indicates significant ownership of the equity of Australian listed companies by institutional investors. As we have noted above, this ownership has implications for how these investors act and the literature and existing data suggests a range of possible arguments that might be tested in the Australian context. The purpose of the study reported in this paper was 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 in addition to a case study of the Australian Council of Superannuation Investors (ACSI), an industry body representing 39 superannuation funds. The institutional investors studied were: Barclay Global Investors (Australia) (BGIA), BT Financial Group, Construction and Building Industry Superannuation Fund (CBus), Catholic Superannuation Fund, Health Super, Portfolio Partners, Public Sector/Commonwealth Sector Superannuation Schemes (PSS/CSS), Queensland Investment Corporation, the Transport Workers' Union Superannuation Fund (TWU), UniSuper, Vanguard Investments Australia Ltd and VicSuper. A full list of funds and their characteristics can be found in Table 1. A list of interviews can be found in Appendix A. Further information regarding the methodology used and the selection of case studies can be found in the longer report on the case studies (http://cclsr.law.unimelb.edu.au/index.cfm?objectid=E3D38F25-B0D0-AB80-E2F1BF648C87997F).

We were not aiming for a representative sample by selecting a mix of investors; rather, we hoped to test the hypothesis in the different contexts of direct investment and indirect investment and with a range of different types of institutional investors. By direct investment, we mean the institutional investor manages its investments, and makes investment decisions, itself. By indirect investment, we mean the institutional investor has arrangements with external fund managers who make the investment decisions for institutional investor.

In addition to 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 that are interested in human resource management issues in investee companies, and thus may have had particular implications for the conclusions we have drawn. 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 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 management of investee companies. A survey of the literature in the area informs us that this is a novel study. Given the dearth of prior research into this area, 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. However, quantitative generalisations cannot be made from a small number of cases to a population. Furthermore, because our study was restricted to the attitudes and practices of institutional investors, we are unable to draw wider conclusions concerning whether the practices of institutional investors, where they intend to influence investee companies, have their intended effect. It is 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 type and so on. Nevertheless, as our short review of the existing literature indicates, various authors speculate that such a causal connection may exist.

## 2. Case Study Findings

Where institutional investors sought to influence investee companies, we asked (i) why they seek to influence the companies, and (ii) what mechanisms they use to exert this influence. Where they did not seek to influence investee companies, 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 the institutional investors studied consider companies' employment practices when making investment decisions and, if so, (v) what kinds of practices they take into account. In addition to this, 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 or ability to influence investee company employment practices.

Most of the superannuation funds studied are industry superannuation funds. The difference between industry superannuation funds and other types of institutional investor is particularly significant. This is firstly because under Part 9 of the *Superannuation Industry (Supervision) Act 1993* (Cth), industry superannuation funds are required to have equal representation of members and employers on their boards, usually nominated by employer associations and unions respectively. For instance, CBus has member directors appointed by the Australian Council of Trade Unions (ACTU) and sponsoring unions, whereas the employer representatives are appointed by Master Builders of Australia. It might be expected that the employee representatives would pursue labour issues through the investment strategies of the funds on whose boards they sit. Secondly, industry superannuation funds often manage their funds via external fund managers, whereas other institutional investors generally manage their funds internally. It is possible that these characteristics of industry superannuation funds might result in different attitudes towards the human resource practices of investee companies.

A summary of the key characteristics of the institutional investors studied and some of our main findings are outlined in Table 1. Our study revealed an intention on the part of seven of the institutional investors interviewed to influence the human resource practices of investee companies to adopt 'high commitment' practices through a variety of mechanisms. Directors who are appointed by trade unions to the boards of industry

superannuation funds would generally 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 have done (Romano 1993; Jacoby 2007). For example, some of the unions represented on the CBus board have been involved in union shareholder campaigns which focussed on core labour standards (Anderson and Ramsay 2006). However, despite this, 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.

Those institutional investors interviewed that did 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, Vanguard and BGIA, closely match the 'universal investor' profile in that they use quantitative investment selection and retention processes and invest broadly across the entire market in the long-term. However, both utilise mathematical models in selecting and retaining investments, which appear to preclude them from taking into account human resource management issues in their share selection or retention methods.

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- the Australian Securities Exchange top 300 listed companies) and ensures that

holdings are maintained at the same weightings by industry and sector. Human resource management considerations cannot factor into this process and Vanguard's company engagement practices are largely limited to considering and exercising proxy votes. Similarly, the Corporate Governance Manager from BGIA stated that a significant barrier to taking labour management issues into account is the difficulty of placing more 'qualitative' measures, such as human resource management considerations, into its highly quantitative stock selection and retention process. BGIA is only just beginning to develop its engagement policies beyond proxy voting.

The rationale provided by the three superannuation funds that do not actively seek to influence the human resource management practices of investee companies was quite different. All of these superannuation funds are of the view that labour management could be an indicator of a well functioning company, however, they are unable to directly engage with companies or consider human resource management issues as the institutions maintain an 'arms-length' relationship with their external fund managers. Furthermore, the costs involved in researching, monitoring and engaging companies in relation to human resource management issues are deemed significant. 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.

***Insert Table 1 around here***

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

Consistent with Deakin's 'universal owner' argument, our research found that the common rationale provided by the institutional investors studied for seeking to influence human resource practices in investee companies was to promote long-term value for members. We found that representatives from 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 which are perceived to present risks in relation to the realisation of investments in mainstream (i.e. non-SRI)[2] products. Mitigating risk was the predominant reason provided for active engagement with investee companies regarding their industrial relations and human resource management.

All the institutional investors studied stressed their central obligation to create financial value for their members. This emphasis was reflected in responses to a ranking exercise in which we asked respondents to rank 10 stakeholders in order of priority, with one being the highest and 10 the lowest. The results of this ranking exercise can be found in Table 2. 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 regarding 'social issues', including human resource issues, for

some of the superannuation funds studied. The CEO of the PSS/CSS explained this phenomenon in the following terms:

> If everyone's got the same fiduciary duty why does everyone have a slightly or even radically different investment strategy? … [T]he real difference is of course risk because some people have a different risk tolerance. … [W]hen 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.

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 environmental and social issues because they have an impact on your risk profile and they're opportunities.

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:

> [N]ot 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 [the company] 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.

Contrary to evidence collected in the US by Johnson and Greening (1999: 564) which suggested that pension funds (the equivalent of Australian superannuation funds) were more likely than mutual funds to influence investee companies concerning their social practices, a number of the Australian non-superannuation institutional investors studied also seek to influence human resource practices in investee companies. Respondents from the non-superannuation institutional investors similarly perceived that 'high commitment' labour management practices amongst investee companies is consistent with long-term value. The Managing Director of Portfolio Partners was particularly insistent regarding upon this point:

> 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. … [C]ompanies must become more effective and efficient in their quest to reach their bottom line goals. … [W]e believe a 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.

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, rather than related purely to ethical considerations. As the Head of BT Governance Advisory Service (BT GAS) stated, 'we're not an NGO and so therefore ethics and moral issues are determined in relation to those that give rise to a risk'.

*Insert Table 2 around here*

### *How Developed are the 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 (Waring 2005: 3). These include proxy voting, writing letters to companies both individually and collectively, and raising labour management issues in meetings with management. However, we found that, generally, their methods were not sophisticated or systematic.

Proxy voting – the most commonly used 'voice' mechanism amongst investors – generally occurs on matters raised by the board of directors of companies at annual general meetings and these rarely concern the labour management of non-executive level employees (cf. Anderson and Ramsay 2006). All interviewees who engage in proxy voting said they had voted on executive remuneration issues. Direct 'voice mechanisms', such as meetings with company management, are much more likely to be used by institutional investors regarding labour management issues. 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 the remuneration of company executives.

Except in the most egregious of situations, the particular human resource strategies adopted by companies are seen as a management issue, and interviewed investors often stated a reluctance to 'second guess management.' For example, the interviewee from BT said that whilst BT actively engages with companies in relation to their human resource management practices, they are 'very sensitive to micromanagement.' The President of ACSI explained this attitude: 'companies have extremely specific knowledge about their situation and you don't'. This reluctance to meddle in management issues has been overcome by some institutional investors by conceiving of labour management issues as broad governance risks. The interviewee from the 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'. 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.

Perhaps the most systematic of the direct engagement mechanisms is the use of BT GAS – by the PSS/CSS, VicSuper and the CSF – 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 (the Australian Securities Exchange top 200 listed companies) in relation to human resource management issues when the member superannuation funds practice an 'arms-length'

approach to their investments or use indexed investment strategies. At the time of the interviews, BT GAS was part of one of the institutional investors studied - the BT Financial Group.

Other institutional investors studied engage directly with companies concerning 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. Where a governance risk has been identified, UniSuper will initially write a letter to company management and, if the response is perceived to be inadequate, it will then 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 company analyses, however, it relies mainly on anecdotal information uncovered by analysts during routine workplace visits of investee 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, primarily because companies are not required to disclose information regarding labour management. A respondent from the PSS/CSS, which has an active company engagement strategy, stated that, "[b]y and large the disclosure on companies human resource policies and practices is pretty pathetic". Interviewees noted with approval the increasing propensity

for investee companies to release sustainability reports, thus reducing the costs involved in gathering information of this nature. However, companies are not required to disclose this information and there is no standard method of doing so. As such, comparison of sustainability reports is difficult. Schemes such as the Global Reporting Initiative, sponsored by the United Nations, are seen to be helpful in this respect (see 'Performance Indicators' section: Global Reporting Initiative 2006).

Portfolio Partners has been attempting to research human resource management practices in Australian ASX 300 companies through the distribution of a survey, and it is moving toward further incorporation of labour management considerations into its routine engagement processes through the appointment of a Manager of Sustainability, who is expected to research and engage with companies more routinely 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, 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. 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.

In most cases, interviewees commented that the process of engagement with companies over human resource management issues had been positive. In general, they expected that 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, rather than the company changing its practices immediately. Where interviewees were dissatisfied with the explanation given by management, 'selling pressure' was only very rarely applied. For example, the Chief Executive Officer and Chief Investment Officer of UniSuper comment that "[selling] is always … available to us and we can always do that but … it's not necessarily a very useful form of action because you don't actually change behaviour in doing that."

As part of our research, we also interviewed a representative of Monash Sustainability Enterprises (MSE). One of the functions of MSE is to provide consulting advice to organisations in the finance sector (including some institutional investors) on the sustainability practices of Australian companies. MSE was the only interviewee to keep data concerning the effectiveness of engagement. It advises institutional investors with $7 billion in Australian equities, which ought to be persuasive for company management regarding targeted issues. MSE maintains that, in relation to the various social and environmental issues it has researched, most companies have been open to ongoing engagement and some companies have clearly modified their behaviour following engagement, with such instances increasing. However, according to its assessment as at the end of 2005, 25 companies in the ASX 200 had refused to engage with it.

In sum, the fact that institutional investors are generally not adopting systematic mechanisms for engagement or measuring the impact of their engagement with companies over human resource issues speaks of the nascency of the strategies. Whilst our study indicates that there may be growing acceptance by both company managers and institutional investors 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.

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

We expected that if institutional investors carry out investment share selection 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. Our research found that in mainstream (non-SRI) products, any 'screening out' of companies which adopt poor labour management practices occurs on an informal basis rather than based on formal guidelines or close oversight of external fund managers.

Six of the institutional investors studied said that some consideration of human resource management issues is made in the selection of investments. For instance, 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. UniSuper

expects external fund managers to consider 'high commitment' human resource management practices as an indicator of sound company management, as well as considering issues such as staff turnover and occupational health and safety as potential governance risks. However, this expectation is not driven by policy guidance. Other interviewees 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 companies' human resource practices in selecting and retaining equities is most systematic within SRI products. For those institutional investors that offer SRI products, most use a 'best of sector' or 'sustainability' approach, in which companies are rated according to various 'high commitment' labour management practices and selected or retained on this basis. The only exception to this process is the SRI Australian equities product provided by Health Super, which 'screens out' companies involved in 'negative activities' (e.g. child labour) and 'screens in' companies with 'positive policies', including those in relation to human resource management. However, investments contained in SRI funds as a proportion of total funds under management are generally small in case study institutions. Of the six investors with SRI products only one of these has attracted over one percent of funds under management.

### *Universal Owners*

Only partial support for the 'universal owners' theory put forward by Deakin (2005:11) is found in our case studies of institutional investors. Many of the institutional investors studied for this project employ strategies aimed at maintaining investment in an individual company at levels that allow for easy exit. Further, some of the institutional investors studied are not large enough to have investments of over 3 percent in the largest individual companies. Consistent with 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-studies found that institutional investors are near universal owners of the ASX 200 and exit is understood as an option of last resort. This is for various reasons: some simply prefer not to limit the diversity of their investments by 'screening out' investments; in some cases, such as Vanguard, this is linked to an indexed investment strategy. Nevertheless, reluctance to exit should not be exaggerated (Stapledon 1996: 177). Whilst most institutional investors may consider themselves to be invested for the 'long-term', they employ fund managers 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 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 is said to reflect 'the near-permanent share ownership of ASX

200 companies by Australian superannuation funds and other long term institutional investors' (BT Financial Group (April 2005)). 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 … we don't want to pick the two or three cows that are at the head of the herd running the fastest; we want to make the whole herd run faster.

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

## 3. Conclusion

Our study sought to discover whether institutional investors in Australia seek to influence investee companies regarding their human resources management strategies and are thus behaving consistently with the profile of 'universal owners' proposed in the relevant literature. 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, 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 should 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 the 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 (2005) and Deakin (2005) 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 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 and believe there is a link between 'good' human resource management and company performance. Poor labour management issues are commonly conceived of as a risk to long-term returns, 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.

Research conducted outside Australia suggests that superannuation funds, rather than non-superannuation funds, are more likely to monitor and influence the human resource management and industrial relations practices of investee companies (Johnson and Greening 1999). 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 and those 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 or 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 separately from their investment selection strategies. Furthermore, the small size of institutions in Australia compared with their UK and USA counterparts may create a significant barrier to engagement.

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 investors studied has only begun in the last five years and engagement policies and practices are generally embryonic. 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. Proxy voting does not generally concern human resource issues and enquiries regarding labour management issues are not generally conducted routinely. In the absence of routine and standardised reports on human resource management, institutional investors rely on 'incident based' newspaper reports of labour relations problems or anecdotal evidence,

which cannot provide a complete picture of labour practices. 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. Furthermore, due to a general reluctance to meddle in 'management issues', institutional investors 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. As a consequence, institutional investors may, in future, look more like the 'universal owners' described in the literature.

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**Table 1**

**Summary of Case Study Institutional Investor Characteristics**

| Institutional Investor | Details[#] | Take HR into account in investment selection* | Based on systematic analysis of HR^ | Use selling pressure re HR[+] | Use voice mechanisms re HR[¥] |
|---|---|---|---|---|---|
| BT Financial | $73 bill<br>Internally managed pooled funds<br>Performance measured in short term increments | ✓<br>On ad hoc basis | × | × | ✓<br>Only when it is perceived to be a concern to realisation of investment |
| Portfolio Partners | $9 bill<br>Internally managed | ✓ | ✓<br>Based on survey of companies | ✓<br>Sell investments in companies with poor | ✓ |

| Institutional Investor | Details[#] | Take HR into account in investment selection* | Based on systematic analysis of HR^ | Use selling pressure re HR[+] | Use voice mechanisms re HR[¥] |
|---|---|---|---|---|---|
| | | | | social performance | |
| Queensland Investment Corporation | $32 bill<br>Internally managed<br>Maintain liquidity in ASX 100 but not smaller companies | ✓<br>On ad hoc basis | × | × | × |
| Barclays Australia | $41 bill (in Australia)<br>Mixture of indexed and active funds<br>Internally managed | × | × | × | × |
| | | | | | |
| Vanguard | $36 bill (in Australia)<br>100% indexed<br>Internally managed | × | × | × | ×<br>Have recently begun proxy voting |

| Institutional Investor | Details[#] | Take HR into account in investment selection* | Based on systematic analysis of HR^ | Use selling pressure re HR[+] | Use voice mechanisms re HR[¥] |
|---|---|---|---|---|---|
| | | | | | |
| Catholic Super Fund | Industry Super Fund<br>$2 bill<br>Externally managed funds | × | × | × | ✓<br>BT GAS |
| PSS/CSS | Industry Super Fund<br>$10 bill<br>Externally managed funds | ✓<br>Stipulated in guidelines for fund managers | × | × | ✓<br>BT GAS |
| Vic Super | Industry Super Fund<br>$3.1 bill<br>Mainly indexed<br>Internally managed | ✓<br>10% of mainstream funds managed according to sustainable approach | ✓<br>(For 10% only) | ✓<br>(For 10% only) | ✓<br>BT GAS |

| Institutional Investor | Details# | Take HR into account in investment selection* | Based on systematic analysis of HR^ | Use selling pressure re HR+ | Use voice mechanisms re HR¥ |
|---|---|---|---|---|---|
| Uni Super | Industry Super Fund<br>$15 bill<br>90% externally managed<br>10% internally managed | ✓ | × | × | ✓ |
| CBus | Industry Super Fund<br>$8.2 bill<br>100% externally managed | × | × | × | × |
| TWU | Industry Super Fund<br>$1.6 bill<br>100% externally managed | × | × | × | × |
| Health Super | Industry Super Fund<br>$5.5 bill<br>100% of Australian equities investments | × | × | ×<br>Only in 0.3% of funds (positive and negative screening in | × |

| Institutional Investor | Details# | Take HR into account in investment selection* | Based on systematic analysis of HR^ | Use selling pressure re HR+ | Use voice mechanisms re HR¥ |
|---|---|---|---|---|---|
| | managed externally (small percentage of cash investments managed internally) | | | SRI product includes HR issues) | |

# Where dollar figures are noted, this denotes total funds under management as of 2005 or 2006, depending upon the fund.

* Denotes the use of indicators or information about the HR performance of companies when choosing in which companies to invest.

^ Where indicators or information about the HR performance of companies is used when choosing in which companies to invest, this information is collected systematically, using a consistent methodology.

+ Where a company's HR performance is judged not to meet the performance criteria of the institutional investor, this results in selling shares in that company.

¥ Denotes engagement with the company through meetings, letters or proxy voting regarding HR matters.

**Table 2: Ranking Exercise: Order of Priorities as an Investor#**

| | Clients | Share-holders | Employees | Community | Customers | Company | Suppliers | Lenders | Country | Other |
|---|---|---|---|---|---|---|---|---|---|---|
| Barclays | 1 | 2 | -- | -- | -- | 3 | -- | -- | -- | -- |
| BT | N/A | 2 | 2 | 4 | 1 | 5 | 6 | 7 | 8 | -- |
| PP | 1 | 1 | 1 | 2 | 3 | 1 | 3 | 3 | 2 | -- |
| QIC | 1 | 2 | 3 | 3 | 4 | 2 | 4 | 4 | 5 | -- |
| Vanguard | 1 | | | | | | | | | |
| CSF | 1 | 2 | 4 | 3 | 5 | 6 | 7 | 8 | 9 | 10 |
| CBus | 1 | -- | 2 | 3 | 4 | -- | 4 | -- | 6 | -- |

| | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| Health | 1 | 2 | 4 | 5 | 6 | 3 | 8 | 7 | 9 | -- |
| PSS/CSS | 1 | 2 | 3 | 4 | 5 | 6 | 8 | 9 | 7 | -- |
| TWU | 1 | 4 | 4 | 2 | 4 | 4 | 4 | 4 | 3 | 4 |
| UniS | 1 | 2 | -- | 1 | -- | 6 | -- | -- | 3 | -- |
| VicS | 1 | -- | 3 | 6 | 3 | 2 | 4 | 5 | 7 | -- |
| Care Super | 1 | 2 | 3 | 5 | 6 | 4 | 8 | 7 | 9 | 10 |

# Respondents were asked to rank 10 stakeholders in order of priority with one (1) representing the highest priority. Where respondents did not believe the stakeholder category was relevant for their organisation, this is denoted with '—'. Some respondents ranked stakeholders equally or did not use all numbers between one (1) to ten (10).

## 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

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

[2] In this paper we have chosen not to focus on Socially Responsible Investment funds as they constitute such a small proportion of overall investment by institutional investors. We were concerned with the policies of funds under mainstream management.