NEWTON

Investment Management

BNY MELLON | INVESTMENT MANAGEMENT

THE FUTURE OF WORK

By Rebecca White

September 2020

BACKGROUND
WHAT ARE THE SOCIAL ROLES OF COMPANIES?

Every company, by definition, is a social enterprise that has an implicit social contract with its workers, the communities it serves, and the environment in which it operates, something explicitly recognized in a recent US Business Roundtable statement.[1] In order for a business to retain its social license to operate, this social contract must be respected. The interests of various stakeholders should be considered, and find long-term dynamic equilibrium; short-term imbalances may be navigated, but create pressures that are unsustainable if ignored in the longer-term.

OUR PREMISE

1. Social Factors Are Material

Social factors are material to stakeholders, particularly so for employees. The average UK worker spends almost ten years at work over a life time.[2] Moreover, our employment experiences can impact almost every aspect of our lives, affecting our mental and physical wellbeing as well as our financial situation.

Social factors can also be financially material for companies. There is academic evidence to suggest this, such as a recent study,[3] which found a link between long-term financial returns and employee satisfaction in certain labor markets. Anecdotally we have seen material impacts on share prices following the discovery of poor social practices. A recent example involves a clothing retailer whose suppliers were exposed for paying less than minimum wage. The continued media coverage, and criticism of the company's response intensified the damage to the company's reputation and share price. In addition, an airline in 2017-2019 experienced deteriorating relations with its employees and unions which ultimately triggered a series of industrial action across key markets, often causing share price reactions. Employee discontent over wages, benefits and difficult contractual provisions, as well as the failure of management to engage constructively with unions, led to an unhealthy workplace culture for employees and workers.

The mismanagement of human capital can directly affect operational costs for a business, leading to higher turnover and escalating recruitment and training costs. Furthermore, cultural factors can have a significant intangible impact on a business, hitting operational performance, customer satisfaction, and the ability to retain employees. The Work Institute conservatively estimates that the cost of losing just one US worker is $15,000, with the costs associated with voluntary employee turnover doubling over the last decade to $617 billion.[4]

2. Social Factors Have Historically Been Under-Addressed

Arguably, social factors are less well understood by investors. It has previously been suggested, including at the PRI (Principles for Responsible Investment) in Person conference 2019, that social factors have been somewhat neglected by the markets. However, the focus on these issues appears to have intensified since the Covid-19 pandemic.

The lack of access to high-quality data, or disclosures, compounds investor challenges in understanding social risks and opportunities. As such, we are part of the WDI (Workforce Disclosure Initiative) to encourage better disclosures of material social data across business operations and supply chains. However, the use of non-standard or qualitative disclosures, as well as engagement with management, can present investment opportunities for active investors looking to incorporate this analysis.

3. Social Risks and Opportunities Are Linked to Long-Term Structural Trends

A number of structural market trends have characterized developed labor markets for some time now. These include nugatory productivity growth, stagnating wages, the rise of automation, and changes in employment legislation. A 2020 Federal Reserve study found that wage growth has lagged productivity for the last 40 years, leading to a declining income share and potentially also a fall in living standards.[5] These trends affect the macroeconomic backdrop, and the type of companies that we look to invest in.

1 https://www.businessroundtable.org/business-roundtable-redefines-the-purpose-of-a-corporation-to-promote-an-economy-that-serves-all-americans
2 https://www.accountancyage.com/2018/10/02/how-long-does-the-average-uk-employee-spend-at-work/
3 https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2461003
4 https://info.workinstitute.com/hubfs/2019%20Retention%20Report/Work%20Institute%202019%20Retention%20Report%20final-1.pdf
5 Market Power, Inequality, and Financial Instability, August 2020

Social tensions have increased in recent years. For example, 'in-work poverty' has spread, and inequality has increased. The Joseph Rowntree Foundation estimates that one in eight UK workers suffer in-work poverty, affecting over four million people.[6] We have also seen a wave of social movements in the socio-political sphere, such as Black Lives Matter, the French gilets jaunes (yellow vests) movement, and broader political polarization.

Finally, it is increasingly felt that corporates need to step up in order to address these challenges.

4. The Pandemic Is a Catalyst

The global pandemic and lockdown have increased investors' focus on the role of companies in society, most notably around the treatment of their customers, employees and suppliers. Many workers who are on precarious contracts and receive low wages and few, if any, benefits, are now viewed as essential to societal and economic systems. According to the *Financial Times,*[7] the rate of furlough among the lowest-paid quintile of workers was double that of the highest paid. The Resolution Foundation also found that workers on zero-hours contracts were twice as likely to be furloughed. In the US, a University of Chicago paper found that 68% of workers eligible for benefits under the CARES (Coronavirus Aid, Relief, and Economic Security) Act would receive more in government support than they would have via their employment.[8]

Companies relying on government funding with excessive levels of executive pay, shareholder returns, or aggressive taxation practices, are regularly on the receiving end of significant backlashes. Consumers are increasingly likely to adjust their spending behavior to punish perceived miscreants, so attracting negative publicity now has greater potential to adversely impact company performance.

The lockdown also appears to be accelerating a number of pre-existing trends such as the shift to automation, re-shoring of supply chains, and flexible working arrangements. For example, McKinsey estimates that up to 73 million US jobs could be lost to automation in the next decade,[9] many of which will be middle-pay, such as in manufacturing. Labor-market growth is expected in both high and low-paid roles, potentially resulting in an increasingly polarized labor market. This inequality may also be reflected in flexible working practices, with office workers more likely to have this option. A survey by Boston Consulting Group found that 76% of US companies implemented flexible working arrangements owing to the pandemic,[10] with just 5% of employees working remotely beforehand.

WHAT ARE THE INVESTMENT IMPLICATIONS OF THE FUTURE OF WORK?

These structural, long-term trends, mispriced risks and the shockwaves created by the pandemic will undoubtedly have investment implications. Some will be far more tangible than others, and many existing trends, risks and opportunities have merely accelerated. Central to these trends, we believe, is the demand for 'good employment', which we go on to discuss in detail later in this paper. It will also be important to consider the changed macroeconomic backdrop, including the increased levels of government spending and debt, the potential for government stimulus, and the associated opportunities for the structural reform of national labor markets and macroeconomic policy. Such developments will be instrumental in shaping our working lives.

Other themes associated with the future of work include the growing acceptance of the view that companies are social enterprises, which may benefit local businesses or see a rise in 'B Corporations', whereby a company makes a legal commitment to running itself in the interests of stakeholders over just shareholders, and delivering purpose over profits. Alternatively, we may see increased regulation and legislation aimed at addressing the impacts companies have on stakeholders, such as via tighter taxation or employment laws.

We have also seen a sharp shift towards flexible working practices, driven by necessity. Many companies and managers with doubts about working from home may have received comfort during this period. For example, a recent survey by PwC revealed only 26% of chief finance officers are now concerned about losing productivity owing to remote work, compared with 63% at the outset of the pandemic.[11] Moreover, growing numbers of employees are likely to request a permanent shift in favor of working from home; there is a commercial reality that in order to attract key talent, companies will have to offer attractive, flexible working practices. This could have

6 https://www.jrf.org.uk/blog/solving-uk-work-poverty-means-responsible-investors-asking-right-questions
7 https://www.ft.com/content/6c7b59ad-be4f-46b3-8386-072f106a1960
8 https://bfi.uchicago.edu/wp-content/uploads/BFI_WP_202062-1.pdf
9 https://www.mckinsey.com/featured-insights/future-of-work/jobs-lost-jobs-gained-what-the-future-of-work-will-mean-for-jobs-skills-and-wages
10 https://www.bcg.com/featured-insights/how-to/prepare-protect-workforce-covid-pandemic?utm_medium=Email&utm_source=esp&utm_campaign=covid&utm_description=ealert&utm_topic=none&utm_geo=global&utm_content=202005&utm_usertoken=CRM_52aa29799a3c147bd0fe08aabc3c12440929cee1&redir=true
11 https://www.pwc.com/us/en/library/covid-19/pwc-covid-19-cfo-pulse-survey.html?fbclid=IwAR0xJTPoYZOUC9B6v_QZi8b7M4BbxMPCGDbyvlYixIqkA-kW1KIftGEAE94

numerous long-term implications, such as a change in the demand and pricing of commercial property, higher demand for suburban living, increased spending on the home, increased home entertainment, or changes to hobbies. All these trends could lead to fundamental changes to our work-life balance and approach to family life.

The pandemic has also highlighted other population and demographic-based themes, some of which are interlinked. For example, populations are living much longer, and there is a greater requirement for life-long learning. An aging population has implications for the workforce, government spending, and for pensions and retirement savings. It also affects consumer spending, as well as prospects for younger generations. Many forms of education could be affected, including traditional schooling, university, and vocational and professional experiences and qualifications. A recent research survey highlighted that 55% of respondents believed vocational training was becoming more important compared to academic qualifications.[12] Specific skills required may change rapidly owing to other themes discussed, and the means of delivering education may shift towards an online model.

As mentioned above, the pandemic has accelerated themes which, in some cases, have been observable for some time. These include digitalization, automation, and a shift away from globalization, sometimes referred to as re-shoring or deglobalization. These have a plethora of thematic, macroeconomic and security-specific implications, as well as considerations for society and workers. These range from a focus on supply-chain resiliency, to threats to lower-skilled employment, and a shift to virtual employment. We believe that these will change how we conduct business, and our lives, and will create both financial risks and opportunities for companies, which companies will need to balance against their societal obligations.

These themes and their implications are outlined below:

How Has Covid-19 Accelerated Employment Trends, and What Investment Implications May This Have?

COMPANIES AS SOCIAL ENTERPRISES
- Increased public scrutiny
- Expectations around tax
- Changes in tax rules, particularly given increased debt?
- Bribery and corruption
- Support local businesses movement
- Rise in B Corporations

MACRO
- Increasing public debt
  - Increased public jobs?
  - Reliance on stimulus/green funding
  - Need for connectivity and internet
- Potential unemployment post furlough schemes
- Demand for social security reforms?

AUTOMATION
- Threats to lower-skilled roles
- Demand for technology/'human' skills e.g. emotional intelligence
- Polarization in education/lifestyles and the potential for rising social tension
- 'In-work poverty'
- Productivity and wage pressure

DEGLOBALIZATION
- Focus on supply-chain resiliency
- Need to diversify
- On-shoring and localized supply chains – what does this mean for labor demand/emerging markets?

GOOD EMPLOYMENT
- Increased demand for security/changes in employment contracts
- Increased benefits, e.g. sick pay
- Addressing increasing employee turnover – retaining talent
- Addressing 'In-work poverty'
- Demand for fulfilling/purposeful roles

DIGITALIZATION
- Online collaboration/creativity
- Virtual everything, e.g. makeovers/exercise/education/health care
- Online gaming
- Payments
- Online shopping
- Reduced business travel
- Increased internet, cloud and phone usage

LONGER LIVING
- Pensions
- Agism/inclusivity
- Longer working lives
- Impacts on the young
- Care for the elderly

EDUCATION
- Life-long learning
- Accelerated learning
- University attendance – potential change in intake numbers, degree choices and access
- Shift to online/virtual
- Changes in demand for skills

FLEXIBILITY OF WORK
- Work from home/virtual 'inclusion'
  - Home refurbishment/spending
  - Home entertainment – alcohol, dining, pets
- Demand for commercial property/continuity sites
  - Reuse of property and impact on city centers
- Work-life balance
- Challenges to typical gender roles?
- Changes to the commute, e.g. cycling

12 https://ir.citi.com/1EvtXnvcJA3z9E9xY2xdLnd52iXAvcEHE6A8otCO31%2BsqvdVUcGsgmwycp0hFnAcSr%2F1GucfTzk%3D

WHAT IS GOOD EMPLOYMENT?

The International Labour Organization (ILO) defines good employment as follows: *Decent work sums up the aspirations of people in their working lives. It involves opportunities for work that is productive and delivers a fair income, security in the workplace and social protection for families, better prospects for personal development and social integration, freedom for people to express their concerns, organize and participate in the decisions that affect their lives and equality of opportunity and treatment for all women and men.*

The Business Roundtable believes that good employment involves companies investing in their employees: *Remaining competitive in the 21st century demands that companies create programs to broaden the skills of current employees, support the professional aspirations of people of all backgrounds and equip the next generation of workers with the knowledge and experience to excel in the jobs of the future... At many companies these investments and initiatives begin with creating training opportunities for existing employees to expand their skills to take advantage of job opportunities in high-demand fields and occupations.*

Newton's interpretation of a company's responsibility to its employees encompasses these fundamental components but goes further. We believe a company should consider the wider social impact of its employment, which in turn requires consideration of its business model, corporate purpose, and the compatibility of capital allocation and internal investment decisions with these aims.

We have more specifically outlined the core components of good employment as security, well-being, purpose and respect. Within these core components, there are specific practices that we seek to understand such as remuneration or safety in the workplace. Beneath these practices, there are both quantitative and qualitative means of analyzing company performance, such as living wage accreditations or lost-time injury frequency rates.

Further details are set out below:

High-Level Concepts, Practical Expectations, and Trackable Indicators

SECURITY

Hours and Scheduling
- Proportion of workers on zero-hour contracts
- Classifications as self-employed or as contractors
- Evidence of recent layoffs or restructuring

Pay
- Proportion of employees receiving living wage
- Gender pay gap reporting
- Pension contributions
- CEO pay ratio

Entitlements
- Proportion of employees receiving sick leave or holiday pay
- Paid parental leave
- Health insurance (US-specific)

WELLBEING

Safety
- Injury frequency rate
- Board-level oversight of occupational health and safety

Work/Life Balance
- Average working hours
- Payment of overtime
- Maximum hours
- Flexible working policy
- Parental leave programs

Diversity and Inclusion
- Engagement surveys
- Staff turnover
- Workforce composition data (e.g. gender, ethnicity, disability, age, qualification)
- Approach to recruitment

PURPOSE

Personal and Career Development
- Proportion of roles filled internally
- Employee training
- Mentoring programs

Job Design
- Risk of automation / level of skill or expertise required
- Turnover / average tenure
- Variety of workload

Corporate Purpose
- Understanding of role within broader team and company
- Interaction with other employees and stakeholders

RESPECT

Employee Engagement
- Surveys
- Satisfaction ratings
- Upward feedback
- Freedom of association/union representation

Reward and Recognition
- Regular performance reviews
- Incentive programs, e.g. profit sharing or employee equity

Healthy Culture
- Whistleblowing procedures
- Code of conduct
- Board-level oversight of human capital management
- Relationships with employees and managers

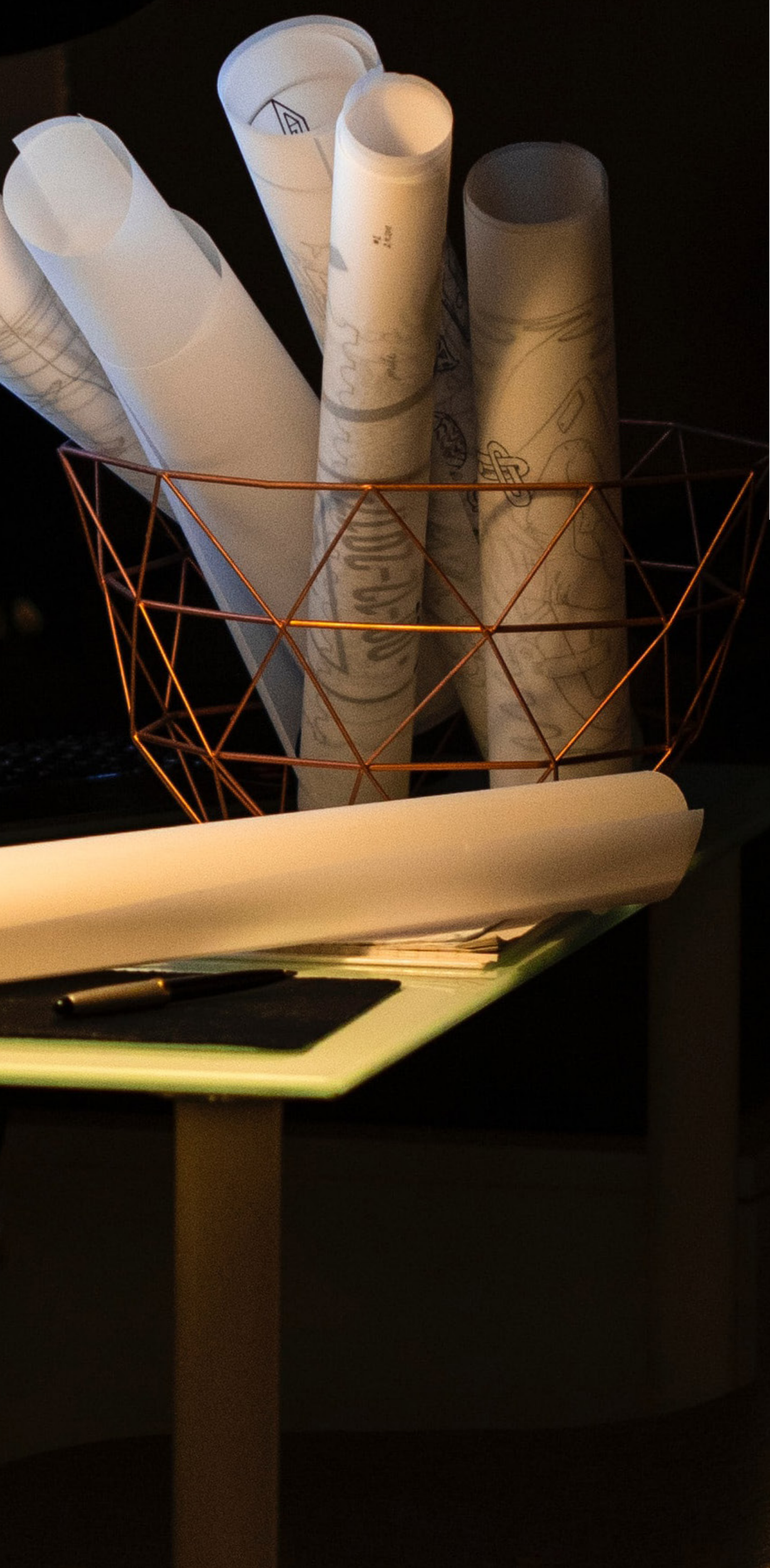
> "Fair and Decent with Realistic Scope for Development and Fulfilment."
>
> **Taylor Review**

APPENDIX 1:
HOW DOES THIS AFFECT STEWARDSHIP?

Active engagement by shareholders provides an opportunity to have real dialogue about salient issues that go beyond traditional financial metrics. And, when dialogue refuses to yield results, executives and boards can ultimately be held to account through the power of proxy voting, a central part of securities ownership. Unlike many passive alternatives, active managers also have the ability to divest where persistent engagement and voting activities do not achieve the desired outcomes. In this context, we have published some specific examples of our recent engagement work on our website:

www.newtonim.com/us-institutional/responsible-investment/engagement-in-practice

Newton has the ability to engage with companies around social issues to better understand material risks and opportunities, as well as to drive preferential social outcomes. This may be done individually, or as part of a broader investor coalition, such as the PRI engagement groups or the Workforce Disclosure Initiative (WDI).



APPENDIX 2:
HOW DOES THIS RELATE TO ESG INTEGRATION?

Our investment philosophy is anchored in the belief that the long-term value of an investment is ultimately driven by the relationship between and among all stakeholders, including directors, investors, customers, suppliers, employees, the environment, society and regulators. The long-term viability of an investment requires decision-makers to understand and balance the requirements of these groups. Not to include ESG (environmental, social and governance) insights would give an incomplete picture of the merits of an investment opportunity, and we therefore think of it as part of 'Finance 101' for security analysis. As such, we integrate ESG issues into investment processes where the understanding of the materiality of these issues will, we anticipate, improve risk-adjusted returns over the proposed investment horizon.

Examples of ESG Integration

- Avoiding a company which has such poor relations with its employees that they strike or are unproductive, resulting in a material reduction in revenues and increase in costs.
- Avoiding a company which derives revenues from bribery and corruption, and therefore may be an unreliable source of income in the future or be the subject of regulatory sanctions.
- Engaging with a company to understand how its directors and staff are incentivized through remuneration and, where appropriate, encouraging better practices. Employee and executive share ownership can, but not always, indicate alignment of objectives and behavior.
- Understanding if a country's approach to managing environmental and social issues can affect its ability to meet its sovereign debt obligations.
- Actively exercising our voting power by voting against long-standing directors at a company's AGM in a scenario in which we believe the board lacks diversity and needs or would benefit from refreshment.
- Engaging with a company to better understand and/or influence corporate culture.
- Ensuring the alignment of interests between the board, management, majority and minority shareholders. For instance, in some regions, state-owned entities pursue political, rather than shareholder, objectives.
- Understanding if a company has a history of shareholder-unfriendly actions such as conducting merger and acquisition activity or related-party transactions which enrich management but do not provide aligned owner outcomes for minority shareholders.

Stakeholder Framework for the Future of Work

Stakeholder	Expectation	Using ESG as an Insight	Sustainability Opportunities
Employees	Decent employment and quality	Human capital management: diversity and inclusion, union relations, health and safety, compensation and benefits	Employees are seen as an asset not a cost: providing training to equip employees for the future of work, payment of the living wage to ensure adequate living standards, ensuring a work-life balance
Customers	Delivering value and building a relationship of trust	Competitive behavior, data protection and privacy, brand reputation	Clients not customers: providing access to a currently underserved need, delivering a personalized experience, inclusive brand image, authenticity and trust
Suppliers	Fair supply-chain management	Human rights: working conditions, forced labor	Operational resiliency, engagement on material ESG issues to improve supplier standards, building partnerships
Communities	Respect for, and engagement with communities	Indigenous rights, bribery and corruption, taxation	Development of local infrastructure/ industry, proactive community outreach and engagement
Shareholders	Long-term value creation	Generating positive returns over a 3-5 year time horizon, transparent and truthful reporting	Generating positive returns over the investment time horizon and beyond, alongside positive societal outcomes

APPENDIX 3:
HOW DOES THIS RELATE TO SUSTAINABLE INVESTMENT?

Examples of social sustainability challenges issues include climate change, technology disruption, demographic shifts, human rights, labor standards, corruption, and inequality. These issues are interconnected and highly complex, with significant, yet uncertain, outcomes for the global economy and civilization.

Many of these issues are largely unaccounted for by traditional economic models, financial markets and accounting standards. The integration of these issues is also typically excluded within mainstream investment approaches unless there is potential for the issue to affect risk-adjusted returns. This means that the full costs of our current production or consumption choices are not borne by the producers or consumers, but spill over to other stakeholders in current and future generations. This potential mispricing, caused by externalities, can lead to a potential long-term misallocation of resources.

Beyond the risks that these issues represent, sustainability themes also provide significant structural growth opportunities. The UN's Sustainable Development Goals (SDGs) provide a common framework for understanding the most pressing requirements for people globally. These underserved requirements represent growth markets for those companies with the necessary vision and business model to provide solutions. Newton's sustainable investment strategies typically have a greater emphasis on these secular growth areas.

Beyond this, we believe companies must address salient social interests in order to improve both financial and social outcomes across an extended time horizon. When a longer-time horizon is considered, there is likely to be greater alignment between financial and social interests as it takes time for salient considerations to develop into material business risks and crystallize, resulting in a financial impact. For example, the health implications of smoking tobacco were a heavy externality on consumers and society, until extensive regulation meant that these costs were internalized. Alternatively, environmental or social considerations may become financially material following a shift in social norms, often occurring during times of crisis such as the World Wars, or potentially following the global Covid-19 pandemic, or owing to adverse stakeholder reactions.[13]

Moreover, this extended time horizon also gives rise to the increased likelihood of regulation to address market externalities, as well as changes in consumer behavior. However, there is the potential for residual company practices with negative societal repercussions, which may well be material to specific stakeholder groups, but are not likely to be financially material, even beyond the initial investment time horizon. Unfortunately, some workers will tolerate poor working conditions, practices or pay, out of necessity. With high levels of regional unemployment, and a lack of alternative employment opportunities, low-paid and low-skilled workers are considerably more likely to tolerate these. In addition, the demise of trade unions, lack of enforcement of legislation and current gaps in employment laws fail to curb this vicious cycle, as captured by James Bloodworth during his undercover research on work in low-paid Britain.[14] On the other hand, we expect that a sustainable company should have regard for, and a means of addressing, such conflicts in stakeholder interests.

How Can This Be Implemented into Investment Strategies?

Our sustainable strategies seek to support financially successful companies which are:

- **Solution providers:** companies that offer solutions to global sustainable development issues that are captured by many of our long-term investment themes, as well as the UN Sustainable Development Goals. Examples include food security, education, pharmaceuticals, social housing, development agencies, and access to finance.
- **Best in class:** companies that are already performing to a high standard in terms of shared value in their direct operations and supply chains, or which integrate sustainable development priorities into their business strategy.
- **Transformers:** companies that have committed explicitly to improve their impact on society, which will lead to a transformation of their business models.

We will avoid companies that are involved in market failures. Examples of market failures are monopolies, those overcome by negative externalities and involved in areas such as unhealthy food, tobacco, gambling and weapons, or violators of the UN Global Compact.

13 Harvard study. Pathways to Materiality: How Sustainability Issues Become Financially Material to Corporations and Their Investors, 2019.
14 Hired: Six Months Undercover in Low-Wage Britain, James Bloodworth, 2018.

newtonim.com

@NewtonIM

Newton Investment Management

Your capital may be at risk. The value of investments and the income from them can fall as well as rise and investors may not get back the original amount invested.