

GETTING AHEAD OF THE CURVE ON DYNAMIC MATERIALITY

How U.S. investors can foster more inclusive capitalism

Despite soaring corporate profits and strong market performance, wealth and income inequality are increasing, leading to public disenfranchisement and imbalances which can eventually jeopardize crucial business functions and diversified investors' portfolios. Institutional investors are increasingly concerned with the financial implications of social and environmental risks, but often lack the tools to identify and mitigate them. This discussion paper is designed to support U.S. investors in understanding how sharing more wealth and influence with workers and communities can correct imbalances and support early identification and mitigation of emerging risks. Specific tools and opportunities are highlighted which can foster more sustainable and responsible value creation and ultimately a more inclusive and thriving economy.

This discussion paper has been written to contribute to the conversation on stakeholder capitalism. It is a 'work in progress' document and does not necessarily reflect Omidyar Network, Oxfam and Predistribution Initiative policy positions. The views and recommendations expressed are those of the authors and not necessarily those of Omidyar Network, Oxfam and Predistribution Initiative.

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FOREWORD

The world's first trillionaire will emerge in the next decade. That startling projection comes from another recent report from Oxfam¹ on the state of global inequality at a time when progress toward the United Nations' Sustainable Development Goals has stalled or is backsliding.² In particular, rising inequality – be it income, wealth or otherwise – is compounded by climate change, public health and humanitarian crises.

Any investor seeking to manifest a more sustainable and equitable economy should consider this level of wealth disparity to be a clear warning that the status quo of our financial system is not working.

As the leader of two organizations seeking to transform finance by placing measurable social, economic and environmental impacts at the heart of every investment decision, I see a tremendous opportunity to reimagine the current economic paradigm. At the forefront of this vision is stakeholder capitalism – a system in which workers, communities, suppliers, consumers and investors play a fundamental role in enhancing transparency, accountability and value across the private sector.

To be sure, stakeholder capitalism is not a silver bullet, but it will be an essential, hard-fought step in creating an economy that works well for all. Undervalued stakeholders, such as workers and communities, have critical perspectives and knowledge that can support investors and companies in understanding and mitigating system-level risks like inequality, climate change and biodiversity loss.

Advancing stakeholder capitalism is embedded in the missions of the U.S. Impact Investing Alliance and the Tipping Point Fund on Impact Investing, two organizations committed to scaling the impact investing field with integrity. However, my interest in the topic dates back to my time at business school over 20 years ago, when I first interrogated the limitations of shareholder primacy for failing to account for externalities, both positive and negative. Years later, we have made some progress toward upending that flawed ideology in favor of valuing a broader set of stakeholders, but there is more work to be done.

Stakeholder capitalism is often met with skepticism out of concern that it is more of a theoretical concept than a practical solution. This new report illuminates the tangible ways in which workers, communities and other stakeholders can hold the private sector accountable and, indeed, add considerable value. What follows is a thorough exploration of why shared wealth and responsibility across stakeholder groups is beneficial for all, with specific examples and case studies cited. I applaud the report's authors for making a compelling case for stakeholder capitalism and offering pathways for its implementation.

I will close by emphasizing advocacy as one of the most powerful tools of an investor. That extends well beyond shareholder engagement to include the role of the private sector in urging policymakers and regulators to take action where it is needed most. The U.S. Impact Investing Alliance is honored to have Oxfam, the Predistribution Initiative and Omidyar Network as members of the Coalition on Inclusive Economic Growth, a group we co-lead with B Lab U.S. & Canada, bringing together impact investor and business organizations dedicated to cross-sector action on an inclusive economy agenda. The magnitude of global challenges we face will not be addressed by one sector alone. Cross-sector champions are needed for stakeholder capitalism to succeed.

Please join me in approaching this report with openness to better understand your role in the fostering of an economy defined by the fair and equitable distribution of wealth, resources and power.

Fran Seegull

President U.S. Impact Investing Alliance and Executive Director, Tipping Point Fund on Impact Investing (TPF)

EXECUTIVE SUMMARY

Today, institutional investors find themselves at a critical juncture in the conversation around inequality in the United States (U.S.) as they begin to explore and assess how economic and social disparities pose risks to their portfolios. As wages fail to keep pace with inflation despite soaring corporate profits, there is a growing sense of disenfranchisement across the American public, impacting crucial business functions such as workplace productivity, customer satisfaction, and employee turnover – in turn, jeopardizing a company’s bottom line. Protectionism is growing, and societies are increasingly polarized. Private sector consolidation has made it increasingly difficult for small businesses to thrive, further concentrating wealth in the hands of those who have already accumulated the most. More and more, diversified investors are concerned with the economic, social, and political risks of these dynamics and are seeking tools to understand and mitigate them.

This discussion paper, which aims to foster a dialogue with the U.S. institutional investor community, outlines strategic opportunities and tools for investors and their portfolio companies to share more wealth and influence with their workers and communities, thereby fostering more sustainable and responsible value creation and ultimately a more inclusive and thriving economy. Corporate stakeholders – including workers, communities, and consumers – hold unique and valuable perspectives from their vantage points “on the ground” and “in the field.” They offer a wealth of information that can serve as early warning signals to investors, drawing attention to issues in portfolios before they become material risks.

By developing stronger relationships – including sharing influence – with these stakeholders, investors and company executives can better understand their own blind spots when it comes to impacts and dependencies on people and the environment, thereby avoiding negative impacts and risks while identifying strong opportunities for regenerative value creation. These improved relationships can lead to a more ‘inclusive capitalism, helping to foster a healthier and more vibrant economy with greater opportunity for all. Sharing influence – and wealth – with workers and communities can help overcome the disenfranchisement that many distressed and marginalized people feel relative to financial and political centers of power, helping to de-escalate tensions we see today.

The idea of stakeholder capitalism is often met with skepticism amongst investors. Many diversified long-term investors see their interests as aligned with those of their stakeholders (and the stakeholders of their investees) by default and therefore may not see the rationale for sharing influence with workers and communities. Yet blind spots along with misalignments across incentives and interests prevent congruence in practice.

The poor quality of information available to investors presents a major barrier. Investors recognize the concept of dynamic materiality, whereby negative impacts to people and nature evolve to become financially material (whether in the single financial or system-level sense) risks over time, but without access to valuable data on these issues, they have little insight into when these changes manifest, how to respond, and how to stay ahead of the curve.³

Investors do have some tools at their disposal to promote corporate responsibility, including disclosure frameworks, votes at annual meetings, shareholder resolutions, “Vote No” campaigns against directors and/or executive compensation, and divestment. However, these approaches are limited and, without input from the stakeholders they seek to support, tend to lack efficacy or meaningful impact. With clear alignment on intended outcomes, investor actions also can be complemented by the efforts of workers, communities, and consumers working to influence change through constructive dialogue and action.

Many tools we outline in this paper are already embedded within some companies, industries, and geographies, with some investors currently promoting and using them to inform decision making.

For example, the Interfaith Center on Corporate Responsibility (ICCR) network of investors has significant programming to support investors on their approaches to stakeholder engagement.

Each of the mechanisms we mention in this discussion paper offers benefits to stakeholders, investors, and companies alike. Through brief case studies and references to existing literature and research, this paper identifies insights and experiences that can be replicated and scaled. These include:

- **Grievance mechanisms:** Robust grievance mechanisms can serve as a formalized means for affected stakeholders to raise concerns and seek appropriate remedy. Early identification and management of stakeholder concerns can help private sector entities avoid costly incidences from manifesting, whether due to operational delays or litigation arising from negative impacts to workers and communities, or from negligent behavior affecting consumers or clients. In addition to companies, investors can also implement grievance mechanisms to help them identify and address risks in their portfolios before they manifest.
- **Freedom of association and collective bargaining:** As unions have faced policy and regulatory hurdles in recent decades, their ability to ensure worker protections keep pace with standardized measures of economic growth (such as Gross Domestic Product, or GDP) have also fallen behind. However, there is recently renewed focus on and support for freedom of association and collective bargaining. Investors face key decisions around how and whether to engage with and support these practices. By engaging proactively with the current labor movement, investors can mitigate potential financial risks from ignoring calls from unionized workers, such as costly work stoppages and ongoing collective bargaining negotiations. Beyond managing direct portfolio risks by engaging with unions, investors can also benefit from healthier unions more broadly because of their ability to help manage inequality and other systemic risks.⁴
- **Human rights due diligence:** If left unaddressed, human rights violations can significantly impact a company's bottom line, in turn affecting investors' long-term returns. By prioritizing human rights due diligence, companies can uncover actual or potential impacts and risks that are caused by their operations, products, services, or business relationships – including throughout their supply chain. It can shed light on potential blind spots across company operations and value chains that investors may not have otherwise seen.
- **Free, prior, and informed consent (FPIC):** Companies that adhere to FPIC – particularly projects that require the purchase or conversion of significant amounts of land – engage with communities about the project design and impacts. This gives communities ongoing opportunities for input, helping to ensure local buy-in and reducing the likelihood of opposition that can lead to project delays or cancellations, thereby threatening profits. By undertaking FPIC effectively, companies are better positioned to avoid risks and instead benefit from strong partnerships with communities who are incentivized to see the local project succeed.
- **Workers on boards:** Establishing positions for workers on corporate boards can help ensure the faster and clearer flow of information from the workforce to management and the board, improving accountability and transparency. In other nations where this practice has been implemented, literature suggests companies have clearly benefited, particularly during periods of financial distress. This practice has demonstrated an ability to enhance corporate resilience, foster cooperation between workers and management, help create long-term value, and enable greater innovation.
- **Worker ownership:** Worker ownership is a strong model for enhancing stakeholder alignment and company performance. Not only does it create a pathway for workers to build their wealth and influence, it also can generate strong risk-adjusted returns for companies and providers of capital.⁵ It offers workers an opportunity to share in the returns of strong

corporate financial performance, thereby aligning the incentives of workers with their management teams and investors and narrowing wealth gaps between returns to labor versus management teams and investors. This practice can take many forms and is highly correlated with faster growth, higher profitability, better long-term productivity, pay, job stability, and firm survival, as well as fewer layoffs in recessions.⁶

- **Community ownership:** Like worker ownership models, community ownership offers pathways for communities to build wealth and influence, while aligning incentives with management teams and investors. Several of these models have demonstrated success across a growing number of investments, particularly in infrastructure and other real assets. Community ownership models can be structured in a variety of ways and contexts depending on the unique situation and can deliver benefits to all, and there is a growing interest in applying this model to operating companies.

Government oversight is also key to guaranteeing that businesses are on track to create an inclusive, accountable capitalism for multiple stakeholders. In addition to providing incentives, government regulation, taxation, and enforcement can support positive long-term outcomes for companies and their stakeholders, including investors. For example, regulation can help develop a level playing field across investors and companies, thereby avoiding “tragedy of the commons” and “prisoners’ dilemma” dynamics. Regulation also improves standardized, high-quality corporate transparency and asset manager accountability, reducing investment risks resulting from unethical business practices and creating greater visibility for investors in their portfolio decision making. Of course, regulation is only as good as its enforcement. Through enforcement, investors are protected from excessive risk-taking by other market actors.

This discussion paper aims to join investors in dialogue on: 1) how they are positively impacted by sharing more wealth and influence with workers and communities; and, 2) what an effective and accountable form of inclusive capitalism can look like in practice. At a high level, it outlines tools, insights, and the rationale for their use, serving to catalyze discussion to develop further guidance on how these tools can be practically and meaningfully implemented. With these tools and actions, investors, companies, and their stakeholders can work together to evolve our economy and markets to be more inclusive, overcoming the looming risks to both social and financial stability.⁷

STAYING AHEAD OF THE CURVE ON DYNAMIC MATERIALITY

Since 1995, the top 1% of income earners have captured nearly 20 times more global wealth than the poorest 50% of people.⁸ Today, millions of people are facing hunger, not just in the Global South but in countries like the U.S. Wages have not kept pace with inflation, let alone real GDP growth over the past 40 years.⁹ Climate breakdown is crippling economies as droughts, heatwaves, and storms lead to mass migrations.¹⁰

Meanwhile, across markets globally, small business owners are facing the pressure of increased corporate and market concentration, driven by factors including concentrated capital allocation to large companies and investors, anti-competitive business activities, and mergers and acquisitions.¹¹ Across a wide range of industries, from banks to healthcare to baby formula, a few corporations dominate,¹² reducing dynamism in markets, pressuring wages, inflating prices, and potentially contributing to asset bubbles and credit crises, producing unjust and imbalanced outcomes that contribute to financial instability.¹³

Corporate profits have hit record highs, but these profits have come at a great cost to the climate, the planet, and equality across the globe¹⁴ as shareholders and executives reap benefits that are not shared widely. Corporate executives – and executives of some of the largest asset managers – are among those who have benefited most in the short term: in the U.S., adjusting for inflation, the compensation (largely stock-based) of top Chief Executive Officers (CEOs) increased 1,460% from 1978 to 2021, while workers' annual compensation grew by 18.1%.¹⁵ In the U.S., the wealthiest 10% of the population owns 89% of all stocks, while the bottom 50% does not own even 1%.¹⁶ Globally, this discrepancy is magnified multiple times.¹⁷

There is also mounting evidence that much of the accrual of financial benefits to shareholders today may come at the expense of future generations – including but not limited to future shareholders – given negative externalities such as climate change, inequality, and biodiversity loss.¹⁸ As these risks and inequalities grow, trust between institutions and the public erodes as social and political instability rises both within and between countries.¹⁹

To understand these dynamics and the incentives that lead to them, it is critical to consider the entire capital markets value chain. Among investors, asset owners and allocators sit at the top of this chain²⁰ and together with governments, they influence the incentives for asset managers and companies. While historically, asset owners and allocators have generally sought to meet their required rates of return across their portfolios by maximizing the return of each individual investment regardless of negative externalities, these investors increasingly realize that negative externalities eventually pose risks to economic and therefore market performance through feedback loops.²¹ Because their portfolios are already significantly diversified across markets, further diversification does not offer a route for investors to avoid these risks – often referred to as systemic or systematic risks – in their portfolios.²² Research shows that these risks are highly financially material to investors' diversified portfolios, with the vast majority of returns dependent on these factors, versus idiosyncratic risk and return.²³ Long-term institutional investors are becoming particularly mindful about these issues, recognizing that they typically have an intergenerational fiduciary duty.²⁴

Dynamic materiality is the process through which environmental and social impacts that were once considered to be immaterial to financial returns emerge as financially material risks or opportunities over time.²⁵ This materiality can emerge as a result of growing stakeholder concerns about a particular issue, new policies or regulations to address a societal or environmental issue, the actual manifestation of negative impacts to people or the planet, or because investors better

understand or become aware of risks. Through dynamic materiality, many investors are even reinterpreting their own understanding of materiality – for example, shifting from focusing on single financial materiality to systemic materiality as they increasingly recognize the importance of considering positive and negative externalities in addition to an individual investment’s financial return.²⁶

This paper highlights an often overlooked yet invaluable source of information for investors to get ahead of the curve on dynamic materiality. Workers, community members, consumers, and other ecosystem players such as small businesses – who experience first-hand the on-the-ground impacts of companies or market structure – have critical early insights for preventing and mitigating these risks. These stakeholders have a unique vantage point that no investor can access entirely on their own.²⁷ Often, the negative impacts of a private sector actor on workers, suppliers, consumers, communities, and/or rightsholders²⁸ may manifest unbeknownst to investors.

Excluded from the corporate responsibility discourse – and often intentionally so – are corporate governance and investment approaches that are accountable to other stakeholders beyond investors’ beneficiaries.²⁹ Underpinning this exclusion is the belief that stakeholder capitalism lacks accountability from anyone, as corporate boards of directors will have too many different groups with misaligned interests to please. There is also a related fear that, without the single, clear mandate to maximize returns to shareholders, corporate directors may take advantage and pursue their own interests. But given the concept of dynamic materiality, where diverse stakeholders’ concerns can become financially material over time and given the rich knowledge and first-hand experience of those stakeholders, excluding them from governance decision-making becomes a risk in itself.

Important pathways do exist for multiple stakeholders to contribute to private sector accountability, ensuring that the benefits of value creation – from job creation, to profits, to products and services – are widely realized, thereby contributing to a more vibrant and better-balanced economy. Such pathways also recognize a positive interaction with democratic government, helping to institute regulation and accountability and recognizing government’s roles in wealth creation and driving innovation.

No single investor, financial intermediary, service provider, corporate executive, worker, or community member can ensure that the private sector operates without harm to society. An inclusive, accountable capitalism relies on a variety of mechanisms and approaches to create a balance of power among stakeholders. It also has the potential to be the truest form of diversity, equity, and inclusion (DEI), because it recognizes the value of people and their perspectives to the success of a company and the broader economy. Such a form of capitalism can also help companies and investors identify which environmental and social risks to focus on, without grounds for being accused of favoring investors or corporate managers’ personal beliefs and values, thereby diffusing political tension. An inclusive capitalism need not be a threat to investors and their returns – instead, it can offer quite the opposite.

This discussion paper is designed to support institutional asset owners and allocators, as well as other long-term, diversified investors, in understanding the business case for inclusive capitalism, along with approaches to incorporating this concept into investment decision-making. A key intention is to catalyze discussion amongst investors so approaches to implement these tools more widely can be developed and adopted.

ARE LONG-TERM DIVERSIFIED INVESTORS BY DEFAULT ALIGNED WITH THEIR STAKEHOLDERS?

Many investors who have diversified portfolios and long-term outlooks often express the belief that their interests are aligned with those of their own stakeholders, such as pensioners in the case of pension funds, as well as those of their investees' stakeholders, such as workers, communities, and consumers or end-users. Their rationale is that negative human impacts often materialize as systemic and systematic risks in diversified long-term portfolios, and investors therefore should have an interest in measuring and managing these risks. However, there are numerous reasons why this perceived alignment may not play out in practice.

- Incentives are misaligned:
 - While many investors have developed strong corporate governance teams, it can be challenging for these teams to find alignment with investment professionals (e.g. portfolio managers and analysts). Investment teams are often incentivized primarily by financial return metrics, and their performance is reviewed on relatively short timeframes, such as one to three years, or five years at best. They are typically expected to meet or exceed financial benchmarks that do not account for negative externalities. These incentive structures often don't align with the corporate governance teams, which can lead to inconsistent efforts involving companies and asset managers. For example, an institutional investor's corporate governance team may be engaging with a portfolio company to offer quality jobs, but at the same time, a financial analyst from the investor may look to magnify returns to meet historical financial benchmarks by incentivizing a portfolio company's use of higher leverage, which can put pressure on companies to cut costs related to quality jobs.³⁰
- There is a lack of quality information:
 - With investment and corporate governance professionals often operating from a perspective of advantage or even privilege, they may not have a strong understanding of how a portfolio impacts its stakeholders, particularly those from lower-income or marginalized backgrounds. It can be risky for them to make decisions on what is best for everyone else without a deep understanding of their portfolio's social and environmental dependencies, impacts, risks, and opportunities, which will likely be incomplete without input from affected stakeholders themselves.
 - The capital markets value chain is deeply complex and intermediated, with numerous actors playing a role in various layers or stages of an investment. Information flowing to investors is generally sourced from corporate managers and third-party service providers. Asset owners and allocators often face an additional filter through their asset managers, while existing disclosure frameworks and information sources on environmental and social issues are fragmented, still maturing, and sometimes conflicting.³¹ Even many corporate executives and their management teams – who are closer to activities on the ground (although arguably this is more difficult for multi-national enterprises and other large companies) – either have difficulty or lack strong interest in understanding their companies' stakeholders.
 - Environmental, social, and governance (ESG) disclosure, measurement, and management frameworks, data services, and ratings have been developed primarily by companies and investors, particularly in developed countries, with little input from the people that such factors most impact. As a result, investors and data providers may not yet be aware of issues that become material risks to their portfolios. As time passes and new risks become financially material through the process of dynamic materiality, these frameworks and providers may not evolve quickly enough.³²

- o Inequality, which is increasingly recognized as a systematic and potential source of systemic risk, is heavily affected by market structure dynamics, such as asset manager concentration, corporate concentration, or disparities between countries.³³ These dynamics are not captured by traditional ESG and impact investing frameworks and are not issues that can be solved only through adjustments to corporate governance alone. Rather, they also require adjustments to capital allocation practices.

THE VALUE OF STAKEHOLDER ENGAGEMENT MECHANISMS AT BOTH INVESTOR AND CORPORATE LEVELS

When one thinks of stakeholder engagement, it is often in the context of a company engaging with its shareholders. However, there is strong rationale for investors – both asset owners and allocators, as well as asset managers – to also engage with stakeholders such as workers and communities impacted by their activities. For example, investors cannot always rely on their portfolio companies for robust practices and transparent information. As a form of checks and balances, investment institutions may consider implementing their own grievance mechanisms to help reach stakeholders directly and enable recourse should their concerns be overlooked by a portfolio company. This type of intervention can enable investors to keep abreast of risks that may otherwise be hidden and engage with companies to hold them to account.

Asset allocation and investment structuring decisions can also have overlooked impacts and broader implications for a company's stakeholders. For example, increasing allocations to highly leveraged private equity buyouts can yield negative outcomes for workers and community members. Sometimes these transactions – led by investors – can overburden portfolio companies with debt, to the extent that they can no longer provide quality jobs to workers or offer quality and affordable goods and services to their customers and communities. These dynamics can also lead to financial risk at the portfolio company level, as well as systemic financial risk across markets and portfolios when many companies have high debt burdens.

Similar dynamics occur in public markets, where investors can set incentives for companies to return capital to shareholders at the expense of quality jobs and quality and affordable goods and services. In such situations, or in other situations where stakeholders feel “financialization” may have a negative impact on their lives and social stability, it can be valuable for both the asset manager and institutional asset owner or allocator investing into the asset manager to have grievance mechanisms. Such mechanisms can help educate investors about their own negative impacts, consider how they may affect long-term financial returns and financial stability, and catalyze interventions to improve capital allocation and deal structuring before risks manifest.

In addition to grievance mechanisms, investors may consider including workers or community members on their boards and advisory committees, or structuring other forms of engagement to ensure that investment and engagement decision-making considers diverse perspectives familiar with real impacts across human, environmental, and economic systems. Such approaches allow investors to have a fuller picture of their and their investees' dependencies, impacts, risks, and opportunities. This already occurs in some pension funds, such as labor and public pension funds, but the practice could be further refined and expanded with additional skills training and capacity building on various aspects of finance for these worker and community representatives.

DO INVESTORS HAVE ALL THE TOOLS THEY NEED?

Investors currently have some tools at their disposal to manage environmental and social risks. Investors of public companies can choose to engage with a company about its environmental and social risks; express their concerns at the company annual meeting by voting, filing shareholder resolutions, or launching a Vote No campaign against directors and/or executive compensation; take the company to court; or, divest. Yet in today's increasingly polarized world, these approaches have their limits, and most day-to-day business decisions are left to management.

For example, engagement has primarily led to improvements in terms of corporate commitments and transparency, rather than concrete changes in practice or actions.³⁴ When repeated attempts to engage a company do not deliver the desired results, investors might step up their efforts by filing shareholder resolutions at company meetings. The topics that investors can raise are subject to Rule 14a-8 under the U.S. Securities Exchange Act, as well as to the whims of political outcomes. In addition, even if a resolution is permitted to go to a vote, it is not guaranteed to receive support from a range of investors. Amidst tensions relating to ESG, investor support for shareholder resolutions was lower in 2023 than in the previous year.³⁵ And even in situations when a resolution does receive majority support, there is no guarantee that the company will follow through its commitment to implement it.³⁶

Recognizing these limitations, some investors have turned to holding corporate boards of directors accountable through proxy voting. Yet while shareholders as owners elect the board of directors, the incumbent board selects the directors who are voted on by shareholders. Only on very limited occasions do shareholders present an alternate slate of candidates, since proxy contests entail a massive cost. Corporate directors run unopposed more than 99% of the time.³⁷ The only other option is Vote No campaigns to remove directors, but few of these campaigns have yielded the desired results.

Another option, litigation, is costly, and there is no guarantee that investors will achieve a favorable outcome. Moreover, universal demand laws across 23 U.S. states have significantly weakened shareholders' litigation rights by raising procedural hurdles to pursue, for instance, derivative lawsuits, making it more difficult for shareholders to seek remedies.³⁸ ³⁹ At the other end of the spectrum, if an investor divests, then it loses the opportunity to engage with the company to reform its business practices.

And in private asset classes like private equity, venture capital, and private credit, Limited Partners (LPs) face legal and regulatory restrictions that limit their ability to influence portfolio management decisions. Lack of liquidity after committing to a fund is also a challenge.

While investors currently have important tools for holding portfolio companies accountable, they are not sufficient to change the day-to-day management decisions and corporate practices that affect stakeholders, create potential risk, and impact long-term investments. For risks to truly be minimized for both stakeholders and investors, a multitude of mechanisms that enable others to participate in private sector accountability are necessary.

MECHANISMS INVESTORS CAN USE TO ENGAGE AND SHARE WEALTH AND INFLUENCE

To improve the effectiveness of managing impacts, dependencies, risks, and opportunities, investors and companies can engage with civil society – including communities, labor advocates, and consumer advocacy organizations. They can also engage more responsibly with policymakers and regulators.

Without diverse stakeholder input and collaboration, investors are likely to have a more limited understanding of their portfolios and even overlook critical risks or opportunities. Stakeholders are closer to core issues and challenges, which in many cases directly impact them. Having access to stakeholder insights can help investors understand and manage risks before they manifest. Stakeholders can also work with investors to influence private sector behavior in ways that protect and enhance shareholder value.

This section presents – at a high level – various mechanisms that investors can use to engage and share influence with stakeholders to promote more responsible business conduct. These include:

- Grievance mechanisms
- Freedom of association and collective bargaining
- Human rights due diligence (HRDD)
- Free, prior, and informed consent (FPIC)
- Workers on boards
- Worker ownership
- Community ownership

Many of the mechanisms are already embedded within certain companies, industries, and geographies; whether voluntarily or through legislation and/or regulation, or through multi-stakeholder dialogue. However, there are certain mechanisms that are critical baseline foundations for any effective stakeholder engagement strategy, including grievance mechanisms, freedom of association and collective bargaining; HRDD, and FPIC, all of which serve to reinforce one another. Adding workers to boards and structuring worker and community ownership models are potential value adds, which can provide powerful structures for deepening stakeholder engagement, in addition to core baseline approaches. All the mechanisms are featured in literature offering insights and experiences that can be replicated and scaled. Various toolkits exist on certain topics to support implementation. While presenting each approach, we summarize key takeaways from existing literature, provide brief case studies, and address the:

- benefit of a particular approach for society;
- opportunity for investors to better identify, measure, and manage risks – including systemic and systematic risks – that would not have been visible otherwise; and,
- business case for companies to adopt these practices.

This paper reviews the above mechanisms at a high level. In future work, we could go into further detail about the mechanics of these interventions, as well as engagement and capital allocation strategies that investors might undertake to promote adoption among portfolio companies. We may seek to further develop guidance on these tools through interactive roundtables with investors and

stakeholders and provide additional resources for how investors can improve their own internal investment governance and practices to institutionalize these practices.

GRIEVANCE MECHANISMS

Robust grievance mechanisms can serve as a formalized means for affected stakeholders to raise concerns and seek remedy on issues before they become financially material risks. They can also help private sector entities avoid future similar incidences. A grievance mechanism is a formal, legal or non-legal complaint process that can be used by workers (within the company's workplace and in supply chains), consumers, communities, and/or third-party organizations (such as civil society or advocacy groups), or even other business relationships.⁴⁰ A grievance mechanism may enable remedy for a harm, as well as alert companies and investors to practices that may present risks to its reputation, operations, or supply chain stability.

What is an effective grievance mechanism?

There are a wide variety of grievance mechanisms at the company, sector, national, regional, and intergovernmental levels. The UN Guiding Principles on Business and Human Rights (UNGPs) list eight criteria for a grievance mechanism to be effective: **it should be legitimate, accessible, predictable, equitable, transparent, rights-compatible, a source of continuous learning, and based on engagement and dialogue with stakeholders.**⁴¹

Multi-stakeholder groups such as **AIM Progress** have developed the Grievance Mechanisms Maturity Framework Guidance to support companies, especially fast-moving consumer goods companies, in developing and implementing grievance mechanisms in company operations and supply chains.⁴² The **Fair Labor Association** has a robust third-party complaint process that accepts complaints about serious workers' rights violations at facilities of participating companies.⁴³ Any person, group, or organization can confidentially report serious violations of non-compliance to the Fair Labor Association. These mechanisms align closely with the UNGPs.

Several companies have mechanisms to receive grievances, but to date, there is very little information on the effectiveness of company-specific grievance mechanisms.⁴⁴ Still, some companies are moving in the right direction – for example, Reckitt in the UK has developed a grievance mechanism to engage first-tier suppliers and intends to integrate, over time, more robust mechanisms in its supply chain.

Alongside the guidance for private sector entities in developing their own grievance mechanisms, the **OECD Guidelines for Multinational Enterprises** have also established a grievance mechanism to support companies, investors, and their stakeholders in identifying and addressing emerging concerns.⁴⁵

Grievance mechanisms can help avert harm that could otherwise be costly for private sector entities. Operational delays that stem from worker dissatisfaction or community opposition can translate into higher financing, insurance, and security costs; poor labor relations and/or a breakdown of trust with unions; lower output resulting from delayed production; and the possibility of projects being cancelled.

Workplace conflict can lead to increased absenteeism,⁴⁶ lower productivity, higher worker turnover, and significant legal costs. Unresolved grievances with workers cost U.S. businesses a collective US\$359 billion in paid hours (the equivalent of 385 million working days) each year.⁴⁷ A company can lose more than US\$7,000 per day because of people-related issues, including interpersonal conflict.⁴⁸ In 2021, a Canadian study revealed that workplace conflict can cost a Canadian business up to US\$2 billion per year.⁴⁹ Yet these conflicts could be avoided with effective grievance mechanisms.

Worker sentiment as a leading indicator of business risk

The #metoo era pulled back the curtain on a long history of sexual harassment scandals in the workplace.⁵⁰ In 2018, more than 20,000 workers globally staged a walkout of Google's offices after it was revealed that the company had paid millions of dollars in exit packages to senior executives who were accused of misconduct and stayed silent about those transgressions.⁵¹ That same year, Wynn Resorts lost billions after it was revealed that founder and former CEO Steve Wynn was accused of sexual harassment and assault by several employees.⁵² The company lost over US\$3.5 billion in value over the allegations and his denial.⁵³

Workplace sexual harassment costs U.S. companies collectively over US\$100 million a year in fines and US\$350 million in litigation costs and settlements.⁵⁴ This is in addition to time lost due to absenteeism and presenteeism.⁵⁵ In many cases investors were unaware of the situation before it was too late, particularly when companies used non-disclosure agreements to cover up sexual harassment allegations. If these companies had implemented effective grievance mechanisms, they and their investors likely could have better addressed or prevented these incidences, avoiding the high costs and reputational damage that resulted from escalation.

At the community level, companies without grievance mechanisms can also face significant operational challenges. For example, interruptions in operations due to community-company conflict can cost an extractive company up to US\$10,000 per day during initial exploration, US\$50,000 per day during advanced exploration, and US\$20 million per week during operations.⁵⁶ In 2020, failing to obtain a social license to operate was recognized as one of the biggest risks for mining companies.⁵⁷ In the same year, analysis by the Justice and Corporate Accountability Project of six cases of community-company conflict involving mining companies revealed that information pertaining to community conflicts was financially material in each case.⁵⁸

Grievance mechanisms provide an opportunity to hear from stakeholders about the impact that business activities are having on their communities and to consider how these activities can manifest as reputational, operational, or supply chain risks. Businesses with effective grievance mechanisms have access to timely information that can help senior management prevent risks from manifesting. This can also inform better internal decision-making, as well as engagement and capital allocation strategies in a portfolio, both for companies and investors. Information received via a grievance mechanism can help inform evaluation and monitoring of an investee's internal policies and practices, performance against policy commitments, and the development of remedial action plans if necessary.

Whistleblowing can help the early detection of internal and external grievances

A whistleblowing mechanism is broad in scope and allows for reports from people regardless of whether they are directly affected by an issue, whereas a grievance is usually raised by the person who has been directly affected. Over 40% of whistleblowing cases reported to companies are provided by employees.⁵⁹

Whistleblowing has been found to be a useful method to capture corporate fraud and misconduct.⁶⁰ An effective whistleblower policy helps companies and investors manage risks, avoid scandals, and protect their long-term wellbeing and reputation. For example, a whistleblower program can be used to provide information about sexual harassment in the workplace or in communities where companies operate. Investors can avoid legal repercussions and regulatory scrutiny by empowering stakeholders to report on toxic company culture with assurance that their concerns will be appropriately investigated and addressed where problems are identified, without retribution. When mechanisms are available to stakeholders to report wrongdoing, cases of fraud and abuse can be more easily detected.⁶¹

While grievance mechanisms may be an upfront investment, if designed effectively, they have the potential to insure against future risks and even bolster opportunities. When the entire process is transparent and guarantees against retaliation, such mechanisms can create a level of trust between the stakeholder and the business. Within the workplace, an effective grievance mechanism can increase morale, improve retention, reduce incidents, and improve productivity, all drivers of strong corporate performance. In general, grievance mechanisms can reduce operational disruptions, and companies and investors can secure buy-in from those critical to their business success.

FREEDOM OF ASSOCIATION AND COLLECTIVE BARGAINING

While traditionally a polarizing issue, collective bargaining and unionization can drive overall positive outcomes for a company's stakeholders – in particular, its workforce – in turn driving better business and investment performance, as well. In their work to raise wages, bolster benefits, foster stronger communication between management and employees, and improve workplace health and safety, trade unions can serve to mitigate stakeholder, corporate, and investor risks alike, reducing absenteeism and turnover, increasing productivity, providing mechanisms for remediation, and more. With support for freedom of association and collective bargaining gaining momentum among workers and communities in the U.S. since the onset of COVID-19, it is a critical time for business and investment leaders to consider how the goals of these practices in fact support long-term financial gain.⁶²

The summer of 2023 has been pegged as the “hot strike summer” as workers across a number of industries – including film and entertainment, transportation, hospitality, automotive, healthcare, and more – took to the picket lines over working conditions and/or pay.⁶³ There is no indication that there will be a reversal in this trend anytime soon, especially as support for unionization has been increasing within the U.S. In 2022, 59% of U.S. workers supported increased unionization in their own workplaces⁶⁴ and 71% of Americans said they approved of labor unions (up from 68% in 2021).⁶⁵ Approval for unions has been especially high among young adults (77% in 2021),⁶⁶ while the percentage of union members aged 25-34 rose from 8.8% to 9.4% between 2019 and 2021, or an increase of 68,000 workers.⁶⁷

This recent upward trend has been driven, in large part, by the lack of a worker voice to stem rising levels of inequality and the need among workers for better pay, benefits, and working conditions.⁶⁸ In recent decades, declining union rates – particularly due to loosening policy and regulation – have contributed to stagnant real wages and rising inequality.⁶⁹ Despite robust employment headline numbers in the U.S., many workers today lack full-time employment and associated benefits, including healthcare, sick leave, and parental leave, potentially distorting unemployment numbers and reducing comparability relative to historical norms.⁷⁰ Moreover, the federal minimum wage is pegged at US\$7.25, meaning that workers earn 27.4% less in inflation-adjusted terms than they would have in mid-2009 and 40.2% less than in early 1968.⁷¹ Meanwhile, CEO pay has skyrocketed 1,460% since 1978. The CEO-to-worker pay ratio only grew wider during the pandemic, with workers – especially women workers and those in low-paying jobs – bearing the brunt of the crisis.⁷²

This growing inequality contributes to disenfranchisement among workers, hampering workplace productivity, driving higher rates of turnover and increasing calls for protectionism in the face of globalization's impacts. Freedom of association and collective bargaining can reduce wage inequality and hence lower the level of workplace friction. Unions have proven track records in raising wage levels for low- and middle-wage workers.⁷³ Unionized workers earn 10.2% higher wages than their non-union peers, have better benefits, and collectively raise wages across industries.⁷⁴

The union “premium” in wages is even higher when accounting for race and gender, signaling that union efforts can foster greater workplace equity. Black workers earn on average 17.3% more than their non-union counterparts, and Latino workers earn 23.1% more.⁷⁵ Hourly wages for women represented by unions are estimated to be 4.7% higher on average than non-unionized women workers with similar characteristics,⁷⁶ while freedom of association can help reduce gender discrimination in the workplace.

Efforts to unionize at some of the largest multinationals have been met with resistance. Amazon, Apple, and Starbucks have allegedly launched fierce counterattacks against unionization drives at their companies.⁷⁷ Moreover, right to work laws in more than half of U.S. states undermine unionization efforts.⁷⁸ This represents a missed opportunity for these companies as the economy faces labor shortages, especially in sectors characterized by poor working conditions, pay, and benefits.⁷⁹ While market concentration and monopsony dynamics may be protecting these companies from the financial downsides of antiunionization campaigns in the near term, the massive inequality that results from these practices negatively affects diversified investors’ portfolios.⁸⁰

Overall, collective bargaining can reduce levels of absenteeism and the number of employees leaving their jobs, thereby improving worker turnover. This is particularly because union members earn more than their non-union peers, but also because unions secure better benefits such as paid sick leave, health and safety protections, job security, and a structured, constructive mechanism for workers to communicate with management.⁸¹ While some companies may claim that a low-wage/high-turnover model has suited their business models, the cost of replacing a low-wage worker is estimated at around 20% of their annual salary.⁸² In places where workers and unions are integrated into the decision-making process, the company can realize productivity gains and reduce costs that otherwise come with repeatedly training new workers.⁸³

Workforce retention is critical for companies during periods of labor shortages.⁸⁴ Though global job growth has accelerated, companies have reported continued capacity constraints because of a shortage of labor.⁸⁵ Fed up with unsafe or poor working conditions, inflexibility, and low pay, many have quit their jobs or left the workforce entirely.⁸⁶ Because of labor shortages, many companies across the economy are operating on reduced hours or have even had to shut down.⁸⁷

Many workers have left sectors entirely.⁸⁸ Globally, 65% of workers who quit their jobs did not return to the same industry, and 17% of these did not return to the workforce.⁸⁹ Workers value “workplace flexibility, meaningful work, and compensation.”⁹⁰ Moreover, labor supply will continue to dwindle as the U.S. working age population declines.⁹¹ A declining growth rate in the population will also result in a lower replacement rate of workers entering the market.⁹² Low birth rates and high rates of turnover globally will only add to these pressures. Those companies that offer workers the best working conditions will be better placed to attract a larger share of the dwindling workforce.

Improved communication between workers and management can also improve workforce productivity.⁹³ Collective bargaining can facilitate this dialogue, contributing positively to setting conditions of employment that can result in, among other things, higher job security, working-time regulations, occupational health and safety protections, and access to training.⁹⁴ A 2019 paper on collective bargaining from the OECD explains that “[U]nion density and collective bargaining increase productivity because they facilitate communication of information to company management, establish mutual responsibility for a company’s success, reduce turnover, promote productive modes of organizing work, resolve industrial disputes effectively, promote training and reduce time lost to injury or death.”⁹⁵

Workplace health and safety improve when workers are represented by trade unions. A study of 13,350 nursing homes found that unions were associated with a 10.8% lower COVID-19 mortality rate among residents and a 6.8% lower worker infection rate.⁹⁶ Within the construction industry, the U.S. Occupational Safety and Health Administration (OSHA) found that union worksites are 19% less likely to have an OSHA violation and had 34% fewer violations per OSHA inspections than non-union worksites.⁹⁷ Moreover, investors are more likely to know about business risks, as unionized

workplaces tend to report workplace safety hazards more frequently to OSHA. They can do this given less fear of reprisal due to protection of the union.⁹⁸

The role of workers in shaping the labor markets and their jobs is at a significant inflection point. In recent decades, the economy has shifted from being less capital-expenditure intensive to relying more on intangibles, including labor,⁹⁹ with the market value of the S&P 500 growing from 32% intangibles in 1985 to 90% by 2020.¹⁰⁰ Today, many companies proudly proclaim that labor is their greatest asset. Yet with the undermining of unions, there are few reliable mechanisms to manage labor relations and ensure that these stakeholders are adequately compensated for the value they create and risk they take. Relations between workers and management are increasingly recognized as a material risk to businesses, as well as a contributing factor to the destabilizing threat of inequality.

Investors' support for freedom of association and collective bargaining is vital to retaining workers and creating a pathway for workers to negotiate for their needs – whether it be income, health and safety, the improvement of corporate culture, or other benefits.¹⁰¹ Fulfilling these needs can then reduce inequality and social and market instability, thereby benefiting diversified investors' portfolios. In addition, by engaging proactively with the labor movement, businesses and investors can avoid financial losses by lowering the likelihood of workplace disruptions. The presence of freedom of association and collective bargaining is a critical factor in determining firm and portfolio-level long-term performance.¹⁰²

HUMAN RIGHTS DUE DILIGENCE

As part of their social license to operate, companies and investors have a crucial responsibility to protect human rights in their own operations and supply chains. Regardless of industry, the potential for business-related human rights harms present significant risk, and private sector entities may, as noted by McCorquadale and Nolan, “both directly and indirectly, and deliberately and inadvertently be involved in human rights abuses.”¹⁰³ Private sector activities can cause severe harm that have the potential to damage the lives of rightsholders and weaken the social fabric of societies more broadly.¹⁰⁴ These impacts, in turn, can drive negative economic and business outcomes.

The UN Guiding Principles on Business and Human Rights (UNGPs) is a risk management framework for companies and investors to conduct human rights due diligence (HRDD) and avoid human rights abuses. More specifically, HRDD is defined by the UN Human Rights Council as “a comprehensive, proactive attempt to uncover human rights risks, actual and potential, over the entire life cycle of a project or business activity, with the aim of avoiding and mitigating those risks.”¹⁰⁵ To manage the human rights impacts caused or potentially caused by investments, corporate operations, products, services, or business relationships (including suppliers, subcontractors, and other business partners), companies and investors should incorporate HRDD and engage affected rightsholders throughout the process.

What does HRDD entail?

HRDD includes all processes companies and investors have established to manage the human rights impacts caused or potentially caused by their investments, operations, products, services, or business relationships. HRDD should include:¹⁰⁶

- Identification of **actual or potential human rights impacts**, drawing upon internal and external expertise, including potentially affected groups and at-risk and marginalized groups;
- **Prevention of impacts** by integrating the findings into functions, processes, and decision-making, and **mitigation by taking action**;
- **Tracking of responses and efficiency of measures** through qualitative and quantitative

indicators, as well as drawing upon feedback from stakeholders; and,

- **Communication to various stakeholders on the actions undertaken** to address the risks and impacts identified, as well as the efficiency of the proposed measures.

A significant piece of HRDD involves engaging with stakeholders. We elaborate on this in the next section – particularly regarding free, prior, and informed consent.

Significant regulation is emerging that is aligned with HRDD. In the U.S., the Uyghur Forced Labor Prevention Act (UFLPA) requires companies in certain high-risk sectors sourcing from Xinjiang in China to prove that their supply chains are free from forced labor.¹⁰⁷ In addition, the Alien Tort Statute holds companies accountable for misconduct occurring across the supply chain.¹⁰⁸ Under the U.S. Tariff Act, U.S. Customs and Border Protection prohibits imports when it has sufficient information that an imported product was mined, produced, or manufactured, wholly or in part, by forced labor.¹⁰⁹ Other states, countries, and regions are also increasingly adopting human rights legislation.¹¹⁰

Companies that are prepared for pending regulation and legislation are more likely to reduce risks emanating from noncompliance. Yet even when regulations are not strong, HRDD can protect companies and investors from reputational risk. For example, the U.S. Fair Labor Standards Act codifies a basic floor of protections for children in the workplace and bars minors from working in certain jobs. However, states across the country are drafting exceptions that would allow for the employment of children in sometimes hazardous working conditions. While such activity may be legally permissible, it is still publicly controversial.

HRDD can shed light on potential blind spots across company operations and value chains that investors were previously unaware of. A New York Times investigation revealed that migrant children were allegedly employed across many industries in several U.S. states by companies that supply several multinational corporations among others.¹¹¹ Further, the study found that about two-thirds of all unaccompanied migrant children work full-time even though nearly all U.S. companies prohibit child labor in their supply chains.¹¹² HRDD can ensure that quality information flows both downwards and upwards, including across the company and the supply chain, enhancing transparency and reducing risk. This ensures the early detection of impacts, which can increase a company's capacity to prevent human rights violations.

It is becoming abundantly clear that, if left unaddressed, human rights violations can cost businesses financially, affecting investors' returns and companies' business operations. The costs of integrating HRDD and ensuring deep engagement with different stakeholders are low compared to the significant costs that some companies bear when their operations violate human rights, including operational, reputational, and legal risks¹¹³ that HRDD can help reduce.

HRDD can confer many direct financial benefits, including improving risk management, strengthening brand reputation, reducing disruptions, lowering worker absenteeism and presenteeism, increasing positive recognition from civil society groups, workers, and shareholders, and building trust and support with affected communities. Ultimately, these benefits can contribute to protecting the company's and investors' long-term financial interests.

FREE PRIOR AND INFORMED CONSENT

Adherence to free, prior, and informed consent (FPIC) should fall within a company's approach to HRDD. In this section, we provide additional detail on the practice and its unique implications for stakeholder engagement.

FPIC is the principle that Indigenous Peoples and local communities must be adequately informed about projects that affect their lands in a timely manner, free of coercion and manipulation, and that they should be given the opportunity to approve or reject a project prior to the initiation of

activities.¹¹⁴ For Indigenous Peoples, FPIC is a human right guaranteed under international law.¹¹⁵ For projects in Indigenous communities in developing countries, this practice has been institutionalized by the International Finance Corporation (IFC) - the private investment arm of the World Bank Group) and financial institutions which adhere to the Equator Principles. In addition to FPIC as a best practice with Indigenous communities, another Oxfam paper emphasizes that "The safeguard provided by the principles of FPIC is increasingly interpreted as a best practice standard for affected local communities who do not fit the international legal definitions of rights-holding Indigenous Peoples."¹¹⁶

FPIC processes vary based on the decision-making customs of each Indigenous nation, though common elements should be applied across projects and sectors and for all communities (Indigenous Peoples and non-indigenous frontline communities) including that the process is:

- Free – Consent is free from coercion, intimidation, and manipulation.
- Prior – Consent is sought prior to project development and continues to be obtained throughout the project lifecycle. Communities should have the opportunity to give or withhold their consent at each phase of project development where changes to project design entail potential impacts on communities.
- Informed – Engagement includes full and timely access to all relevant project information in formats that ensure understanding of project risks and impacts. This aspect of FPIC requires that project proponents be particularly mindful as to the languages, literacy levels, and cultural sensitivities of affected communities when creating informational content. Requests for clarification and additional information should be attended to. Ultimately, this communication and its format is critical to inform a community's decision to consent.
- Consent – Communities have the power to give or withhold their consent to a project or elements of it. Consent is a collective decision made by the community, based on their own decision-making processes. It is important to note that in some circumstances, even when project proponents and investors believe they have achieved consent by engaging with community leaders, elders, or local and national authorities, community opposition can jeopardize a project. Thus, best practices for FPIC implementation include engagement with different parts of communities – including marginalized groups – in focus groups to ensure that different members of communities are heard and that their rights are not violated.

Companies that adhere to FPIC insulate themselves from expensive conflicts that could threaten profits and, in some cases, make projects economically unfeasible. In the agricultural and natural resources sectors, as well as in infrastructure, companies face financial risks around insecure land rights that could otherwise be managed in part through FPIC and participatory land-use mapping, as well as broader adherence to the IFC Performance Standards on Environmental and Social Sustainability. Interviews with almost 80 companies revealed that they lack systems and processes to assess and respond to tenure risk.¹¹⁷ In Africa, an assessment of 29 tenure disputes showed that 13 of these resulted in delays of over 500 days, while six extended beyond 1,000 days: in almost all cases, the projects were ultimately cancelled and disposed of at a large loss.¹¹⁸

Operational interruptions that stem from community opposition can translate into project delays; increased financing, insurance, and security costs; poor labor relations; a breakdown of trust with local unions, regulators, and policy makers; lower output due to delayed production; and the possibility of projects being cancelled.¹¹⁹

The cancellation of Amazon, Inc.'s warehouse in New York stands as an example of the importance of public participation in decision making.¹²⁰ While limited engagement was conducted with local authorities, the announcement of the development caught most local residents off guard, resulting in significant protest and an eventual cancellation of the project after substantial planning and investment had taken place.¹²¹

Conflicts with local communities can also result in legal challenges, tying companies up for months or years in complex court battles, including prosecution in international courts for human rights

abuses, direct action including disrupting operations and seizing infrastructure, public censure, and reputational damage.

FPIC can highlight hidden risks of community-company conflict that investors would otherwise be unaware of, and community consent is often necessary for companies operating in certain sectors. A 2011 study of the costs of community conflicts for extractive companies found that:

In terms of lost productivity [...] a major, world-class mining project with capital expenditure of between US\$3–5 billion will suffer roughly US\$20 million per week of delayed production in Net Present Value (NPV) terms. Even at the exploration stage, costs can accrue. In the case of a serious exploration project for a new mine, around US\$10,000 will be lost every day of delay in terms of wages, idle machinery and so on.¹²²

For example, shareholders of Tahoe Resources lost considerable market value when it was sold to Pan American Silver Corp in 2019. This is in part because work on the company's Escobal silver mine was suspended in 2018 in Guatemala over violation the Indigenous People rights to prior consultation, and the share price fell from US\$27 to US\$5.¹²³ The company derived 45% of its revenue from that mine in 2016.¹²⁴ This loss could have been avoided if the company had adopted the principles of FPIC.

On average, it is estimated that good engagement can cost an investor about 2% of overall project cost (for projects averaging US\$497 million).¹²⁵ In contrast, the estimated cost of mitigating social conflict can be, at a minimum, between US\$25 million and US\$40 million due to delays to the inception or operation of a project.¹²⁶ While "broad community support" represents a lower standard than FPIC, its inclusion in the IFC's performance standards illustrates that best practice is evolving beyond mere consultation and engagement with communities toward recognizing the need to secure local approval.¹²⁷ At minimum, if frontline communities have not been able to freely permit or stop a project moving forward, then consent has not been achieved.

Company management of community relations can create reputational risks and impact business operations

Whether it be accusations of dumping mine waste into a river in Bouganville in Papua New Guinea,¹²⁸ accusation of failing to gain community consent at the Oyu Tolgoi copper and gold project in Mongolia,¹²⁹ or accusations of polluting waterways at an ilmenite mine site launched by its subsidiary in Madagascar,¹³⁰ Rio Tinto is no stranger to controversies across the globe. In 2020, the company acknowledged that it needed to change the way it operates after destroying two ancient and sacred rock shelters in Western Australia that dated back 46,000 years during efforts to expand iron ore mining operations.

Rio Tinto's investigation revealed that the incident was part of "a series of systemic failings." After facing severe backlash from the public, international media, the Australian government, and international investors for its initial poor response, senior executives including the CEO, Jean-Sébastien Jacques, resigned.¹³¹ Since this incident, the company has been trying to rebuild its relationship with the local Indigenous group, including by releasing its first communities and social performance report.¹³² Elsewhere in Serbia, the government scrapped plans to issue exploration licenses to Rio Tinto after weeks of protests and public backlash over the company's plans for a lithium mine.¹³³ If Rio Tinto conducts robust FPIC and community consultation prior to commencing any project, it has the opportunity to build trust and a mutual understanding with local indigenous and non-indigenous communities of what is acceptable, negotiable, or off limits, thereby preventing disastrous and costly outcomes.

WORKERS ON BOARDS

Having workers on a company's board of directors is common practice across Europe. Nineteen of the EU member states, plus Norway, have some provisions for worker representation on company boards, with 13 of these applying across much of the private sector.¹³⁴ In Germany, having workers on boards, known as "codetermination" (where shareholders and employees share control over corporate decision-making) has been codified into law since 1976¹³⁵ and can have positive effects on productivity and profitability.¹³⁶ In the U.S., 53% of respondents in a 2018 survey from Civis Analytics supported having employees elect representatives to the board of directors,¹³⁷ while some shareholders are filing resolutions at several of the largest multinational companies asking management to place workers on boards.¹³⁸

During the Global Financial Crisis, companies with workers on boards demonstrated higher resilience than those without.¹³⁹ In Denmark, Sweden, and Norway companies with workers on their boards were better able to negotiate alternative ways of reducing labor costs than relying on mass firing.¹⁴⁰ Evidence from Germany suggests that workers and employers worked together to overcome the recession, avoiding the worst of the economic slump.¹⁴¹ German companies with codetermination registered higher profits, experienced milder fluctuations, and exhibited a more modest decline in company valuations during the crisis.¹⁴² From 2006 to 2011, cumulative shareholder returns for companies in Germany with codetermination averaged 7.2%, while for companies without workers on the board, returns were negative to the tune of an average of 21%.¹⁴³

Workers on boards, or their representatives, can serve as a check against excessive CEO pay and as a barometer to help investors assess whether companies are sacrificing long-term performance for short-term gains. The average compensation package of CEOs in Germany consisted of less than 25% stock options, while in U.S. CEO pay packages, stock options are on average almost 63% of the compensation.¹⁴⁴ This is not to imply that workers on boards in Germany are against providing incentive-based compensation. Based on executive compensation data between 2006 to 2011 for 405 listed companies, codetermination in Germany has demonstrated a significantly positive effect on performance-based components of compensation.¹⁴⁵ Within the U.S. CEO compensation increased 1,460.2% from 1978 to 2021 (adjusting for inflation).¹⁴⁶ The issue in the US is that incentive structures are skewed to excessively focus on the short-term, often at the cost of considerations that would be beneficial for long-term value creation.¹⁴⁷

Having workers or their elected representative(s) on the board can increase cohesiveness between labor and capital and reduce the frequency of workplace disruptions. In a survey of managing directors at Swedish firms, 61% believed that employee representatives "contribute to a positive climate of co-operation."¹⁴⁸ Employees are also less likely to renege on agreements with management when those agreements are negotiated with workers on boards.¹⁴⁹ Companies can manage risks stemming from employee dissatisfaction more effectively, thus minimizing negative impacts on productivity and operational efficiency.¹⁵⁰ Moreover, there is sufficient literature to support the assertion that diverse boards (with both social diversity and diversity of roles) are better positioned to avoid "group think" in the boardroom and produce improved long-term returns for shareholders.¹⁵¹ Different perspectives, especially those that workers bring, can change boardroom dynamics, generate higher-quality decisions, and enhance creativity and oversight.¹⁵²

Increased worker participation on a board can also result in better information flow about the company to the highest level of oversight and accountability.¹⁵³ Because workers are more ingrained in daily operations and processes, they have first-hand knowledge of managerial performance and internal risks to the firm, and this knowledge can lead to improved decision-making at the board level.¹⁵⁴ Workers or their representative(s) serving on the board can provide information about the implications of potential corporate decisions on the workforce, as well as other aspects of operations, policies, and procedures. Workers can provide the board with information about the impacts of firm activity on worker productivity and morale. This input is

distinct from simply representing the views of the workforce, which are generally otherwise supported through the process of collective bargaining.

Critically, worker-representative directors can enable input from a workforce perspective at the inception of discussions, rather than after decisions are already made, and at a strategic rather than an implementation level. This level of transparency can help minimize information asymmetries and support the development of mutually beneficial solutions.¹⁵⁵

Some express concerns that allowing worker representatives on a company's board can increase agency costs and result in a lower share of profits going to shareholders.¹⁵⁶ However, the German experience shows that codetermination has not been to the detriment of shareholders.¹⁵⁷ "Prudent" levels of employee representation have actually led to better board decision-making by improving monitoring and thus reducing agency costs.¹⁵⁸ Evidence from France – where private companies above a certain size are required to have one or two workers on their boards – highlights that shareholders at French companies have received some of the highest dividends across Europe.¹⁵⁹

U.S. public pension funds offer a strong example of collaboration between workers and other directors on boards

Worker directors fulfill the same fiduciary duty as other board members, though they bring different experiences and perspectives to the boardroom that could be important when making business decisions. Several U.S. county, city, and state public pension funds include worker/member representatives on their boards. These funds represent the long-term financial interests of members of different unions, and the worker/member representatives are therefore vested in ensuring that the pension fund is focused on creating long-term shareholder value. To complement their specialist knowledge as workers, these board members could receive additional training on finance and investments. Similar measures could be taken with corporate boards. Alternatively, workers could elect a qualified representative to the board.

WORKER OWNERSHIP

Worker ownership – specifically “broad-based” ownership, as opposed to stock (or only options) held by a smaller subset of employees – has a long history of building wealth and influence for workers, and there are now increasing opportunities for providers of capital to generate strong risk-adjusted returns by investing in worker-owned companies. By offering workers an opportunity to share in the returns of strong corporate financial performance, worker ownership can foster a true ownership culture and a desire to engage with and grow the company. Particularly when workers are knowledgeable about how their labor contributes to corporate financial performance, and when they have influence in workplace decision-making, there can be a greater sense of alignment that helps grow the “economic pie”. This section explains worker ownership in slightly more detail than other sections since it is a newer concept for institutional investors that is rising rapidly in popularity and can include various considerations relating to business operations, corporate governance and capital structure.

In the U.S., approximately 32 million employees participate in some form of employee ownership plan – with approximately 14 million participants in broad-based ownership plans – and according to analysis from the National Center for Employee Ownership (NCEO), “overall, employees now control about 8% of corporate equity.”¹⁶⁰ Workers at such enterprises have retirement accounts worth, on average, more than double those of workers at traditional firms, and they are only one-fourth as likely to be laid off.¹⁶¹

There are a number of models that offer attractive opportunities for investors to align their interests with those of workers which include:

- **Employee Stock Ownership Plan Trusts (“ESOP Trusts” or “ESOPs”):** ESOPs are often utilized to transition a company from a retiring business owner to employee ownership. Typically, trusts are established to hold company stock on behalf of eligible employees, while the company buyout is completed using debt financing paid back over time by the company, with workers then receiving shares as a retirement benefit.
- **Employee Ownership Trusts (“EOTs”):** EOTs are a newer model of worker ownership in the U.S. (with a longer history in Europe). They are similar to ESOPs in that trusts are established in a buyout to hold shares on behalf of employees. However, instead of receiving their shares upon retirement, employees receive a portion of ongoing profits (or dividends) annually or more frequently. EOTs also utilize a Perpetual Purpose Trust model to keep the business employee-owned “in perpetuity” by taking the business off the market. EOTs are not regulated and can offer a greater degree of flexibility on the design of ownership interests and governance.
- **Other Broad-Based Equity Plans:** Equity plans have traditionally been used exclusively for management, but more and more investors are offering these plans to a broad-based group of employees.¹⁶² These plans can be structured in a variety of ways.
- **Worker and Multi-Stakeholder Cooperatives¹⁶³:** Cooperative models – in which employees, rather than investors, hold voting stock – have historically been challenging for investors to access. In these models, investors can hold non-voting preferred equity or provide debt financing. However, it is also possible to set up a worker or multi-stakeholder cooperative that can be owned and controlled by more than one type of membership class (i.e. where workers do not own 100%), allowing more traditional involvement by investors.

Each of these structures can hold varying degrees of ownership, from a small minority to a 100% ownership interest.¹⁶⁴

ESOP Trusts vs. Employee Stock Option Plans

When the term ESOP is used, most investors think of stock option plans found in technology companies or as a part of management incentive plans. However, in the employee ownership space “ESOP” is used to refer to ESOP Trusts, a distinct model for broad-based ownership often found in 100% employee-owned companies, and which currently hold total assets of over US\$1.6 trillion across publicly traded and privately held companies.¹⁶⁵

Beyond aligning worker incentives with managerial and investor interests, worker ownership models have the potential to reduce systemic and systematic risks relating to economic inequality by offering opportunities for workers to build wealth through capital markets. Equity ownership has the potential to be a wealth multiplier for workers and, depending on the structure, can require only minimal dilution and cash outlay for investors. Being in an ESOP Trust, for example, is associated with 92% higher median household net wealth, 33% higher median income from wages, and 53% longer median job tenure compared to the average American worker.¹⁶⁶

Homeland Food Stores – a unique restructuring with strong worker voice

HAC, Inc. – an 80-store Midwest U.S. grocery chain with banners including Homeland, Cash Saver, United, and Piggly Wiggly¹⁶⁷ – demonstrates the value of worker ownership as an investment bargaining tool in which workers, with appropriate representation, can negotiate for equity ownership.¹⁶⁸

HAC was previously owned by its main distributor – Associated Wholesale Grocers (AWG), a US\$10 billion-in-revenue retail cooperative distributor of groceries. When AWG was ready to sell HAC in 2010, the management team expressed interest in buying the company together with the workers who were organized through the United Food & Commercial Workers Union

(UFCW), and in late 2011 the parties completed the transaction through a loan from the seller.¹⁶⁹

Governance of the resulting company included two union seats on the board out of a total of nine. Board decisions regarding the collective bargaining agreement are made by a special committee of independent directors, from which management and union directors recuse themselves. As the company continues to grow, it is introducing additional efforts to engage workers, including through an ownership committee comprising three store managers and three union stewards, and staffed by a dedicated human resources specialist, which oversees numerous employee engagement initiatives.

Worker ownership can also contribute to reducing gender and racial inequalities. On average, employee owners of color have 30% higher income than employees of color without ownership stake, and women employee owners have 17% more wealth than those without ownership. This gap grows to 24% for single women.¹⁷⁰

Furthermore, worker ownership is often correlated with better long-term productivity, pay, job stability and firm survival, as well as fewer layoffs in recessions. In a 2018 study from Upjohn, employee-owned companies were found to be generally more resilient during crises, and with quit rates at these companies half the quit rates of their peers, employee retention is likely to play a key role in that resilience.¹⁷¹ It is worth noting that firms' relative productivity advantages decline in recessions, perhaps given higher retention rates.¹⁷² However, higher retention rates also motivate deeper skills training and lower costs than those relating to high worker turnover. Moreover, worker ownership is linked to greater corporate transparency when workers have bargaining power, as well as a lower likelihood of strikes in unionized companies with ESOP Trusts.¹⁷³

For diversified investors concerned about socioeconomic inequality affecting market stability, these outcomes – including lower unemployment and higher-quality jobs – are a clear way to reduce risk in a portfolio. Worker ownership is also of interest to both conservative and liberal public policymakers,¹⁷⁴ with its potential to address rising populist concerns about wealth and power imbalances. Many jurisdictions, like the U.S., have public policies or other efforts that support worker ownership, such as tax incentives for employee-owned companies and for owners who sell to their employees. Worker ownership is thus widely perceived to highlight how the distribution of returns from a company does not have to be a zero-sum game, though there are still considerations as to how much equity is owned by which stakeholder group and the risk-return balance for each.

KKR – a worker ownership model in the context of inequality

Since 2011, investment firm KKR has supported more than 35 companies in implementing broad-based employee ownership programs and ownership cultures, impacting more than 60,000 employees.¹⁷⁵ In 2022, KKR and a consortium of 18 other private equity firms launched a nonprofit focused on expanding worker ownership called Ownership Works.¹⁷⁶

One example of an employee ownership program supported by KKR is CHI Overhead Doors, a garage door manufacturer that KKR acquired in 2015.¹⁷⁷ Upon acquisition, only 18 of CHI's 800 employees had equity in the business, receiving a collective payout of US\$57 million, with US\$30 million of this distributed between two members of management.¹⁷⁸ Under KKR's ownership, the company restructured the program so that 100% of workers – including management, factory workers, truck drivers, and administrative staff – received some level of equity ownership as part of their compensation packages¹⁷⁹<https://mail.google.com/mail/u/0/> and instituted several programs and initiatives.¹⁸⁰

During the holding period, business and company performance improved¹⁸¹ and both the rate and severity of injuries at CHI declined by more than 50%.¹⁸² Reduced turnover and increased worker retention during the slow season are seen as contributing factors to these results (as workers did not have to be repeatedly trained).¹⁸³ Wages increased by 7% in 2020 and 12.5% in

2021, while operational concerns like procurement and scrap reduction also improved.¹⁸⁴

KKR paid an early dividend of US\$1,300 to US\$4,000 to each worker who had been at the company for at least two years.¹⁸⁵ Over the course of KKR's ownership, hourly workers and truck drivers received an average of US\$9,000 in dividends each, in addition to a payout of equity upon the sale of the business.¹⁸⁶

In May 2022, KKR sold CHI to Nucor Corporation, valuing the company at US\$3 billion, or 10 times KKR's initial investment.¹⁸⁷ Total investment returns from the sale are estimated to be US\$2.7 billion. According to KKR's press release, 800 employees received an average of \$175,000, with some veteran truck drivers receiving over US\$800,000.¹⁸⁸ This payout amortized over the years of working at the company (assuming four years) is approximately US\$44,000 per year.

Though this demonstrates a valuable step in the right direction by a private equity firm, it is important to consider the distribution of equity and ultimate pay ratios between workers, management, and fund managers in any given deal, particularly when it comes to managing the system-level risk of inequality.

While the potential for private equity firms to structure more worker ownership deals is appealing, it is also important for asset owners and allocators to consider not just what workers are paid, but the distribution of risk and return across all participants in the "capital markets value chain," from asset owners and allocators, to asset managers, to corporate management, and workers. Private equity firms typically capture a significant amount of value created, which has led executives of the largest private equity firms to become some of the highest paid globally.¹⁸⁹ Thus, even when a worker is paid a living wage or is given an opportunity to participate in the distribution of returns, the amounts often pale in comparison to the executives of these large fund managers. These dynamics can result in pay ratios that are much higher than the average CEO-to-worker pay ratio (approximately 344:1) that already concerns many Americans.¹⁹⁰

Taylor Guitars – an institutionally backed private debt transaction to facilitate a full worker ownership conversion

Founded in 1974, Taylor Guitars is one of the largest guitar manufacturers in the U.S., with over 1,200 workers and approximately US\$150 million in revenue in 2021. Through succession planning, the company worked with Social Capital Partners (SCP), an impact investor, to structure the financing of an ESOP. Given the ability of many Canadian pension funds to pursue direct deals, SCP was able, alongside the founders of Taylor Guitars, to partner with the Healthcare of Ontario Pension Plan (HOOPP), which has US\$100 billion in assets under management, to provide debt financing for the sale of 100% of the shares of Taylor Guitars from the founders to an ESOP trust representing its workers.¹⁹¹

The details of the structure of the deal are not public, though several elements are in the public domain. SCP played a role comparable to a private debt manager, in this case acting as a fundless sponsor to bring in HOOPP – a sophisticated long-term institutional investor. Importantly, the transaction met HOOPP's size and risk-return thresholds for commercial investment, supported the investor in achieving its members' retirement goals, and resulted in positive impacts that contribute to lowering the systematic risk of inequality. Meanwhile, due to the seller financing provided, the company founders were able to retire with more cash upfront than with a traditional ESOP financing, as well as a strong and impactful legacy.¹⁹²

The company is now employee-owned, and employees will receive an annual grant of shares within the ESOP trust. The Taylor Guitars deal is unique in that it is one of the first, if not the only, instance to date of a pension fund participating directly in a full worker ownership conversion, with a targeted risk-adjusted rate of return. Some full worker-ownership conversions may not share the same level of worker participation in governance as the Homeland case study (above), but have the potential to include features with more worker

While all forms of worker ownership provide an economic ownership interest to employees, they do not always offer comparable levels of enhanced governance rights. Many worker ownership models do have the potential to integrate strong worker voice components,¹⁹⁴ such as works councils, board seats for employees, or forms of open book management. As noted, worker-owned cooperatives are typically governed democratically by workers, with the majority of board seats elected on a “one member one vote” basis. On the other hand, ESOP Trusts typically have more traditional board governance, though they can also have board members elected by employees or investors. Depending on the worker ownership model used, there can be varying degrees of flexibility on the structures of governance but generally research suggests, greater worker representation or engagement enhances alignment and performance.

Worker ownership, when designed with best practices and coupled with worker engagement – such as grievance mechanisms, workers on boards, freedom of association, and collective bargaining – can provide both companies and investors with valuable outcomes, including increased productivity, job retention, lower injury rates, along with income and wealth benefits to workers, in turn reducing overall inequality. This can be a helpful strategy to managing risk in portfolios, and investors have a growing range of tools and resources available to include worker ownership in their investments.¹⁹⁵

COMMUNITY OWNERSHIP

Similar to worker ownership, community ownership can offer the communities impacted by a company with a path to build wealth and to constructively contribute to solutions that support stability and development of the area. It can help community members in building agency and voice in society, advancing civic engagement that supports stable democracies, economies, and therefore markets.

Community ownership offers ways to simultaneously align community interests with those of management and investors, as well as to integrate a community’s voices into investments. As owners, communities are empowered to participate in decision-making that will benefit their local ecosystem and holistically integrate new projects and investments in the area. Some of the most effective community ownership models support local job creation, safe and affordable housing, agreements to locally procure certain goods and services, periodic payments, and ongoing governance and engagement tools, such as board representation, community liaisons and councils, comment boxes, and grievance mechanisms. With local knowledge and lived experience in a community, residents have strong insights and incentives to protect local assets and contribute to their success.¹⁹⁶

When communities welcome, for example, an infrastructure or development project, they take significant risks in terms of land commitments, access to ecosystem services, health and safety, and other factors that pertain to their long-term well-being. Equity ownership can provide an important way to compensate communities for the risk that they take and value that they create throughout the life of a project. As with workers, sharing ownership with the local communities that host a project results in a stronger alignment of incentives.

The Wataynikaneyap Transmission Project delivers benefits to all

Wataynikaneyap Power LP (Watay) is a licensed transmission company in Canada, with 51% of the company equally owned by 24 First Nations communities and 49% owned by a subsidiary of Fortis Inc. and other private investors.¹⁹⁷ The First Nations communities have the option to increase their ownership and control to 100% 25 years after the operational date for the

transmission line. This project demonstrates how the public equity investors of a company such as Fortis can engage with their portfolio companies to pursue similar transactions.

The project was established to connect remote First Nations communities as well as surrounding areas to the electrical grid, thereby reducing the region's and First Nations' reliance on diesel generation. In 2016, Ontario officially selected Wataynikaneyap as the transmitter to undertake the project.¹⁹⁸ The project has received widespread support and government funding.¹⁹⁹

Community engagement for the project was led by the First Nations involved, and while not all 24 First Nations will benefit from the transmission line's connectivity, neighboring communities will still benefit from shared ownership in the company. The project, Fortis notes, is benefiting greatly from community participation, including local community knowledge and employment that has supported the project's outcomes in terms of routing, project design, and construction.

The proposed transmission line to these communities is estimated to save US\$1 billion from reduced diesel dependency, with the cost of diesel generation for a subset of First Nations communities estimated at around US\$43 million per year and growing.²⁰⁰ The project will prevent 6.6 million tons of greenhouse gas (GHG) emissions over 40 years through the replacement of diesel fuel.²⁰¹ It is also estimated that it will create 769 jobs during construction and nearly US\$900 million in social value,²⁰² as well as a steady stream of revenue from providing electricity to the communities.²⁰³

The US\$1.5 billion Cascade Power project in Alberta is another example of a community ownership model benefiting First Nations which also involves institutional investment.²⁰⁴

Community ownership can also include projects structured with minor percentages of community ownership – often as settlements for past disputes or as a part of broader corporate social responsibility programming (i.e. as part of impact benefit agreements (IBA)).²⁰⁵ Often in such arrangements, particularly given the minority position of community owners, equity ownership does not include influence over the project or company that would be notably different than what is offered through FPIC and traditional IBA processes. Ownership can also be negotiated to be held by a specific entity managed or governed by the community, such as a trust. In other cases – particularly with state-owned or managed enterprises – shares in the entity can be publicly listed for citizens to buy or can even be distributed to citizens.²⁰⁶ Governance and influence over a community project or company is typically commensurate with the percentage of equity ownership.²⁰⁷

Increasingly, impact investors are identifying opportunities to finance projects led by and mostly owned by Indigenous peoples. Partnerships with Indigenous peoples who have invested their own capital for equity ownership in a company or project, alongside a private developer or public utility, are sometimes financed in part through development loans, public grants, or subsidies, demonstrating the power of blended finance.

Navajo Power used blended finance²⁰⁸ to serve Indigenous Peoples

The launch of Navajo Power,²⁰⁹ a majority-Indigenous-owned public benefit corporation, has raised nearly US\$10 million from impact investors to further catalyze approximately US\$3 billion of clean energy infrastructure investments into Indigenous communities by 2030. Navajo Power is currently developing several projects and has committed to invest at least 80% of its profits in new projects within these communities.²¹⁰ Moreover, the communities where projects are built become shareholders of Navajo Power through a "Turquoise Share," representing 10% of the company's ownership, with the opportunity to benefit from dividend distributions.²¹¹

Navajo Power's financing includes an anchor US\$3 million program-related investment by the W.K. Kellogg Foundation, which took on equity risk but structured the deal as flexible debt in

order for Navajo Power to retain Native ownership of the company. This structure also advances the company’s mission of maximizing economic benefits for partner communities.²¹² While catalyzed through flexible capital that was not subject to commercial risk-adjusted returns, as Navajo Power grows it may be well-positioned to offer attractive financing opportunities for larger institutional investors with mandates requiring risk-adjusted returns. The concept of blending these forms of capital is referred to as “blended finance.”

Communities and investors are beginning to explore opportunities to build stronger partnerships through shared equity ownership in other assets besides infrastructure. In the U.S., there are increasing examples of real estate development featuring community ownership, though fewer examples with institutional investor participation. For example, Los Angeles Community Ownership Real Estate (LA CORE) was founded by several local organizations to bring commercial real estate under the community stewardship of local nonprofits to best serve local residents. LA CORE has acquired at least five commercial properties with 19 leasable units, for a total of US\$10 million, US\$3 million of which was financed with New Market Tax Credit equity provided by JP Morgan Chase.²¹³

As community ownership grows in popularity, there has been interest in seeing how these models can apply to platforms such as Facebook, Airbnb, Uber, and Lyft, where users, renters, or drivers participate in the ownership of the platform. Such approaches have strong potential for positive impact, though they are still in nascent stages of development and not yet accessible to institutional investors. New policy interventions can help incentivize and break down barriers that might otherwise prevent their development.²¹⁴

The case of REI offers valuable lessons for big companies

Recreational Equipment, Inc. (REI) is the largest U.S. consumer cooperative, with US\$3.7bn in revenue in 2021. For a one-time fee of US\$30, members receive a 10% dividend for life on purchases of full-priced items, along with other benefits.²¹⁵ In 2021, the company distributed US\$234 million in member rewards.²¹⁶ With membership, a customer becomes a partial owner of the REI Co-op. As stated by former CEO Dennis Madsen, “...when customers are owners, their interest is not solely about earnings. They’re interested in seeing good products and prices at their stores.”²¹⁷ As well as receiving an annual dividend, members are also able to vote for the board of directors.²¹⁸

In the last few years, REI workers at two of its largest retail stores have been working to unionize, an effort that has not necessarily been welcomed by REI managers.²¹⁹ While a given stakeholder mechanism, like community ownership, may benefit and give voice to one stakeholder of the company, it does not guarantee voice or benefits for other stakeholders – in this case, workers. As such, investors should remain mindful of the needs of all stakeholders and of mechanisms that allow for balanced representation across key stakeholder groups.

There are multiple paths for institutional investors to engage with and benefit from these models, from investments through public equities (like the Watay transaction), to private equity or private debt (like the Navajo Power transaction, which also leveraged catalytic capital). In terms of accessibility, there may also be opportunities for smaller projects to be aggregated into larger financing packages, for example by asset managers or holding companies.

Community ownership does not guarantee community voice and governance control or influence. While wealth benefits from equity ownership can build community and worker voice more broadly across society, the commensurate structures of corporate governance – and other levers of stakeholder input including FPIC – are needed alongside ownership to support the strong communication and cooperation essential in any partnership. Best practices are emerging and evolving, and strong models of community ownership provide an important platform for communities to engage with and benefit from corporate projects and operations that directly

impact them. Still, it is critical not to view community ownership as a replacement for good regulatory processes from governments, inclusive community engagement processes from companies, and rights-based approaches to interactions with Indigenous Peoples and other marginalized populations. Instead, community ownership should be seen as one important mechanism of stakeholder engagement and input, to be used in concert with other mechanisms such as freedom of association and collective bargaining, grievance mechanisms, HRDD, FPIC, and others.

GOVERNMENT OVERSIGHT IS ESSENTIAL TO ECONOMIC STABILITY

Over the past several decades, the private sector has generally advocated against government reach and oversight, arguing that regulatory efforts hinder profits. However, many are recognizing that increased government oversight can be beneficial to long-term investors, helping them hedge against financial risks and compete in the market on a level playing field. For example, as a result of weak regulation and a lack of private sector accountability (particularly in some financial sectors), the 2008 financial panic and ensuing 2009 global financial crisis led to the destruction of US\$20 trillion in financial assets held by U.S. households.²²⁰

Importantly, governments can enforce transparency and act as a check against corporate fraud and wrongdoing, all of which have an impact on financial value. As the world faces increased threats of climate risk, biodiversity loss, and inequality, policy and regulation help private market actors solve collective action problems that otherwise result in a “prisoner’s dilemma.” By using various tools – regulation, taxation, and enforcement – government oversight, when effectively conducted, can support positive long-term outcomes for a company’s stakeholders, including its investors.

REGULATION AND ENFORCEMENT

A well-functioning and robust regulatory regime is indispensable to the proper functioning of any economy.²²¹ Investors are likely to experience increased gains from regulation in the following ways:

1. Regulations can help ensure greater transparency from companies and investors about their business conduct, minimizing the risk that investors are harmed because of unethical practices by other private sector entities, which can be detrimental to a company’s or portfolio’s long-term potential to create value.
2. Regulations can ensure that no one company or investor, or group of companies or investors, has an unfair advantage, especially in sectors where market concentration is high and where dominant players make it extremely challenging for new and innovative participants to enter the sector.
3. Regulations can result in standardization, comparability, reliability, and consistency of data, making it more possible for investors to assess and evaluate the impacts, risks, and opportunities across their portfolios.
4. The benefits of government regulation can enable investors and companies to act responsibly without fear of losing a competitive edge.

Improved policies that ensure protection and benefits for stakeholders such as women can benefit investors

Women and girls undertake more than three-quarters of unpaid care work in the world and make up two-thirds of the paid care workforce.²²² On average globally, a woman will work four more years in her lifetime than a man because of her unpaid care responsibilities.²²³

During the pandemic, as schools shuttered, women resigned from the workforce in large numbers to tend to care responsibilities at home. In the U.S., while both parents took on more childcare responsibility, working mothers were more likely to disproportionately cut down their working hours than working men.²²⁴ The high cost of childcare resulted in many working

mothers decreasing hours or leaving the workforce entirely.²²⁵ At the peak of COVID-19, economists believed that the economy may have been prevented from growing by US\$30 trillion due to women leaving the workforce.²²⁶

Caregiving responsibilities predominantly fall on women and restrict their ability to participate in the workplace,²²⁷ while childcare costs continue to keep many of these women from re-entering the workforce.²²⁸ The U.S. lacks federal policies to support unpaid and underpaid care workers and to meet the needs of working families, caregivers, and care workers.²²⁹ The U.S. economy will lose US\$290 million per year in GDP by 2030 and beyond if the number of paid caregivers does not increase.²³⁰

Government action to compel investment in childcare, paid leave, and pay equity would ease the burden on women, increasing the talent pool and providing a path for many to return to work, which would be beneficial for companies, investors, and the economy as a whole.

The efforts of some private sector entities to influence public policy and regulations to serve their own interests – particularly through lobbying, political spending, and other political activities – limit and undermine the ability of stakeholders to hold companies to account. It can also lead to disenfranchisement of Americans who see that individual citizens’ influence in societal decision-making is overshadowed by large companies and investors. Weakened regulations have resulted in environmental damage, increased climate risk, exacerbated discrimination and inequality in the workplace, market concentration and the rise of monopolies and oligopolies, poor working standards, aggressive tax avoidance, and increased data privacy concerns. Investor support to advocate for public policy that will regulate private sector lobbying and political spending is critical.

For corporate and investor agents who want to act responsibly, codified regulations and corresponding sanctions represent an important assurance mechanism. They lessen the risks that a business will become uncompetitive if it lives up to certain standards, insofar as other companies cannot undercut it by taking shortcuts or externalizing costs. The other side of this point is that widespread irresponsibility and frequent misconduct can trap all parties.²³¹

Tools to enhance transparency, oversight, and accountability are needed to tackle corporate concentration

Most of the literature on shifting to a more accountable form of capitalism is focused on what is happening within firms, but it is essential to look also at what is happening between firms. Today, monopolies are characteristic of many industries in the U.S.²³² Corporate concentration through mergers and acquisitions often allows dominant corporations or monopolies to increase their market power, with many ultimately abusing their dominance by engaging in a wide range of anticompetitive market conduct to benefit their bottom line.²³³ According to a 2022 report from the American Economic Liberties Project, such concentration of power can result in “higher prices for consumers, lower wages, less business dynamism and lower startup rates, less innovation, lower growth, rising inequality, the hollowing out of rural areas... fragile supply chains, environmental damage, political capture, risks to national security, and the subversion of democracy (among others).”²³⁴ Such dynamics pose risks to diversified investors’ portfolios.

In the U.S., the Federal Trade Commission Act,²³⁵ the Sherman Act,²³⁶ and the Clayton Act²³⁷ are designed to address anti-competitive behavior and prevent concentrated markets. However, over the past several decades, agencies have been slow to stop the increasing number of mergers and acquisitions that have led to higher levels of corporate concentration. As such, it would behoove investors to support legislation that prohibits corporate concentration. Investors may also consider how their own capital allocation may contribute to monopoly-like dynamics and the system or portfolio-level financial benefits of “deconsolidating” capital flows to reach smaller fund managers and companies. For public pension funds, resourcing this diversification strategy may require additional funding approved by local legislatures.

Other meaningful government interventions that investors can support include creating a cost for carbon, ensuring responsible taxation, instituting penalties for poor labor and environmental practices, mandating minimum wages that reflect the cost of living, and instituting legal liability for corporate abuse.

For regulations to be effective, the government must also exercise enforcement. This can include a range of civil, criminal, and regulatory actions to protect against private sector wrongdoing. Enforcement can protect the bulk of investors from financial burdens should some companies or investors engage in illegal or unethical business conduct. Enforcement encourages better business behavior and reduces the frequency of excessive risk-taking. It is in investors' financial interests to support stringent enforcement actions.

TAXATION

Tax avoidance and profit shifting among multinational corporations and investors have resulted in lower tax revenues for countries across the globe.²³⁸ Because tax avoidance starves government of the resources needed to provide critical services and infrastructure on which businesses and investors rely, it can have wide-ranging and systemic impacts on society.²³⁹ This jeopardizes the long-term performance of investments, causing macroeconomic distortions with subsequent portfolio and system-level risks.²⁴⁰

Tax avoidance takes place at a large scale, with tax structures being manipulated across not only companies, but also investment vehicles and by asset managers themselves. One estimate suggests that corporate profit shifting results in government revenue losses of between US\$70 billion and US\$100 billion for the U.S. government and US\$312 billion globally each year.²⁴¹ In 2019, corporations allegedly shifted nearly US\$1 trillion in profits outside their home countries to tax havens, resulting in global corporate tax revenue loss of 10%.²⁴² In 2018, profit shifting across 79 countries cost these countries revenue on average 1% of GDP.²⁴³

Increased transparency – for example through corporate and investor public disclosure – is essential. Many countries are trying to curb aggressive tax avoidance practices.²⁴⁴ Country-by-country data would help investors assess exposure to increased tax enforcement, the potential for changes in tax legislation, and the geopolitical risks linked to companies' exposure to international markets. Additional transparency could help investors understand which of their investees to engage, and how. For example, some engagements may be with corporate managers, while others may be with asset managers about their own firms' structures. With improved information about the relationships between tax avoidance and financial risks, asset owners and allocators can also be equipped with the incentives and tools needed to reflect and improve upon their own internal practices.

CONCLUSION

Many of the examples and case studies presented in this paper clearly show that investors benefit substantially from a model of governance where diverse stakeholders share power and influence to hold companies accountable and share wealth more equitably.

Despite the good intentions of many in the institutional investment community, they often operate at a distance from most of the stakeholders – in particular, workers, communities, and customers – affected by their investments. Given the large size of financial institutions, it is not feasible for them to exhaustively monitor the activities of hundreds of businesses in their portfolios. Moreover, the governance and incentive structures of most institutions can lead investors to represent their own short-term interests, which can actually be detrimental to their diversified portfolios in the long run, as well as to other stakeholders. Even when traditional corporate governance tools are used to hold companies accountable, they often lack the ability to yield desired results. The mechanisms presented in this discussion paper begin to outline how, in addition to supporting responsible policy and regulation, investors can work with diverse stakeholders to build a more inclusive, stable economy through:

- Grievance mechanisms
- Freedom of association and collective bargaining
- Human rights due diligence
- Free, prior, and informed consent
- Workers on boards
- Worker ownership
- Community ownership

With each of these approaches offering unique corporate forms and approaches, this paper does not advocate for one mechanism over another, although it does emphasize that grievance mechanisms, freedom of association and collective bargaining, HRDD, FPIC, and support of effective policy and regulation are core baseline practices, while workers on boards, worker ownership, and community ownership models are important innovations that can bring baseline practices even closer to constructive models of stakeholder capitalism. Ideally, a given company will use an array of these mechanisms, the application of which will depend on the context and the unique opportunities, characteristics, and challenges that the business must navigate.

Importantly, the role of government in implementing supporting policy and regulation will be critical in the creation of an enabling environment for an inclusive accountable capitalism.

This list of potential interventions is not exhaustive. There are many others and variations, such as works councils and steward ownership models, that are beyond the scope of this paper and should be considered for further exploration.

Ultimately, this discussion paper is designed to catalyze stronger investor interest in these solutions. Further work will be needed to engage with investors and their advisors to improve pathways, technical support, and capacity building for wider implementation and uptake. As next steps, the authors intend to convene investor roundtables for these purposes throughout 2024 and invite you to join us.

ENDNOTES

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communities. In this paper, we use stakeholders to refer to workers, consumers, suppliers, other market actors such as small businesses, rightsholders, Indigenous People, and affected communities, in addition to the asset owners' own beneficiaries.

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with litigation. Directors are usually defendants in these suits, making it less likely that they would want to proceed with litigation.

- ³⁹ A shareholder (stockholder) derivative suit is brought by a shareholder or a group of shareholders on behalf of the corporation against the corporation's directors, officers, or other third parties who breach their duties. A shareholder can only sue when the corporation has a valid cause of action but has refused to use it, and the damage awards of the suit come to the corporation instead of the shareholder.
- ⁴⁰ If a jurisdiction has a strong judicial framework that is easily accessible, stakeholders may choose to seek legal recourse. However, in many cases, and even in jurisdictions with strong judicial frameworks, such mechanisms might not always be available, accessible, appropriate, or the desired course of action. In such cases, non-judicial and voluntary grievance mechanisms – if robust – can function as both a supplement to formal judicial grievance mechanisms, a means to remedy a rights violation, and a way to alert the company or investor to issues.
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investments in various initiatives which included installing air conditioning at the manufacturing plant, adding new breakrooms, building a new cafeteria with healthier food options and establishing an on-site health clinic. This improved worker health and safety, as well as morale. KKR also opened financial accounts for workers to help them improve their personal finances.

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Discussion Papers

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