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Lessons for ESG activists: The case of Sainsbury's and the living wage

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Sainsbury's, one of the UK's large supermarket chains, found itself in the crosshairs of ESG activism in 2022. That was when ShareAction, a well-known responsible investment NGO, filed the first Living Wage resolution in the UK.[1]

The proposal was this:

> *To promote the long-term success of the Company, given developing expectations on rewarding key workers, the opportunities and risks associated with the increased costs of living for workers in the UK, and growing expectations that responsible businesses pay the real Living Wage, we as shareholders direct the Company to accredit as a Living Wage Employer by July 2023.*
>
> *A commitment to pay the "real" Living Wage to all workers is in line with the recent investments by Sainsbury's in direct employees' pay. This should be done at reasonable expense and nothing in the resolution should be read as limiting the board's discretion to take decisions in the best interests of the Company.*

Among the 10 co-filers were blue-chip names in the UK investment world, including Legal and General, HSBC Asset Management, Fidelity International, Nest, and the Brunel Pension Partnership.

This Living Wage resolution was rejected by roughly five out of every six of the Sainsbury's investors that voted on the resolution at the company's Annual General Meeting on July 7, 2022. To understand how and why this measure failed to gain acceptance, it's useful to start by noting the difference between The Living Wage and the National Living Wage, which is briefly described in the box below.

Briefing: The Living Wage and the National Living Wage

The Living Wage is a non-statutory concept overseen by the Living Wage Foundation. To receive accreditation by the Foundation as a Living Wage Employer, companies must commit to paying not only all directly employed staff, but any third-party contracted staff providing a service for the company, at least the "real Living Wage." At the time of the resolution, that amount was £11.05 per hour in London and £9.90 per hour in the rest of the UK. By comparison, the statutory National Living Wage was £9.50 for workers aged 23 and over regardless of location. Those aged 22 and under are subject to the National Minimum Wage, which at the time ran from £9.18 per hour down to £4.81 per hour for those under 18 or apprentices.

The Living Wage is calculated on a bottom-up basis and designed to reflect the amount required to live a decent life in the UK. By contrast, the rather confusingly renamed National Living Wage is a statutory minimum set within a framework that aims to reach by 2024 a government target of two-thirds of median UK earnings. The rate of progression is set based on guidance from a statutory body called the Low Pay Commission,[2] which takes into account general economic conditions while aiming to avoid negative effects on employment and the economy overall. The Commission considers input from both employers and employee stakeholders in coming to its recommendation.

[1] Available at https://shareaction.org/news/shareholders-file-living-wage-resolution-at-sainsburys accessed 16th February 2023.

[2] For a detailed description of the Low Pay Commission's mandate and access to recent reports see https://www.gov.uk/government/organisations/low-pay-commission accessed 16th February 2023

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ShareAction clearly saw its Living Wage resolution at Sainsbury's as the opening salvo in a battle it intended to conduct with the entire UK supermarket sector. It was also one of the NGO's first efforts to draw attention to the importance of the "S" in ESG. The proposal described the resolution as a "litmus test for investors' social commitments amid the cost-of-living crisis."

Sainsbury's management, as readers must have guessed, recommended that its shareholders vote against the proposal.[3] The company pointed out that the vast majority of its direct employees and contractors were already paid the Living Wage. (And following dialogue on the resolution, management announced its intention to bring the pay of all direct employees in line with the current Living Wage.) But in resisting the measure, management also declared their objection to having changes in their employee and contractor pay decided by an external, non-governmental body like the Living Wage Foundation. As the company said in its response,

> We want to ensure we have the flexibility to pay the right rate of pay and benefits to our colleagues, considering the needs of all our stakeholders and the specific circumstances and company performance at that time.

And as management went on to emphasize (*in the bold type used below*):

> ***Fundamentally, we believe it is right for the Company and our stakeholders to make independent decisions regarding pay and benefits, rather than have them determined by a separate external body***.

HEAD ABOVE THE PARAPET

In an unusual move, Schroders, the well-known UK asset manager with one of the five largest investment positions in Sainsbury's, published *ahead of the vote* its rationale for its decision *not* to support the resolution. Kimberley Lewis, Head of Schroders' Active Ownership group, wrote an article titled, "Why Sainsbury's AGM is a Pivotal Moment for ESG."[4] After pointing out that Sainsbury's is widely recognized as a well-run company that considers all important stakeholders in key decisions and has invested heavily in its employees, the article then expressed the concern that imposing this further restriction on Sainsbury's at a time when no other UK supermarket was a Living Wage Employer could undermine the company's competitive position, which would end up doing economic harm to many of its employees and customers as well as its investors.

Lewis closed her article with a warning against the unforeseen risks of applying ESG factors "in a blanket way and without due consideration," describing it as "'unthinking ESG' … which harms the credibility of sustainable investing." Along with this warning, she also expressed her view of the outcome of the impending resolution as "a test of whether important nuances in these debates can be heard".

UNPACKING THE ARGUMENTS

There is much that could be said about this resolution. We might start by asking how ShareAction could claim that the resolution—which requires the company to adopt a floor on employee pay set by a third party—would leave board discretion wholly unaffected and intact, because the Living Wage Foundation "would merely set the minimum level". But while we are raising such questions about the NGO, we could also ask why Schroders, itself a Living Wage Employer, thinks that what is sauce for the goose should not be sauce for the gander too. Failure to explain its voting decision in the context of an Engagement Blueprint that encourages Living Wage adoption seems, if not an oversight, then at least a missed opportunity to provide clarity about its own convictions.

But my purpose here is more analytical than polemical, namely, to examine the claims on both sides of this debate when viewed through the lens of investor and board duties. To help with this analysis, I will start by providing a brief overview of the ESG decision-making principles that London Business School developed with The Investor Forum during 2021 in a project we called "What does stakeholder capitalism mean for investors?"[5] Then I will go on to argue that, however, much the framework supports Schroders' position, the underlying principles are not a free pass for companies and investors to ignore any ESG issue they find troublesome.

To illustrate this point, I'll also use the framework to evaluate another resolution, this one put forward in 2020 by a P&G shareholder on deforestation. In this case application of the principles leads to broad support for this resolution that, unlike the ShareAction resolution, not only passed but received the support of fully two thirds of its investors.

THE FRAMEWORK

The impetus for the collaboration between The Investor Forum and London Business School was investors' confusion and uncertainty about how to evaluate and respond to the multiple competing demands to act on ESG issues while lacking a clear framework for deciding which actions to pursue or support. The framework begins by recognizing asset managers' fiduciary duty to act in the interests of their clients. Despite common rhetoric to the contrary, not all ESG initiatives work to increase shareholder value, even over the long term. Some simply cost money.

None of this should be construed as denying that asset owners and end beneficiaries have non-financial objectives and concerns that may well sometimes lead them to view such costs as worth

[3] See the Chairman's Letter ahead of the AGM: https://www.about.sainsburys.co.uk/~/media/Files/S/Sainsburys/AGM2022/AGM%202022%20Notice%20of%20Meeting%20WEB.pdf

[4] Available at https://www.schroders.com/en/uk/tp/markets2/markets/why-sainsburys-agm-is-a-pivotal-moment-for-esg/?t=true accessed 16th February 2023

[5] "What does stakeholder capitalism mean for investors?", The Investor Forum and London Business School, January 2021, available at: https://www.investorforum.org.uk/annual-event-2022/ accessed 16th March 2023

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Doing Well by Doing Good?

There is evidence across a number of dimensions of ESG that doing the right thing can be rewarded by investors. This might be because ESG initiatives lead to improved productivity and profits. Or such initiatives could lead to the market assigning a higher valuation multiple to a given level of profit, either because of a perception of reduced reputational risk or some investors' (noneconomic) preferences for and "utility" derived from holding such companies.

In 2011, my LBS colleague Alex Edmans published a study in the highly regarded *Journal of Financial Economics*[6] that found that companies appearing on the "100 Best Companies to Work For" list delivered excess stock returns of some 2%–3% per annum over the 26 years from 1984 to 2009. And this was not a flash in the pan. In follow-up work, Edmans found that these results were largely replicated internationally. And others have confirmed the persistence of this finding through at least 2020.[7] Also telling, Edmans finds that not only are such high-engagement companies likely to beat analysts' earnings expectations, but that it generally takes investors up to 5 years to factor these benefits of effective employee engagement into stock valuations.

But just because ESG is sometimes rewarded does not of course mean that it always is. And this general finding on employee satisfaction cannot be taken to mean that increasing pay in low-margin industries automatically pays for itself. Indeed, even a study by academics at Cardiff Business School that was commissioned by the Living Wage Foundation, and was generally positive on Living Wage adoption, conceded that "where the bite of the Living Wage is relatively powerful, as is likely in low-wage industries, then more challenges ensue."[8]

bearing. But in such cases, asset managers' fiduciary duty to act in the interests of their clients imposes on them a second obligation: when intending to pursue ESG initiatives and investments that are *expected* to sacrifice long-run value (presumably without undermining the company's competitive position), corporate boards must first seek and gain the clearest possible mandate from their investors to make such (again, presumably modest) sacrifices. Launching major ESG initiatives involving large capital commitments that are *expected* to reduce shareholder returns *without such a mandate* is courting investor disapproval and, eventually, removal.

In our London Business School report with the Investor Forum, we suggested a three-part test to help investors determine the extent to which they should act on a given ESG issue:

- **Materiality**. For investors to have a mandate to act on a stakeholder issue, successful resolution of the issue (or failure to do so) should be expected to have a discernible effect on the company's long-run profitability and value; or in cases where some sacrifice of value is contemplated, the resolution should reflect a clearly expressed investor preference as articulated in the client mandate.

Where there is not a clear economic case and some sacrifice of value is contemplated, two further principles become particularly important:

- **Efficacy**. There should be a realistic prospect of investor action bringing about the desired change in the real world, such that the stakeholder benefit exceeds the cost incurred.
- **Comparative advantage**. Investors should act when and only when they are well-positioned to address and influence the resolution of the issue, individually or collectively, and as compared with other parties, particularly government or NGOs representing the stakeholders themselves.

Let's now try to apply these tests to the Sainsbury's case.

MATERIALITY

Our first principle—that shareholders should act on a stakeholder issue only when the stakeholder (or issue) is material to the company concerned—is a simple matter of prioritization. Sainsbury's employees are clearly an important contributor to, and have a material stake in, the company's long-run success.

But is the adoption of a Living Wage itself a material stakeholder issue, especially when Sainsbury's reports that the vast majority of its direct and indirect employees are already paid the Living Wage?

There are many lenses for assessing materiality. There is the traditional lens of *financial* materiality: stakeholder issues that clearly affect the profitability of the company. But in response to the criticism of this concept as too narrow, there is growing focus on *impact* materiality—cases in which corporate decisions impose hardship or "costs" on stakeholders, whether or not there is a discernible effect on corporate profits or value. And there is another version called *dynamic* materiality—involving those issues that, if unaddressed, could become financially material. For example, consumers' concerns about corporate treatment of workers in supply chains could end up influencing consumer purchasing habits. Into this mix we also introduced the idea of *intrinsic* materiality, which applies to stakeholder issues relating to traditional social or moral expectations. Finally, stakeholder issues can be company specific or *systemic*, in the sense of affecting the economy as a whole rather than individual companies.

Let's start with financial materiality—does the issue of Sainsbury's Living Wage affect the long-run profitability and value of the company? ShareAction claimed that it does. In support of

[6] Edmans, Alex. 2011. Does the Stock Market Fully Value Intangibles? Employee Satisfaction and Equity Prices." *Journal of Financial Economics* 101(3): 621–640

[7] Boustanifar, Hamid and Young Dae Kang. 2022. "Employee Satisfaction and Long Run Stock Returns 1984-2020." *Financial Analysts Journal* 78(3): 129–151.

[8] Heery, Edmund, David Nash, and Deborah Han. 2017. *The Living Wage Employer Experience, Technical Report*. Cardiff University.

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its proposal, Rachel Hargreaves, ShareAction's Campaigns Manager, stated that "research has consistently demonstrated a positive business case for Living Wage rates, even in low-margin sectors such as retail." And consistent with Hargreaves' argument, there is in fact a theory of "efficiency wages" that hypothesizes that companies choosing to pay above-market wages may get a payback in the form of higher-quality and more productive employees. Such a policy is widely viewed as a major contributor to the widely heralded success of the U.S. company CostCo.

But evidence about the more general case is mixed, and invariably contested. The possibility that higher wages *can* be repaid through higher productivity does not mean they are generally *expected* to be. And, of course, in all cases there is some level of wages at which the relationship will turn down and become sharply negative.

One of the most important tasks and responsibilities of Sainsbury's board and executive team is to determine to what extent, if at all, they want to deviate from market norms in how the company rewards their employees. The board and management are highly experienced, and by all accounts well-attuned to employee attitudes and have clear incentives to improve the company's long-term performance. Is it plausible that Sainsbury's shareholders know more than its management about the wage rates likely to maximize returns?

Moreover, it is not just Sainsbury's board that takes this view. No other UK supermarket is a Living Wage Employer, and this group includes both public and private companies, and those owned by families as well as by private equity firms. How likely is it that *all* of these companies and management teams are missing an easy win-win from increasing wages to increase long-run profits and value? The onus falls on those making this case to prove it. The shareholders supporting the resolutions have notably failed to provide convincing evidence.[9]

This seems to be a case of ESG irrational exuberance and overreach: the desire to claim that any and all ESG activity should be expected to improve long-run performance. But if Sainsbury's management and every other management team in the UK supermarket sector is missing this obvious way to increase long-term value, then rather than filing a Living Wage resolution, investors should simply be firing the boards and installing new managements.

But financial materiality, as we have already seen, is not the only form of materiality. What about impact materiality and systemic risk? Here the materiality is determined by the extent of the company's impact on stakeholders rather than stakeholders' impact on long-run corporate profitability and value. There is little doubt that Sainsbury's could dramatically improve the standard of living of a great many of its employees by, say, increasing their wages by a fifth. But in the grand scheme of things, even the number of such employees is relatively small in number. And ShareAction, it's important to recognize, is going after a much bigger target—economy-wide inequality. As their Sainsbury's proposal states, "low pay drives inequality which slows economic growth and stokes instability, presenting material risks to investors."

And there is in fact some evidence for the negative impact of inequality on growth. But that evidence is far more compelling in the case of developing, low-income than developed, high-income nations—and, here again, the evidence is mixed and disputed.[10] Such is also true of the evidence for inequality being a major contributor to "systemic risk." And as we shall see, the ability of shareholder action to affect such systemic risks is quite limited.

But what about the argument that ESG initiatives can be justified in terms of their *intrinsic* materiality—their appeal to investors' collective commitment to morality, social justice, and corporate purpose. ShareAction also pushed on this front. In the words of Rachel Hargreaves, ShareAction's Campaigns Manager,

> There is no excuse for a highly profitable company with multimillion pound executive salaries refusing to guarantee all its staff, including subcontracted workers, a basic standard of living … the moral case [is] compelling…

But if this appears to be the strongest form of materiality at work in the case of Sainsbury's, there are some major challenges for asset managers when attempting to take actions that purport to represent the moral views of their investor clients. I will later return to these challenges when taking up the question of companies' need to seek, or at least clarify, client mandates for their ESG initiatives.

EFFICACY

Our second principle, efficacy, states that investors should act only when confident about their ability to bring about the desired change in the real world, and in such a way that the stakeholder benefits exceed the associated costs.

If the desired benefit is to increase the wages of affected Sainsbury's employees and contractors, then clearly the shareholder resolution would directly achieve this. But what about the wider impact on the systemic issue of inequality, which also seems clearly to motivate the proposal?

Here the overall consequences are much less certain. If the resolution is successful, that could lead to an industry-wide change in practices. But in what is at least an equally plausible outcome, it could simply make Sainsbury's uncompetitive, leading to loss of market share to companies not adopting the Living Wage policy. Also worth noting is the possibility that, even if investors were successful at passing resolutions at all the *listed* supermarkets, the steadily growing proportion of the UK market subject to *private* control, including Aldi, Asda, Lidl, and Morrisons, would

[9] In response to a challenge from ShareAction, I produced a detailed analysis of their evidence for the business case for living wages, showing why it did not prove the case. The detailed analysis can be found at: https://www.tom-gosling.com/blog/on-share-actions-evidence-for-sainsburys-living-wage-resolution accessed 16th March 2023

[10] Mdingi, Kholeka and Sin-Yu Ho. 2021. "Literature review on income inequality and economic growth." *MethodsX*, 8, https://doi.org/10.1016/2Fj.mex.2021.101402

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use their lower wages to accelerate their growth in market share.

So, even though Sainsbury, Tesco, and Marks & Spencer could become the firms that determine wages in the economy, the alternative outcome is that they become less competitive and lose market share to private firms. We don't really know how such changes will play out. Therefore, while the Living Wage has symbolic appeal, it's efficacy is surrounded by doubt.

Furthermore, does the stakeholder benefit outweigh the cost of the action? Again, this is very unclear. The additional costs of fulfilling the Living Wage commitment are very likely to be reflected in some combination of reduced returns to shareholders, reduced employment, and increased prices. Indeed, the study by researchers from Queen Mary University[11] cited by ShareAction in support of their case mentions that adopters of the London Living Wage have tended to offset the higher wage costs through a variety of actions, including changes to contracting terms, reduction in headcount or hours, and changes in service specifications and supplies—and, in some cases, acceptance of reduced margin. And since there is no evidence suggesting that overall net stakeholder value will increase, the probable effect of a mandated Living Wage is a "wealth transfer" from one set of stakeholders to another. And most important to keep in mind, it's not just shareholders who would bear the costs, but also the customers who pay the higher prices, and the current or future workers who suffer from the potential reduction in employment at the company.

Overall, then, the proposal fails the test of efficacy.

COMPARATIVE ADVANTAGE

The last of the tests in our report is comparative advantage. Here the shareholder should consider whether they (or the company whose shares they hold) is particularly well-positioned to address, or at least influence, the stakeholder issue. Even once they are satisfied that achieving the ESG outcome is in line with their clients' interests, asset managers should be using client money to this end only when their actions have at least a reasonable prospect of influencing the desired outcomes.

So, if the stakeholder issue is viewed narrowly as the pay of the particular affected employees and contractors at Sainsbury's, then, yes, the company has comparative advantage. However, the ShareAction campaign has clearly cast a broader net, purporting as it does to address overall economic inequality.

Here it is not at all clear that investors or Sainsbury's have comparative advantage. System-wide issues such as the appropriate minimum wage levels run into many level-playing-field problems relating to competitiveness. In such cases, governments are generally best suited to address the issue of inequality directly through minimum wages, progressive taxation, and benefits—and, in the longer term, through policies on education, health, and housing.

We often hear the argument that governments are failing to act on ESG issues. But the area of minimum wage rates in the UK seems to be one area where this criticism is unfounded. The UK Government has established a rather well structured and mature process that is overseen by the Low Pay Commission[2], a process that has support from across the political spectrum, and which takes into account a wide range of stakeholder and economic considerations. Indeed, the current Government has mandated the Low Pay Commission to increase the statutory National Living Wage towards two-thirds of median earnings as quickly as possible consistent with its mandate to consider employment levels and the health of the economy more broadly. So, of all the ESG issues that could be singled out, this is one where the institutions of Government appear to be among the most effective.

And that, in brief, is why the ShareAction proposal violates the principle of comparative advantage.

INVESTOR PREFERENCES

Our analysis up to this point shows that the rationale for shareholders supporting the Living Wage resolution at Sainsbury's rests on a shaky foundation. It is largely inconsistent with our three key principles of materiality, efficacy, and comparative advantage.

Nevertheless, when dealing with the question of materiality, I did allow for the possibility that investors' collective sense of morality, of the need to distinguish right from clear wrong, could lead them to support the proposal, thereby outweighing the other considerations. In other words, investors should not support companies that become "bad actors."

The problem with this argument, however, is that should such cases arise, asset managers would need to have crystal-clear mandates from their investor clients identifying and articulating such moral objections as their main reason to act. Without such mandates, asset managers would be using "other people's money" to pursue actions with no economic benefits in view and for which neither asset managers nor their investor clients are well-positioned to expect a successful outcome.

So, this begs the question: Why not just assume that most people would consider payment of the Living Wage a moral imperative? The answer to this question is, it's not at all clear how we establish this. As just noted, we have a political system that has resulted in a quite consistent and well-developed approach to setting a National Living Wage—one that, it's important to note, has not been subjected to the intense cross-party disagreement that has for long been the dominant note in UK politics. Indeed, the UK approach to minimum-wage setting has elicited a striking degree of bi-partisan unity that has persisted for over a decade among Labor, Coalition, and Conservative Governments. Thus, it surely seems reasonable to suppose that many if not most UK citizens view the *National* Living Wage as an adequate response to the problem of in-work pay rates.

Given the difficulty of assuming that clients' views will differ from the prevailing political consensus, my recommendation was that investors voting in favor of the ShareAction proposal have a very clear and explicit mandate from their investor clients directing the asset managers to back the proposal with their (investors') capital. The same asset managers should also clearly inform their investor clients of the potential for negative effects on shareholder returns, failure of the actions to lead to the desired social

[11] Wills, Jane and Brian Linneker. 2012. "The costs and benefits of the London Living Wage." available at https://www.qmul.ac.uk/geog/media/geography/livingwage/docs/Livingwagecostsandbenefits.pdf accessed 27th March 2023

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outcomes, and potential unintended. Including the possibility noted above of regressive distributional effects. Given all these possible outcomes, and the dearth of evidence about how things will play out, it would be foolhardy for investors to rely on the kind of "win-win" argument presented by ShareAction.

THE OUTCOME AND LESSONS LEARNED

When I published these arguments in June of 2022, it clearly struck a chord. A number of investors contacted me to thank me for the reasoned analysis. Further suggesting the article was getting some traction, ShareAction published a rebuttal, to which I then felt obliged to respond.[12]

At the AGM that was held on Thursday July 7, 2022 to decide the proposal, 83.3% of investors voted against it, with only one in six supporting it. The vote thus failed not only to pass, but to meet the 20% level that the UK Corporate Governance Code and the Investment Association views as conveying a "significant" level of investor opposition to management. Notwithstanding this level of investor opposition to the proposal, ShareAction saw fit to evict Schroders from the Good Work Coalition they had established as an investor collaboration to engage with companies to encourage them to adopt better working practices.[13]

There are a number of important lessons for ESG activism that can be drawn from this case. After the AGM took place, I identified four.[14]

The resolution should not be overly prescriptive

A resolution that binds the hands of a board in an operational action is extremely unlikely to succeed. Most investors are very reluctant to second guess the business judgment of the directors they appoint to oversee the management of companies. The Sainsbury's resolution as drafted, by mandating a higher than statutory minimum wage set by an external party, had no chance of getting widespread support from either proxy advisors or the very large, especially U.S.-headquartered, funds, which include the big index funds.

Experience from the U.S. suggests that a resolution requesting *disclosure* would be more likely to be successful, something like this:

> *Shareholders request that the Sainsbury's board produce a report on the feasibility, costs, and benefits of becoming a Living Wage accredited employer.*

Such an approach, if well received, might then be used across the entire sector as the launch point for a gradual process of ratcheting pressure and engagement.

ShareAction clearly hoped that the threat of a resolution would cause Sainsbury's to buckle. But in fact, the nature of the resolution gave Sainsbury's an easy reason to refuse, and there was no chance of it being passed in the form it was written.

The business case needs to be compelling and made with precision and care

ShareAction adopted a rhetorical strategy that focused largely on the moral case for supporting the resolution, as is clear from its written statements and the comments by co-filers cited in their announcement of the action.[15] But although they didn't entirely sidestep the business case, their treatment was at best perfunctory, pointing to "well-documented business benefits of paying higher wages, including higher staff engagement, higher productivity, reduced turnover and training costs." However, ShareAction failed to provide credible evidence that the business benefits to Sainsbury's of paying the Living Wage, let alone committing to long-term Living Wage accreditation, would outweigh the costs, particularly when required to do it as just one player in a competitive low-margin industry. (And for those interested in my own detailed analysis of ShareAction's failure to support its business case, you can find it in my response to its rebuttal of my initial article.[16])

In an industry in which no board, whether of a listed, private, or family-owned supermarket, has chosen to gain Living Wage accreditation, the onus is on the proposer to demonstrate the business case for its resolution. Otherwise, why are all these companies forgoing the win-win opportunity identified?

Of course, investors are free to take a different view of the evidence or to have an investment belief relating to the business value of Living Wages or the systemic risks of inequality. But for most investors, the lack of a well- formulated and -buttressed financial case becomes a decisive obstacle, a reality I now turn to.

The nature of investor mandates needs to be taken into account

As things turned out, then, ShareAction's moral case proved far more powerful than its business case. But a vote inspired by moral conviction, when it appears almost certain to impose large unrecoverable costs on the company, presents a dilemma for asset managers with fiduciary obligations to their investor clients. As noted earlier, asset managers voting their own moral convictions would need a very clear mandate from those clients to justify such a use of what again, and after all, is the clients' money.

And the reality is that such mandates by investor clients to their asset managers rarely get very specific. Engagement and voting policies on Environmental, Social, and Governance issues are normally couched in terms suggesting that ESG investor initiatives will work to increase long-term value and returns, in many

[12] https://shareaction.org/news/living-wages-for-supermarket-workers-decision-time-for-investors and https://www.tom-gosling.com/blog/on-share-actions-evidence-for-sainsburys-living-wage-resolution accessed 16th March 2023

[13] https://www.responsible-investor.com/schroders-asked-to-leave-fair-pay-group-over-sainsburys-living-wage-vote/ accessed 16th March 2023

[14] https://www.tom-gosling.com/blog/what-esg-activists-can-learn-from-the-sainsburys-living-wage-case accessed 16th March 2023

[15] https://shareaction.org/news/shareholders-file-living-wage-resolution-at-sainsburys accessed 16th March 2023

[16] https://www.tom-gosling.com/blog/on-share-actions-evidence-for-sainsburys-living-wage-resolution accessed 16th March 2023

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cases by reducing investors' perception of risk rather than increasing the bottom-line. But either way, none of the ESG proposals I have seen create any expectation, or even contemplate the possibility, that asset managers will vote in ways that sacrifice long-term shareholder returns.

All of which points to an important lesson for ESG activists: The clarity and shared understanding of ESG mandates between asset managers and asset owners is absolutely critical to successful action, particularly in cases where the pursuit of ESG goals requires reductions in shareholder returns (a trade-off that, again, is rarely acknowledged as a possible outcome in the world of ESG).

The engagement strategy needs to broaden, not narrow, support

The language used by ShareAction did not seem to recognize the possibility that people with shared aims could have different views on the means to achieve them. Instead, the NGO threw down the gauntlet by describing its resolution as a "litmus test for investors' social commitments amid the cost-of-living crisis." The statement went on to say that "how investors vote will expose their true colours," and "We expect investors to support this resolution. The country will be watching closely to see how they vote."

At times the explanations for the resolution strayed into the political:

> "We have seen the Government increasingly criticised for failure to tackle the cost of living. Many have called for an Employment Bill to tackle low paid and insecure work, but one is yet to materialise."

And as they go on say,

> "This says a great deal about how thin the UK's social fabric is stretched just now. Thursday's vote at Sainsbury's AGM offers a chance to restore and repair the damage."

In sum, the language could—and to have any hope of winning supporters, should—have been less provocative and more inclusive. Surely, it's possible even for people who agree about the problem to disagree about how to solve it? Many thoughtful people are likely to find continued encouragement and engagement a more productive approach better than forcing Living Wage accreditation on one company in a highly competitive low-margin sector. Many are also likely to view a social challenge like economic inequality as addressed most effectively through an established political process like the National Living Wage and the benefits system—if only because the existence of a relatively mature National Living Wage system for minimum wages means that there are ESG issues on which investors can focus their attention with greater expectation of accomplished their desired outcome.

But ShareAction's proposal brooked no dissent. And in so doing, its criticism of Schroders seems unfair. Although Schroders' Engagement Blueprint stated its intent to encourage companies to pay a living wage, it seems that the investor had already been doing just that in its longstanding engagement with Sainsbury's. I did not interpret—nor can I imagine other large, sophisticated investors as reading—Schroders' Blueprint as requiring it to vote for every resolution that mandates that all companies to seek Living Wage accreditation, regardless of major differences in industry or economic circumstances.

In sum, banishing Schroders from the Good Work Coalition seems counterproductive. This must make Schroders, an investor who seems genuinely committed to engagement on workforce issues, much less likely to support ShareAction initiatives in future. It would also appear to create a significant disincentive for any major investor to join the Coalition in the future, given the risk of receiving similar treatment should they deviate from the ShareAction "party line."

For shareholder resolutions to succeed, they need to gain traction outside a highly motivated but narrow base of support into the broader investor community, which is very diverse in its views.

NOT A FREE PASS

But having raised these concerns about the ShareAction proposal, I find it important to say that the principles we developed with The Investor Forum do not provide a free pass for investors to ignore ESG issues. To illustrate this, let's briefly consider a different shareholder proposal.

A number of large public companies have recently faced shareholder proposals relating to deforestation.[17] In October 2020, the following resolution was filed at the P&G meeting:[18]

Shareholders request P&G issue a report assessing if and how it could increase the scale, pace, and rigor of its efforts to eliminate deforestation and the degradation of intact forests in its supply chains.

The rationale provided by the filer, Green Century Capital Management, was couched in terms of shareholder value considerations: the risk of supply chain disruption due to environmental degradation; competitive effects from falling behind peers on deforestation policies; and reputational and related financial risk. This presumably was intended to secure the support of major index funds.

But as I'll now demonstrate, the case could be made much stronger. What if the resolution had called for P&G to *take action* to reduce deforestation in its supply chains? How would this have squared with our principles?

Let us now briefly run through the application of the principles. And let's start with *materiality*. Green Century Capital Management made a case for financial materiality of the issue. There is a case for this. However, even if one remains unpersuaded by it, P&G by virtue of its supply chain clearly has a potentially material impact on the issue of deforestation. Given widespread concern about the environment, it is also reasonable to believe that the issue has intrinsic materiality in the eyes of a great many end clients of the asset manager.

What about *efficacy*? Large companies have significant ability to influence supplier practices through their supply chain. Moreover, there is very limited ability to reverse deforestation once it

[17] https://news.bloomberglaw.com/bloomberg-law-analysis/analysis-deforestation-shareholder-proposal-wins-signal-a-shift accessed 16th March 2023
[18] https://www.sec.gov/Archives/edgar/data/80424/000121465920007931/r916201px14a6g.htm accessed 16th March 2023

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has occurred. It is significantly cheaper to avoid deforestation in the first place than to remedy the effects once it has happened. Finally, innovation in new practices that enable production of goods without deforestation can have positive spill-over effects across an industry. Admittedly the competitive concerns outlined above still apply. But in this case, there seems to be a high probability that the net stakeholder benefits outweigh the costs by a very large margin, principally because of the gulf between cost of avoiding damage versus cost of remediation.

Third and last, what about the question of *comparative advantage*? Deforestation is an area where effective government regulation is difficult to define and put in place, and enforcement is extremely difficult. It requires collaboration between national governments and enforcement by countries where authorities and institutions may be relatively weak. Therefore companies, and by extension investors, seem particularly well placed to act in this area.

And so, in the case of action on deforestation, the principles of materiality, efficacy at reasonable cost, and comparative advantage are all likely to be met in many cases. Investors still need to be sure that they have a mandate from their clients given that some costs may arise. But the costs are likely to be manageable relative to the benefits, and asset managers may even be able to rely on general pro-social sentiments of end investors as a mandate for action.

Consistent with this reasoning, the Proctor & Gamble resolution was supported by 67% of shareholders.

NUANCE MATTERS

The recognition that shareholders have non-financial as well as financial preferences is welcome, as is the increased willingness of shareholders and their representatives to use their rights to seek to influence companies on ESG issues. ShareAction and Schroders have done us a service by enabling us to have this important debate on an “S” issue within the ESG universe.

But this needs to be done thoughtfully, with particular attention paid to the likely effectiveness of the action and its potential costs, considered in the context of asset managers’ fiduciary duty to, and mandates from, clients. A rather lazy narrative has grown up around the concept of “doing well by doing good” that is predisposed to view all ESG activities as beneficial for long-term value. But clearly, they are not. ESG interventions often involve trade-offs between shareholder value (even over the long-term) and stakeholder value. Moreover, they often result in trade-offs between different categories of non-shareholder stakeholders.

Asset managers need to undertake a rigorous analysis to figure out which ESG issues to act on and which to leave alone. The framework of principles we developed with The Investor Forum helps to do just this.

Thoughtful consideration of the principles suggests that Schroders was right to vote against the Living Wage resolution at Sainsbury’s. Costs to shareholders appear almost certain while the net stakeholder value remains highly uncertain and, indeed, quite plausibly zero. There are unpredictable distributional effects since, as we have noted, many low-income stakeholders may be more harmed than helped by the proposal. Shareholders are not nearly as well-positioned to address the issue of minimum in-work wages as the UK Government. And as we have seen, the UK has developed a widely accepted and generally quite effective independent process backed by a political mandate to set minimum wage levels.

None of this, to be sure, should be taken to mean that Sainsbury’s should absolve itself from responsibility for thoughtfully considering the level of fair pay for workers and contractors. The Living Wage provides a useful and relevant framework for this purpose. Investors should continue to engage with Sainsbury’s to understand how they are ensuring the well-being of their employees and monitoring conditions in supply chains. But the case is not made for investors to force upon the board a particular course of action on pay.

Finally, I am by no means suggesting that shareholders and companies be given a free pass on ESG. I’ve used the example of deforestation to show how the principles can lead to the conclusion that investors should support an ESG-related resolution. But shareholders don’t have unlimited capacity to engage companies on ESG issues; they must focus their energies and efforts where they can achieve the most effective outcomes and where there is most bang for their buck. Living Wage accreditation in the UK doesn’t meet this test. And so the overwhelming majority of shareholders were right to follow Schroders in voting against the resolution at Sainsbury’s AGM in July 2022.

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