THE INVESTOR CASE FOR FIGHTING INEQUALITY:

How Inequality Harms Investors and What Investors Should Do About It.

ACKNOWLEDGEMENTS

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About Rights CoLab

Founded in 2018, Rights CoLab is an experimental platform for expert-level collaboration across the fields of civil society, business, and finance. Rights CoLab develops and drives new approaches that leverage markets to advance human rights in the face of today's urgent challenges.

About Oxfam

Oxfam is a global organization that fights inequality to end poverty and injustice. We offer lifesaving support in times of crisis and advocate for economic justice, gender equality, and climate action. We demand equal rights and equal treatment so that everyone can thrive, not just survive. The future is equal.

INTRODUCTION

In September 2023, investors got yet another wakeup call to the high costs of economic inequality. The United Auto Workers (UAW) called an unprecedented strike against the Big Three U.S. automakers, demanding higher wages and increased protections for the companies' 145,000 employees. UAW president Shawn Fain signaled that inequality was a driving force for striking workers, asserting that, "This is what's wrong with our economy, and this is what's wrong with America right now. The billionaire class keeps taking more and more, and the working class keeps getting left behind."[1]

The UAW strike marked the culmination of what became known in the U.S. as "Hot Strike Summer," in which workers across the corporate ecosystem organized for better working conditions.[2] Cornell University's Labor Action Tracker recorded 449 strikes and nearly 600 other protests across the United States in 2023, spanning industries including food, education, media, healthcare, autos, airlines, restaurants, and agriculture.[3] The movement was widely seen as a reaction to stinging inequality: according to the Economic Policy Institute's assessment, "Precise answers are worker and action-specific, but it's worth noting the context—the U.S. economy has been churning out radically unequal income growth for decades."[4]

One year after Hot Strike Summer, the fight against inequality is nowhere near resolved. The private sector has long justified activities that produce negative externalities as beneficial to their bottom line — low wages keep costs down; tax avoidance preserves profits; high CEO and top executive pay is necessary to attract and retain skilled management. Shareholders focused on short-term returns often benefit from these practices as well. But such practices also generate significant financial risks for investors, particularly those with medium- and long-term investment horizons.

It's clear that workers alone cannot solve economic inequality, though their words and actions — like Hot Strike Summer — shine an uncompromising light on its impacts. Increasingly, as sustainability factors become more mainstream considerations for investment decisions, there is a growing imperative for investors to use their voice in the fight against socioeconomic inequality. And while it has historically been challenging for investors to justify investment decisions that may not favor short-term returns, new data and regulations are emerging to help them clearly demonstrate how inequality hurts investment performance in the long term.

DEFINING SOCIOECONOMIC INEQUALITY

The Organisation for Economic Co-operation and Development (OECD) defines socioeconomic inequality as disparities in income, wealth, and access to opportunities among individuals and groups within a society.

Socioeconomic inequality encompasses not only differences in economic resources but also in education, health, and social mobility, and includes the following key aspects:

1. **Income Inequality:** Variations in the distribution of income among individuals and households, typically measured using indicators such as the Gini coefficient, income quintile shares, and the ratio of income between the top and bottom percentiles.

2. **Wealth Inequality:** Disparities in the accumulation of assets, including property, savings, and investments, which can be more pronounced and persistent than income inequality.

3. **Educational Inequality:** Differences in access to quality education and educational outcomes, which impact individuals' future earnings and opportunities.

4. **Health Inequality:** Variations in health status and access to healthcare services, which are closely linked to socio-economic status.

5. **Labor Market Inequality:** Disparities in employment opportunities, job quality, and working conditions, which affect income and job security.

6. **Social Mobility:** The extent to which individuals can move up or down the socioeconomic ladder relative to their parents. Higher levels of inequality often correlate with lower social mobility, making it harder for individuals to improve their socioeconomic status.

According to the United Nations Development Programme (UNDP), socioeconomic inequality encompasses not only income and wealth differences but also disparities in opportunity, capability, and access to resources, as well as outcomes in areas such as education, health, and living standards — all key dimensions of human development.[5] The UNDP also highlights intergenerational inequality, which entails the transmission of socioeconomic advantages or disadvantages from one generation to the next, affecting long-term development prospects.[6]

These inequalities exist both in-country and between countries and are tracked over time in the UNDP's annual Human Development Report. Over the past few decades, income inequality in many developed countries, including the United States and within Europe, has grown.

At the same time, inequality in many developing countries remains high; for those that have seen economic growth, the benefits often are not evenly distributed, leading to significant disparities in income, opportunity, and access to services. There has been a trend of convergence between countries, particularly between emerging economies and developed countries, as nations like China and India experience rapid economic growth. The least developed countries continue to lag behind, leading to persistent inter-country inequality. Issues such as conflict, poor governance, and lack of infrastructure further hinder their economic development.

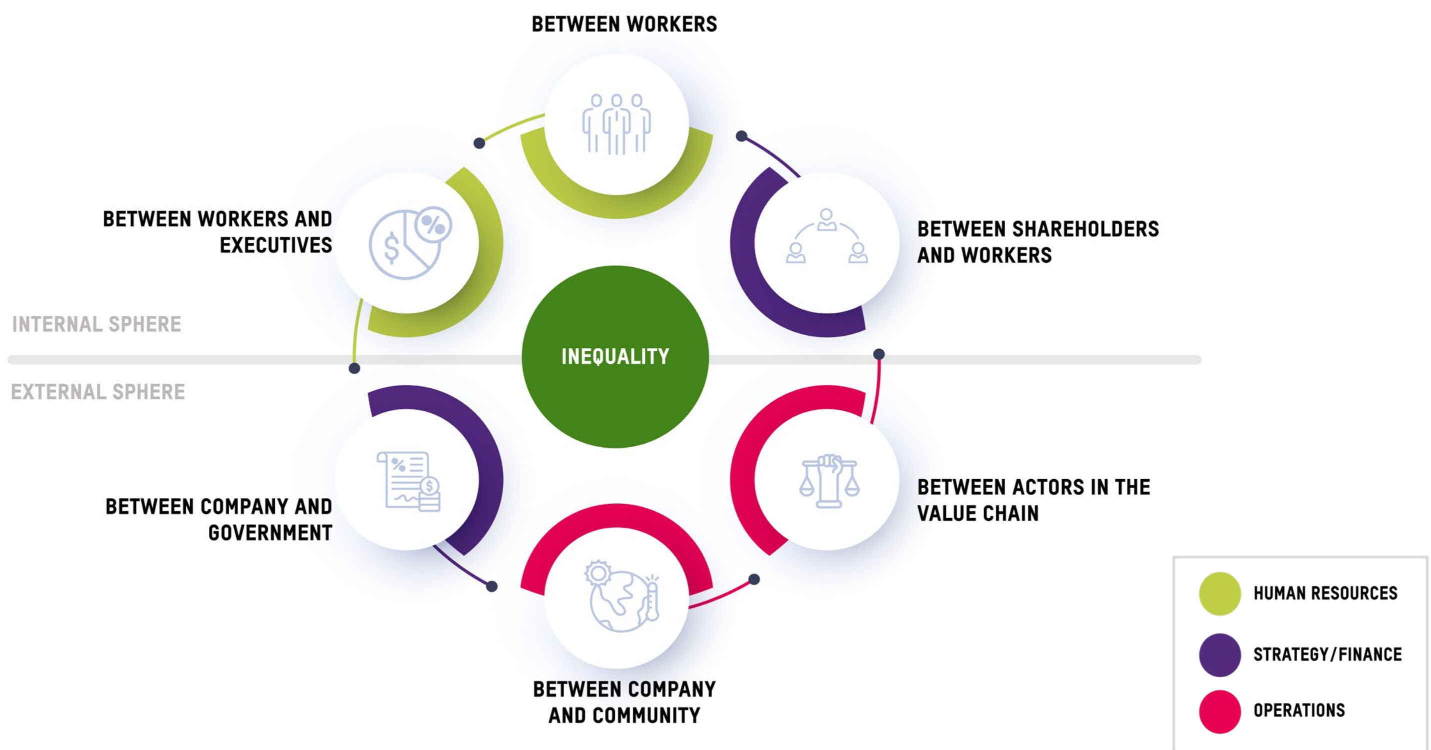
The Peterson Institute for International Economics has developed a three-part typology of proposed solutions:

- **Pre-production policies prepare people to enter the workforce, and include anti-discrimination, education, health, and financial access policies.**
- **Production policies relate to the existing workforce, and address inequalities in the workplace.**
- **Post-production policies redistribute income and wealth. Examples include progressive income taxation, wealth taxation, income support policies such as the earned income tax credit, and food stamps.**[7]

Investors have a role to play in ensuring progress on all three types of policies, but the "production stage" is where they can directly affect corporate impacts on inequality.

The private sector is a major driver of socioeconomic inequality. Companies contribute to inequality through the methods by which they recruit, promote, compensate, and treat people in their jobs.[8] They also drive inequality in how they manage their supply chains, ensure product access, complement or displace local entrepreneurship, lobby and fund political activity, set prices, craft their public relations messaging, practice philanthropy, pay taxes, and create sacrifice zones, where those who are the least empowered bear the brunt of environmental and health-related damage.[9] (See Figure 1).

Figure 1: Company-level contribution to inequality



For investors, these practices can have adverse effects on their portfolios, with companies exposed to increased risks from reputational damage,[10] exposure to litigation and regulatory sanction,[11] reduced productivity,[12] and broader systemic harms to the macroeconomy that companies and investors must absorb. Many have noted investors' "unparalleled ability" to influence firms to better manage their human rights impacts, including those that relate to inequality.[13] Given their duties to their clients, customers, and beneficiaries to mitigate these risks, investors have a key role to play in tackling inequality and incentivizing more fair, equitable, and just corporate behavior.

This report explores recent developments, data, and academic studies that point to rising investor interest in mitigating inequality as part of their fiduciary obligations. Investors will be able to use the arguments presented in this report to guide their stewardship activities with investee companies, with assurance that it is possible, desirable, and even in some cases necessary to reduce corporate inequality impacts to increase risk-adjusted investment returns.

FIDUCIARY DUTY AND THE OBLIGATION TO ACT

In recent years, many investors have used their power as fiduciaries to address both the macroeconomic and broader market risks of inequality. In 2020, New York City Comptroller Scott Stringer and the New York City Retirement Systems negotiated with 14 companies — including 13 in response to shareholder proposals — to adopt policies requiring that women and people of color be considered as candidates for CEO and board seats.[14] Other recent shareholder proposals have called for reducing inequality within corporations, receiving substantial support and sometimes winning majority votes.[15]

Meanwhile, investor coalitions have sprung up to address inequality-related topics such as living wage, CEO-worker pay gaps, racial justice, and worker organizing rights.[16] In April 2024, the White House convened some of the largest U.S. pension funds to commit to promoting worker rights.[17] There was even a boardroom battle to elect labor-friendly directors at Starbucks, led by a union-affiliated pension plan, resulting in a settlement to negotiate labor agreements.[18] Nevertheless, the largest mainstream asset owners and managers have been slow to consider corporate impacts on inequality.[19] With the outsized influence they wield, these financial actors have the capacity to drive meaningful change — making it essential that they become more ambitious in the fight against inequality.

An obstacle to more forceful mainstream investor engagement is a dearth of solid data on the financial risks that rising inequality presents — an oft-cited impediment to stronger stewardship on social issues generally.[20] A 2021 global survey of investors by BNP Paribas found that,

> [t]he social pillar of ESG remains the most difficult to analyse and integrate.... Data is more difficult to come by and there is an acute lack of standardisation around social metrics. This comes at a time when the social component is of growing importance to end investors.[21]

Investors' need for solid evidence of the financial materiality of inequality is magnified in the United States, the world's largest market, where fiduciary duty is more narrowly construed than in many other parts of the world. In the U.S., fiduciaries can harness investment strategies to improve social and environmental outcomes, but only if their actions are consistent with their commitment to protect client and beneficiary financial risk-adjusted returns.[22] As fiduciaries, investors in the U.S. and in many other jurisdictions must show that any decision to buy, sell, or engage a company is intended to advance a financial benefit, including over the long term, or the action is impermissible. It is critical, therefore, that mainstream investors are equipped with decision-useful evidence to guide their actions.

Until recently, investors have had to rely on cherry-picked, decontextualized data to justify their engagements with portfolio companies on socio-economic inequality topics. The researchers that provide this data often struggle to measure certain aspects of the relationship between socio-economic inequality and financial performance. Moreover, the evidence base has suffered from a lack of comparability between studies, particularly in light of geographic variations and levels of market maturity.

That evidence is now emerging.

This report features compelling evidence for the case to tackle inequality, which investors can actively use to build sound fiduciary arguments. It demonstrates that, when engaging to reduce inequality, not only can investors be effective in achieving financial goals, but also that as part of their fiduciary duty they may be required to do so.[23]

In particular, there is now mounting evidence that inequality is a systemic risk that affects the financial system, the macroeconomy, and the total portfolios of large, diversified investors. Inequality increases the probability of financial crises and, under various conditions, can depress the growth rate of the economy. Inequality is also intertwined with other risks to the financial system, such as climate change, food insecurity, pandemics and other health burdens, polarization and social unrest, corruption, and the erosion of democracy and the rule of law. **The largest mainstream investors are diversified owners of thousands of assets, making them significantly more exposed to market risk than to the risk of any one issuer.**

Investor attention to the systemic risk of inequality is growing in response through coalitions and initiatives such as:

- The **Principles for Responsible Investment (PRI)** — a membership organization of more than 5000 asset owners, managers, and service providers — cautions that "systemic risks, such as climate change and inequitable social structures, seriously threaten the long-term performance of economies and asset owners' portfolios, as well as the world in which their beneficiaries live."[24]

- The **PRI Advance** investor stewardship initiative for human rights and social issues notes that, "[h]uman rights encompass a range of social issues which are both urgent and systemic in nature. These issues, from inequality and discrimination to inequitable access to healthcare, undermine not just individual rights but also the societal infrastructure which the global economy relies on for delivering long term growth and prosperity."[25]

- The investor-led **International Corporate Governance Network (ICGN)** affirms that "[fiduciary responsibility extends beyond the traditional duties of care and loyalty to include considerations of timeframe and systemic risks."[26]

- In a report co-authored with the **PRI** and the **Global Sustainable Investment Alliance**, the **Chartered Financial Analyst Institute** notes that "[t]he concept of overall value for clients and beneficiaries is multifaceted. It includes the market value of the entire portfolio (as opposed to individual holdings or individual mandates) ...and the common environmental, natural, intellectual, social, and institutional assets that underpin all economies."[27]

Regulators are also encouraging investors to focus on systemic risk: the U.K.'s Taskforce on Social Factors counsels pension trustees that "pension funds have a direct economic interest in influencing systemic issues."[28]

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Still, firm-level risk and return remain important considerations for investors with concentrated portfolios, such as those managed by private equity funds. Even mainstream diversified investors often regard their fiduciary duty as operating on a firm-specific level, although many are now shifting emphasis to a more balanced approach. The International Sustainability Standards Board (ISSB) — which formulates disclosure standards for a wide range of social and environmental issues with global financial relevance — is primarily concerned with sustainability risk and return at the firm level,[29] making firm-specific risks salient for all investors. At this level, inequality often presents as a trade-off between short-term profit generation and longer-term factors that bear negatively on the financial performance of a firm. For example, a 2021 study determined that wage inequality has a positive direct effect on short-term firm profitability, which "vanishes in the long run" when customer satisfaction inevitably and persistently deteriorates.[30] Fiduciaries operating on a firm level should engage their investee companies on such tradeoffs and underscore the risks of ignoring their long-term effects.

Below we highlight evidence for inequality-related risk and return at both the systems and firm levels, and actions investors can take to address those risks. We turn first to the evidence for the system-level risk of inequality. A single firm may engage in activity that drives inequality, which may benefit its own bottom line but produce wider harm to the economy and ultimately hurt that company in the long run. An investor that is widely diversified will experience the harms of inequality across its entire portfolio, potentially eclipsing the financial benefit of supporting any single firm's contribution to inequality.[31]

The diversified investor can leverage its relationship with the companies it owns to reduce their individual inequality impacts, based on its fiduciary duty to mitigate systemic risks to its entire portfolio. An investor whose portfolio is concentrated in just a few assets, on the other hand, may question whether pressuring a single company to reduce its negative impacts is contrary to its fiduciary duty, unless there is clear evidence of short-term effects on profitability. This investor should also consider reputational and political risks to the firm, as well as long-term effects on firm-level performance where negative impacts are likely to surface.

PORTFOLIO-LEVEL RISKS OF INEQUALITY

Inequality generates systemic risks to the wider economy, contributing to financial crises and slowing economic growth, while also impacting and being impacted by other systemic risks such as climate change, pandemics and other health burdens, social unrest, corruption, and rising authoritarianism. These systemic risks in turn create systematic risks within investors' portfolios.[32] For diversified investors, mitigating the material effects of inequality on their entire portfolio is a fiduciary imperative.

For example, the S&P 500 Index — the most popular equity benchmark for a diversified U.S. investor — provides a clear illustration of the importance of focusing on portfolio-level, rather than firm-level, inequality risks. It is common for investors to own all 500 stocks in proportion to their weight in the index, the median stock of which represents less than 0.1% of the portfolio of an S&P 500 investor. Because fluctuations in the financial performance of the index holdings will have an immaterial effect on the total performance of the portfolio, an S&P 500 investor has far more reason to be concerned about the ways that inequality impacts their entire portfolio, rather than a single company. Meanwhile, for a globally diversified shareholder investing in a popular global index — such as the MSCI All-Country World Index — the effect of the median stock on their portfolio performance is roughly ten times less than the loss effect an S&P 500 investor would experience.[33]

INEQUALITY CONTRIBUTES TO THE LIKELIHOOD OF FINANCIAL CRISES

There is a strong, but often overlooked, correlation between inequality and the probability of financial crises as a system-level risk. In the years since the global financial crisis of 2007-2009, economists have come to see that the debt bubble which precipitated the mortgage bust was partly generated by inequality. Utilizing relative deprivation theory[34] and the concept of "trickle-down consumption," [35] experts have concluded that the impoverishment of middle- and lower-income households drove a turn towards risky consumer debt financing simply to keep up with the Bezos'[36] — in turn developing a feedback loop that then further impoverishes these groups. Since then, more studies over time and across geographies have generalized and supported this argument. [37] Shareholders, their clients, and their beneficiaries are all badly hurt by systemic financial crises, underscoring why investors should exercise their fiduciary prerogative to mitigate inequality.

INEQUALITY DEPRESSES ECONOMIC GROWTH

Many studies have tried to quantify inequality's effect on the larger economy. [38] A 2018 World Bank study found that "for the median country in the world" — defined by gross domestic product adjusted for purchasing power parity (PPP GDP) — a 1% increase in the Gini coefficient[39] (a statistical measure of inequality) can reduce GDP per capita growth by more than 1% over a five-year period. [40] Within the U.S., income inequality is estimated to reduce GDP by 2-4% per year by suppressing aggregate demand. [41]

Studies have also estimated the economic cost of racial and gender discrimination in the American workplace, a key driver of inequality. A 2021 paper from the Federal Reserve Bank of San Francisco cites the following findings:[42]

- Closing the **racial earnings gap** — which is affected by disparities in health, education, incarceration, and employment opportunities — by 2050 would increase GDP by 22%.

- In 2012, closing **racial income gaps** — through higher wages and increased employment among people of color — would have increased GDP by 14% in that year alone.

- Over the past 20 years, closing **racial gaps in higher education, home ownership, and investment** would have generated significant additional income for saving, investing, and consumption, leading to a significant increase in GDP of $16 trillion — and an additional $5 trillion over the next five years.

- Closing the **racial wealth gap** — across dimensions such as income, tangible investments, and stock market investments — by 2028 would increase aggregate output by 4-6%.

- Between 1990 and 2019, **equalizing labor market opportunities and returns** from labor productivity by ethnicity, race and gender would have produced gains to the U.S. economy of $70.8 trillion in 2019 dollars.[43]

Figures of this magnitude have significance for market performance and by extension, for fiduciaries. When inequality depresses the growth rate of the economy, investment portfolios grow at a sub-optimal pace. [44]

INEQUALITY EXACERBATES OTHER SYSTEMIC RISKS

Inequality can magnify and interact with other systemic risks, including climate change;[45] food insecurity;[46] anti-microbial resistance;[47] social unrest, polarization, and policy paralysis;[48] corruption;[49] and authoritarianism.[50] The potential economic costs of climate change are much discussed,[51] and while the costs of conflict,[52] corruption,[53] and authoritarianism[54] have been less explored, they have been found to be significant. The interplay of inequality and health was laid bare by both the opioid crisis and the COVID-19 pandemic. Not only have these health emergencies severely exacerbated inequality; inequality has exacerbated their deadly outcomes.[55] The economic cost of the pandemic and the ongoing opioid crisis, are each estimated to be in the realm of trillions of dollars.[56] And poverty-related food insecurity adds billions in healthcare costs per year to the economy.[57] Investors concerned with the portfolio impact of climate change and other systemic risks must additionally account for inequality, which fosters, and in turn is magnified by other systemic risks.

FIRM-LEVEL RISKS OF INEQUALITY

Socioeconomic inequality-related risks can also directly impact the performance of individual business enterprises. Any disturbances in the external operating environment, such as labor shortages and supply chain disruptions, can bring financial setbacks, while uncertainties related to labor strikes can lead to fluctuations in asset values. Furthermore, as instances of corporate misconduct accumulate and garner greater consumer attention, shifts in social expectations and the enactment of new legislation give rise to reputational and legal risks for organizations.

In this section, we first review a key area where private sector impacts on inequality have rebounded on companies: vulnerable low-wage workers across the supply chain. We then turn to the evidence and investor interest in the firm-level risks of other key issues related to inequality, namely: Living wages, CEO pay, Diversity, Equity, and Inclusion (DEI), organizing rights, taxation and lobbying. Investor interest in these issues was spurred on in 2020 by the dramatic events of the COVID-19 pandemic and mass protests over the murder of George Floyd, which put economic and racial inequality in the spotlight for all, including mainstream investors and regulators.

To date, evidence of the material impacts of inequality on individual company performance is mixed, due in part to the fact that the data are lagging and the subject is under-studied. [58] In addition, effects may manifest over a longer time frame than is typical in academic research, making them especially challenging to measure.[59] Below we explain what the existing literature reveals about this relationship, which suggests that, at a minimum, investors should focus on issues where materiality has already been established. Investors should also consider long-term effects, and require portfolio companies to disclose on the information they need to assess both short- and long-term risks posed by inequality.

SUPPLY CHAIN DISRUPTIONS

Inequality-inducing factors such as low pay, gender and racial discrimination, and poor health and safety conditions companies' ability to attract and retain a skilled and productive workforce. In response, many companies have offshored much of their production and manufacturing to low wage workers in developing countries, who typically lack the power to speak up and are at risk of exploitation — conditions that generate supply chain risks including product shortages, customer and consumer backlash,[60] and price swings. Below we highlight two examples -- one from the apparel sector and the other from the agricultural sector - which illustrate these risks.

SUPPLY CHAIN DISRUPTIONS IN BANGLADESH IMPACTING THE APPAREL SECTOR

The 2013 Rana Plaza garment factory building collapse in Bangladesh was one of the worst industrial disasters in history, resulting in the deaths of over 1,100 workers, most of whom were young, female, and living in poverty.[61] A manufacturing site for many of the world's biggest brands, the tragedy at Rana Plaza could have been avoided; cracks in the structure were discovered the previous day, but debt-strapped workers returned to the site under threat of withheld wages.[62] The disaster exposed unsafe working conditions, constraints on freedom of association and collective bargaining, and a lack of oversight of global supply chains in the garment industry.

The costs of the factory collapse to companies sourcing from Rana Plaza were significant, both in terms of financial liabilities and reputational damage. Brands were hit with substantial legal expenses for lawsuits initiated by victims and their families,[63] as well as investigations by regulators into their involvement in the disaster. In total, involved companies paid approximately $40 million, including medical expenses, funeral costs, and compensation for lost wages and future earnings.[64]

INCOME-RELATED FACTORS AFFECTING COCOA PRODUCTION AND CLIMATE RISK

Inequality-related supply chain risks for businesses dependent on agricultural goods are also financially material. When farmers struggle, they often leave such sectors entirely,[65] or may continue to use modes of production that can reduce productivity and yield. Within the cocoa sector, farmers are rarely paid a living income by companies.[66] Because farmers, particularly smallholder farmers, are paid low prices, many are unable to invest in long-term production-generating materials needed to increase productivity and resistance to unforeseen climate shocks.[67] Because of underinvestment, there is a global cocoa shortage that has resulted in rising prices.[68] This is especially challenging since cocoa supply chains are concentrated, with two-thirds of the world's cocoa beans produced in just two countries, Cote D'Ivoire and Ghana.[69]

Inequality-related supply chain incidents have led to regulatory scrutiny and pressure to improve labor standards and responsible management. In April 2024 the European Council approved the Corporate Sustainability Due Diligence Directive (CSDDD), which requires large companies operating in the EU to identify, prevent, and mitigate risks throughout their supply chains. Non-compliance can result in civil liability and administrative sanction of up to 5% of annual profits, compelling companies to invest in new systems, processes, and training.[70]

Beyond the new requirement, studies show that robust supply chain management produces financial benefits,[71] particularly when firms work collaboratively to improve sustainability practices in the supply chain.[72] There is additional evidence that "firms with fewer supply chain ESG incidents exhibit superior future accounting performance."[73] Conversely, there are demonstrated costs when supply chains are vulnerable. During the pandemic, the sudden decline in demand triggered force majeure clauses in brands' supplier contracts, leading to cancelled orders and hastening supply chain collapse. The Economist Intelligence Unit found that, in addition to brand reputation damage for the inability to maintain a supply of goods, the financial costs of supply chain disruption averaged 6-10% of annual revenues.[74] There is clear evidence that investors have a fiduciary responsibility to exert leverage on their investees to improve sustainability practices in their supply chains.

LIVING WAGES

Wages have an obvious but crucial bearing on inequality. Failure to pay a living wage not only contributes to systemic economic and social risks but can also put enterprise value at risk. Above, we addressed the supply chain disruptions that can occur when workers are underpaid, poorly treated, and constrained in their ability to organize. Paying direct employees poverty wages also creates serious firm-level risks, despite the conventional belief that minimizing labor costs is a management imperative.

Much of the academic literature on the relationship between wage levels and corporate performance examines the effects of raising wages on firm productivity.[75] It is true that when employees are treated well, paid fairly, and not discriminated against, they are likely to be more productive and less likely to quit. The literature is not entirely clear, however, on whether the added cost of higher wages is superseded by increased production and reduced turnover. Some studies have connected wage increases to a level of productivity that overcomes the added wage cost,[76] but in aggregate, studies have not yet produced a clear correlation between increased financial performance and rising minimum wages.[77]

Researchers have begun to explore dimensions of the wage-profitability relationship, however. For example, Zeynep Ton — Professor at MIT Sloan School of Management and President of the nonprofit Good Jobs Institute — has produced a body of work finding positive productivity results when firms increase wages and improve working conditions. In one case, when a pet food chain store increased hourly pay by 24% over three years, Ton and her colleagues found that "[by] 2022, it was able to pay all its employees a living wage, based on the MIT living wage calculator for different locations. These companies didn't just raise pay, they made employees' work more valuable, making the pay investment worthy."[78] As a result, "Employees were able to generate 12% higher sales per labor hour and 25% higher sales per square foot (compared to 9% industry average at the time)."[79]

Ton and her colleagues have also produced studies confirming another factor in the wage rate-profitability equation — that low pay contributes to high turnover.[80] While the degree to which turnover results in negative performance is context dependent,[81] one study found that cost of recruiting, training, and helping new employees reach baseline productivity can be as high as 40% of an individual's annual salary.[82]

When firms pay inadequate wages, they also become more vulnerable to any government action to raise wages. The cost of a mandated wage increase will be most keenly felt by the firms that have been paying the least.[83] Investors who know whether their portfolio companies are paying — or moving towards paying — a living wage have better visibility into the potential human capital risks. However, most investors know little about company wage structure. A study by JUST Capital found that "only 13% of America's largest companies disclose some data about their employees' hourly wages, and even fewer, 9%, disclose the exact value of the minimum wage paid to their U.S. workforce."[84] The nonprofit has also estimated that half of U.S. employees of Russell 1000 companies do not earn a living wage.[85] To help prevent potential risks of low pay — including shocks to their portfolios stemming from mandated wage increases — investors should demand transparency on this topic.

PLATFORM LIVING WAGE FINANCIALS

The Platform Living Wage Financials (PLWF) is an example of how investors can successfully integrate inequality considerations in their investment decisions. Founded in 2018, PLWF is an alliance of 20 financial institutions, representing over €6.9 trillion in assets,[86] which promotes, supports, and oversees investee firms in providing living wages and incomes throughout their global supply chains. Its members are a mixture of socially responsible and mainstream investors, including Amundi, APG, PGGM, ING, and LGIM.

PLWF sees that promoting living wages is a means to support worker rights and contribute to more stable workforces and resilient value chains, which in turn has "a multiplier effect on local economies and socioeconomic opportunities:"

> Investors are starting to consider how living wages can reduce value chain risk, operational risk, reputational risk, loss of market risk, risks to resilience, and legal or regulatory risk. As a result, once living wage and decent work considerations are more comprehensively included in investors' risk assessments, businesses that address living wage concerns in their value chains (among other decent work issues) will be seen as less risky investments, thus likely to attract more capital.[87]

To support this vision, PLWF evaluates companies' living wage standards against 40 performance indicators that are aligned with the UN Guiding Principles on Business and Human Rights and reviews progress annually. Since its launch, the alliance has incentivized over 50 companies across the garment, footwear, agrifood, and food retail sectors to "adopt good practices and promote social and economic resilience in their supply chains."[88] For example, HanesBrands — an investee of ASN Investment Funds — announced in 2019 that it would amend its Global Standards for Suppliers to include fair compensation.

Cedric Scholl, Advisor for Responsible investment at Dutch pension fund PGGM, explains the value of PLWF membership:

> "As investor[s] we look for long-term returns, so that almost three million Dutch pension fund participants do not have to live in poverty after reaching their retirement age. At the same time we encourage companies to pay their employees a 'living wage', so that they, too, do not need to live in poverty."[89]

CEO-WORKER PAY GAP

Of the 10 largest listed companies in the world, seven have a billionaire as either a principal shareholder or CEO.[90] From 1978 to 2022, U.S. CEO compensation is estimated to have increased by more than 1,200%, while average worker pay grew by only 15%.[91] By 2022, CEOs were earning 344 times that of typical workers, a more than 16-fold change over the past five decades.[92] The injustice is not lost on workers. The resurgence in labor organizing post-pandemic has been due to a "shift of worker mindset" that "the bigger higher-ups, the moguls and millionaires, the billionaires, are getting way more than what they are giving."[93]

Since the 2008 financial crisis, shareholders have exercised their ability to directly reduce the gap between median worker pay and CEO compensation through "Say-on-Pay,"[94] At companies that receive low Say-on-Pay votes, directors are more likely to lose external board seats and compensation committee positions, as well as experience decreases in compensation, all powerful incentives to make changes that reduce inequality.[95] Furthermore, low Say-on-Pay votes have been found to lead to increased CEO turnover,[96] signaling that these laws are likely a contributing factor to slowing compensation growth in top management.[97] In the United States, Say-on-Pay is a useful tool for investors when coupled with SEC-mandated disclosure on the ratio of CEO-to-median worker compensation, a measure undertaken in the aftermath of the financial crisis and in practice since 2018.[98] One study found that upon publication of this ratio for the first time, firms with the highest pay dispersion were penalized in the stock market.[99]

Resulting employee and customer dissatisfaction are reasons for investors to worry that high pay ratios might be detrimental to corporate performance over the long term, despite other evidence that high pay ratios can be associated with positive financials.[100] Studies indicate that "high CEO-to-worker pay ratios are negatively correlated with employee ratings of work-life balance, compensation, and job satisfaction," hampering productivity growth.[101] Other research finds that consumers are opposed to high pay ratios and avoid buying from companies that contribute to significant income inequality.[102] One study found a non-intuitive association between firms with high pay ratios and the incidence of data breaches.[103] Each of these factors may increase firm-level risk for companies contributing to inequality, and investors should be permitted to use leverage with their investee companies on these bases.[104]

DIVERSITY, EQUITY, AND INCLUSION (DEI)[105]

It is widely accepted that companies with diverse workforces reap financial benefits. The investor-backed Sustainability Accounting Standards Board (SASB) — the producer of industry-specific disclosure standards that are poised to be the basis of mandatory financial sustainability reporting globally[106] — holds that diversity, equity, and inclusion (DEI) "can create a more inclusive environment and reduce the risk of discrimination and harassment, (...) [and] help teams within a company develop products or services that reflect the needs of a diverse consumer base."[107] Mainstream investors promote board diversity as an engagement priority,[108] and a legal battle currently rages in the U.S. regarding the NASDAQ stock exchange's proposed regulation for all listed companies to have a certain number of diverse directors or disclose the reasons for non-compliance.[109] Companies have begun to issue sustainability-linked bonds — vehicles that until recently were predominately used to incentivize reductions in greenhouse gas emissions — with KPIs connected to gender equality.[110]

Efforts to reduce discriminatory hiring practices and promote diversity in the workplace are increasingly embedded in investment law and policy across the globe. In March 2023, Mexico became one of the first countries in the world to insert gender equality into its "green taxonomy," which supports the implementation of sustainability-related investment in the country.[111] More recently, Brazil issued a consultation on its own green taxonomy that follows Mexico's model in its consideration of inequality issues.[112]

More and more, investors are seeing that a more diverse workforce is financially material. For example, in 2021 Florida's state legislature announced that it would consider the Stop the Wrongs to Our Kids and Employees (W.O.K.E) Act (passed in 2022), which restricts DEI initiatives at Florida firms, leading the shares of Florida companies to decline.[113] Despite this instance, it can be difficult to find strong evidence of how DEI affects firm-level financial performance, due to measurement challenges.[114] The demographic statistics that researchers rely upon don't adequately capture the nuances of how socioeconomic inequality interacts with corporate performance, or the way these factors are influenced by an individual organization's culture.[115] This ambiguity has formed grounds for conservative attacks on corporate DEI programs.[116]

Still, studies have found a strong relationship between firm-level financial performance and aspects of DEI that investors can point to. A 2013 study found that businesses that adopted same-sex domestic partnership benefit policies showed substantive and permanent improvements in firm value and operating performance.[117] Researchers have also demonstrated a positive causal relationship between paid family leave/sick leave and firm productivity, as well as connections between stock price declines and the frequency of employment discrimination settlements or low-profile sexual harassment incidents that reflect a toxic environment.[118]

FREEDOM OF ASSOCIATION

Mainstream investors tend to see unionization as a threat to company financials.[119] In reality, studies examining the relationship between corporate financial performance and unionization — and other core labor rights like freedom of association and collective bargaining — show variation across regimes and regions. One study determined that outcomes depend on whether collective bargaining takes place at the firm level vs. sector or national level, and that vertically coordinated systems at the sector and national level are correlated with higher instances of labor productivity.[120]

A literature review conducted by the Trade Union Congress found that the relationship between unions and financial performance was contingent on factors such as market conditions, workplace practices, firm size, and union strength.[121] Although empirical research in the 1980s and 1990s purported that unionization negatively impacts firm financial performance, by 1998 most studies found no significant relationship.[122] Another study documents the dampening effect that unions exert on managerial risk-taking, thus improving a firm's financial risk profile.[123]

Freedom of association and collective bargaining are core labor rights under U.S. and international law. Human rights due diligence is becoming mandatory in the EU — and likely soon elsewhere[124] — bolstering awareness of labor rights among investors and increasing public pressure on companies to respect them.[125] This includes the United States, where a Gallup poll revealed that Americans overwhelmingly sided with workers seeking higher pay during the 2023 wave of summer strikes.[126]

THE FINANCIAL REVERBERATIONS OF HOT STRIKE SUMMER

The year 2023 brought more labor strikes than any other period in recent American history. Unionized workers — including United Auto Workers (UAW), the Writers Guild of America, Hollywood actors (SAG-AFTRA), United Parcel Service,[127] and Kaiser Permanente,[128] among others[129] — used their collective bargaining power to contest growing inequality, unequal wages, and/or worsening working conditions.[130] The strikes continued into the fall, and with the exception of the teachers strike in 2018, resulted in the highest number of workers on strike since 1986.[131]

The financial effects of the strikes were not only felt by impacted companies but across the economy. The UAW worker walkout affected supply chains for auto parts and dealerships, while prospective car buyers faced increasing costs due to the downturn of production, all of which can suppress sales and result in an economic contraction.[132] Similarly, for the entertainment industry, productions and film sets utilize contractors like carpenters, set designers, makeup artists, and assistants who were no longer able to execute their professions, and whose reduced incomes resulted in decreased spending.[133] In California, a major hub for the entertainment industry, the estimated loss was close to $3 billion.[134]

The Hollywood and UAW strikes alone are estimated to have resulted in over $10 billion in economic losses.[135] Mark Zandi, Chief Economist at Moody's Analytics, estimated that the UAW strike would result in a decrease of 0.2% of GDP in Q4 of 2023."[136]

TAX AND LOBBYING TRANSPARENCY

Tax avoidance and corporate lobbying are both inequality-generating practices that may at first appear to only benefit financial performance. Like mandated wage increases, however, regulatory shifts or media revelations can shock the financials of firms that utilize unfair or corrupt tax and lobbying policies. Again, investors should demand transparent disclosure of these practices.

Tax avoidance through profit shifting, use of tax havens, and transfer pricing can significantly exacerbate inequality between countries as well as within. Economists estimate that between US $100 and $600 billion in annual global tax revenue is lost due to the use of tax havens by multinational corporations, who are then able to underreport their profit in the countries in which they produce and sell goods.[137] One study estimates that up to 40% of U.S. multinationals' overseas profits are shifted to low-tax jurisdictions each year, robbing low-income states of badly needed revenues to support critical health, food security, and other social programs.[138] A 2021 report from the Center for American Progress revealed that major U.S. companies pay an effective tax rate of less than 10%.[139]

Increasingly, firm-level investors have come to recognize that tax avoidance carries regulatory and reputational risk.[140] Global efforts to harmonize the tax system, such as the OECD's new rules,[141] will increase the tax burden of certain companies,[142] leading more and more investors to call for tax transparency. The EU has responded with regulatory efforts such as the Anti-Tax Avoidance Directive and other specific measures, including the proposed Common Consolidated Corporate Tax Base and country-by-country reporting, which help authorities identify potential tax avoidance strategies.

These measures enable investors to assess whether their holdings are exposed to significant risk of regulatory shocks. Some companies have already faced stiff penalties in the EU for tax avoidance. In 2020, Google settled a long-running tax dispute with French authorities by agreeing to pay €965 million (about US $1.1 billion),[143] including a €500 million fine and €465 million in additional taxes.[144]

In addition, reputational risk follows when tax avoidance schemes are exposed, as happened with the Paradise Papers in 2017.[145] Similarly, media exposure of the tax avoidance schemes of companies like Apple,[146] Google, and Starbucks have produced real-time public outrage expressed through trending social media hashtags such as #AppleTaxAvoidance or #AppleTaxScandal. Moreover, there are quantifiable costs to companies, including increased tax assessments, penalties, and litigation expenses (See box on ExxonMobil). These revelations create exposure to material risk for both diversified and non-diversified investors.[147]

EXXONMOBIL TAX AVOIDANCE LIABILITY[148]

Tax authorities across the globe have repeatedly challenged Exxon Mobil's approach to taxation, costing the company significantly in increased tax liabilities and litigation expenditures. According to the company's own annual report, ExxonMobil has paid out settlements with tax authorities every year since at least 2007, including a payment of $538 million in 2019 and $782 million in 2017.[149]

ExxonMobil has faced tax controversies across the globe. In a recent case involving the company's dealings in Qatar and Malaysia, a U.S. federal court denied ExxonMobil a $1 billion refund request, ruling that it had improperly classified mineral leases as sales. The IRS initially assessed a $200 million penalty to ExxonMobil for claiming an excessive refund, though this penalty was overturned on appeal.[150] The company lost a separate request for a $337 million tax refund in the U.S. in 2017[151] and also settled a $600 million tax dispute in Russia in 2017.[152] Even when ExxonMobil does not ultimately lose tax disputes, it is forced to pay significant legal costs.

Through a complex system of offshore subsidiaries in the Bahamas, ExxonMobil was able to avoid paying any corporate income tax in Australia while leveraging internal high-interest loans, leading the company to be dubbed "Australia's worst tax dodger."[153] A 2017 court ruling set in motion government efforts to close the loophole on which this tax avoidance relied, and the Tax Commissioner's office has said that doing so would lead to $12 billion in increased revenue for the government, with most of it paid by oil and gas companies.[154] ExxonMobil's tax payments in Australia have subsequently begun to increase relative to previous years.[155]

Tax authorities could subject ExxonMobil's tax practices to even greater scrutiny. Economic challenges and pandemic-related impacts have led governments to home in on corporate taxation. In a 2022 tax survey, Deloitte found that 96% of U.S. companies "believe that more tax disputes may arise out of increased government deficits due to Covid-19."[156]

In the U.S., the Inflation Reduction Act of 2022 included an increase of $80 billion in funds for the Internal Revenue Service (IRS), with $46 billion earmarked for enforcement. This boosted government funding is expected to bring in an additional $204 billion in taxes through 2031,[157] largely from increased tax enforcement for large multinational companies like ExxonMobil.[158]

In light of increased regulatory scrutiny of corporate tax practices, investors have begun to take action to mitigate the reputational and regulatory risks faced by companies that practice tax avoidance, as well as the systemic risk of tax avoidance across their portfolios. In 2019, Norges Bank Investment Management (NBIM), which has $1.4 trillion in assets under management including the Norwegian Government Pension Fund, published tax and transparency expectations towards companies, in which it outlines its expectation of investees based on three principles: paying tax where economic value is generated, the board responsibility of tax arrangements, and country-by-country reporting as a core element of transparency.[159] In the same year, PGGM, the second largest pension fund in the Netherlands, published a sustainable tax position paper,[160] which highlights how it aims to be socially responsible on tax by following international regulation like BEPS, EU Anti-Tax Avoidance Package (ATAP), the EU mandatory tax disclosure regime (DAC6), and international initiatives like the Global Reporting Initiative's (GRI) standards relating to tax. Additionally in 2021, Principal Tax Counsel Niels Krook also highlighted that although difficult to enforce, PGGM is "trying to move away from the use of tax havens."

Lobbying and political spending can also backfire for companies.[161] Firms that make public sustainability commitments[162] but lobby behind the scenes to water down rules — for example, regarding taxation, collective bargaining, and minimum wages — undermine their credibility as responsible companies and expose themselves to accusations of "greenwashing"[163] and related material investment risk.[164] Recognizing this risk, investors have advocated for greater transparency on corporate lobbying and political spending activity for more than twenty years, with steady progress.[165] When PRI Advance launched in 2022, it identified three expectations for companies, including that they "Align their political engagement with their responsibility to respect human rights."[166] In 2023, politicians themselves stepped in: five U.S. senators urged the SEC to standardize corporate lobbying disclosure.[167] Meanwhile, pressure is also mounting from civil society. Notably, the EIRIS Foundation is creating a Social Lobby Map, which in 2024 will start rolling out assessments of companies' lobbying practices, including the extent to which they weaken or undermine laws and regulations designed to raise human rights and labor standards.[168]

WHAT INVESTORS SHOULD DO TO REDUCE INEQUALITY

The case to address inequality through investment is also strengthening, and investors have begun to act. Researchers have found that diversified investors vote against the most egregious corporate pay discrepancies,[169] and it appears that they may in part be responsible for the decline in CEO compensation by 9% in 2022.[170] Diversified investors also seem to be driving progress in applying a systemic risk lens to their corporate engagements, counteracting concentrated investors' meagre interest in unequal pay.[171] In September 2024, the Taskforce on Inequality and Social-related Financial Disclosures (TISFD)[172] will launch, providing a disclosure and risk management framework that addresses the systemic and idiosyncratic risks of inequality. We can expect that these signs of investor resistance to inequality will only strengthen over time.

TASKFORCE ON INEQUALITY AND SOCIAL-RELATED FINANCIAL DISCLOSURES

Investors seeking evidence of the materiality of inequality, as well as a means to measure and manage private sector contributions to inequality, will soon have a new resource in the Taskforce on Inequality and Social-related Financial Disclosures (TISFD).[173] The framework will be co-created by a coalition of investors, businesses, civil society, and labor organizations, with the aim of assessing the financial risks of socioeconomic inequality. It will also develop a clear evidence base for the pathways between impacts on people, socio-economic inequality and financially material risks, and assess whether sufficient guidance exists on the identification, assessment and management of impacts and risks. When completed, the framework will strengthen the stability of the financial system, reduce inequality-related risks to the economy, and improve the outcomes for people, in particular those who are marginalized or disadvantaged.

TISFD responds to the growing awareness among investors, regulators, and civil society that inequality poses a significant economic and social threat, and that the first two Taskforces — on climate and on nature — did not adequately address socioeconomic risks. TISFD will be interoperable with these initiatives by providing a social throughline, while also serving as a knowledge partner to standard setters such as the ISSB, GRI, and EFRAG. Two distinctive features of TISFD are its inclusive governance structure, and its focus not only on companies' impacts, risks, and opportunities, but those of investors as well.

Despite ambiguities of existing research on inequality risks to firm-level financials, there are sufficient indications of a relationship that warrant investor action. This brief demonstrates material risks to firm finances in the areas of supply chain disruption, tax avoidance strategies, and inclusive workplace policies, all of which are well supported. Where conclusive data are lacking — including on whether raising wages, reducing CEO pay, or supporting unionization efforts will directly result in better financial performance — investors should adopt a long-term outlook when engaging with their portfolio firms on these issues and encouraging transparency including by supporting initiatives for greater disclosure. Moreover, they should be alert to corporate lobbying that works against corporate commitments to addressing inequality.

When it comes to wealth inequality, one way that investors can reduce risks is by promoting worker accumulation of equity — for example, through worker ownership. In 2018 a French dairy conglomerate announced that it would distribute one share of its stock to each of its 100,000 employees.[174] One study found that worker ownership has a small, but positive and statistically significant relation to firm performance, which has increased over time.[175] Worker ownership has also been tied to a lower rate of earnings manipulation and greater financial transparency,[176] as well as improved resiliency during economic downturns.[177] Among the investors recommending worker ownership are notoriously profit-maximizing firms in the private equity arena, a sign that these issues are becoming increasingly mainstream.[178] As is often the case, conflicting studies caution against generalizing,[179] but there is sufficient evidence that the topic deserves the attention of both companies and their shareholders, and investors would do well to include the topic as part of their corporate engagement.

This report provides investors with evidence and justification for taking action to reduce inequality within their portfolios. But the ways that the investing process itself can directly contribute to inequality cannot be ignored. The news is filled with stories of how private equity investors have liquidated struggling companies, leaving employees in the lurch,[180] while investors are among the wealthiest actors in the world.[181] Meanwhile, studies have shown that the asset management industry itself is one of the least diverse in America.[182] In addition, the growing industry concentration among a small number of large asset managers — some of whom hold stakes in all public companies in the same sector — has been connected to a concerning rise in market power.[183]

To achieve a more equitable future, greater attention is urgently needed from the investment community overall. And while investors have historically been beholden to their fiduciary duty to prioritize short-term returns, evidence is mounting that the long-term implications of corporate-generated inequality can be severely damaging to financial performance at both the portfolio and firm level. In addition to more closely monitoring investee firms' material impacts, investors must also consider the holistic nature of their own operations and examine the ways in which they can drive more equitable outcomes through their internal and external practices.[184]

At the heart of the conversation around socioeconomic inequality are the people most impacted by it. And while efforts to organize, like those of the UAW, put the concerns of the many in front of corporate decision makers, it's time for the voice of the few — namely, investors who wield significant influence in the global economy — to chime in. Equipped with a growing body of research and mounting calls for change, investors are poised to usher in a future where the fight against inequality is core to corporate business strategy, and where an equitable economy is truly possible and beneficial for all.

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search Paper No. 2019-07-03. https://doi.org/10.2139/ssrn.3415937; A.L. Boone, A. Starkweather & J.T. White. (21 October 2023). The Saliency of the CEO Pay Ratio. Review of Finance. https://doi.org/10.2139/ssrn.3481540.

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[184] This is an emerging area that several organizations – Predistribution Initiative, The Investment Integration Project, Impact Frontiers, among other organizations – are working on, and which are in scope for TISFD.