

**Q3**

QUARTERLY REPORT  
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**THE HIDDEN COST OF MARKET CONCENTRATION**



Vice President Kamala Harris speaks on Operation Fly Formula: baby formula shortages led to increased scrutiny of the concentrated nature of the market

# WHATEVER HAPPENED TO COMPETITION? ENGAGEMENTS PLAY DOWN ANTITRUST RISK

On 9 July 2021 US President Joe Biden signed an executive order that would enhance existing antitrust laws to “reduce the trend of corporate consolidation” and “promote competition in the American economy.” But despite much rhetoric around the need to make markets more competitive, competition policy enforcement seems to continue to be reactive in nature, focused on specific company cases. The promise of a focus on reducing sectoral industry concentration remains unfulfilled. In contrast, investors are making more significant shifts to address issues arising from ownership concentration.

PIRC has adopted competition policy as a theme in its stewardship work over the past two years. In common with what we see happened at a regulatory level, we have switched between company-specific issues and sectoral challenges. Frequently, as in the case of the US baby formula market, these overlap.

After contaminated baby formula was discovered in Abbott Laboratories product, the Food and Drug Administration (FDA) ordered a shutdown of its plant in Michigan. Because Abbott dominates the market, along with Reckitt Benckiser, a nationwide shortage ensued, with the

US relying on imports to fill the gaps.

By 22 May out-of-stock rates reached 70% and supermarket shelves were devoid of formula products throughout the US, and in Canada too. The Wall Street Journal notes normal rates are usually around 10% so it naturally followed that questions about market concentration and supply vulnerabilities would follow these shortages.

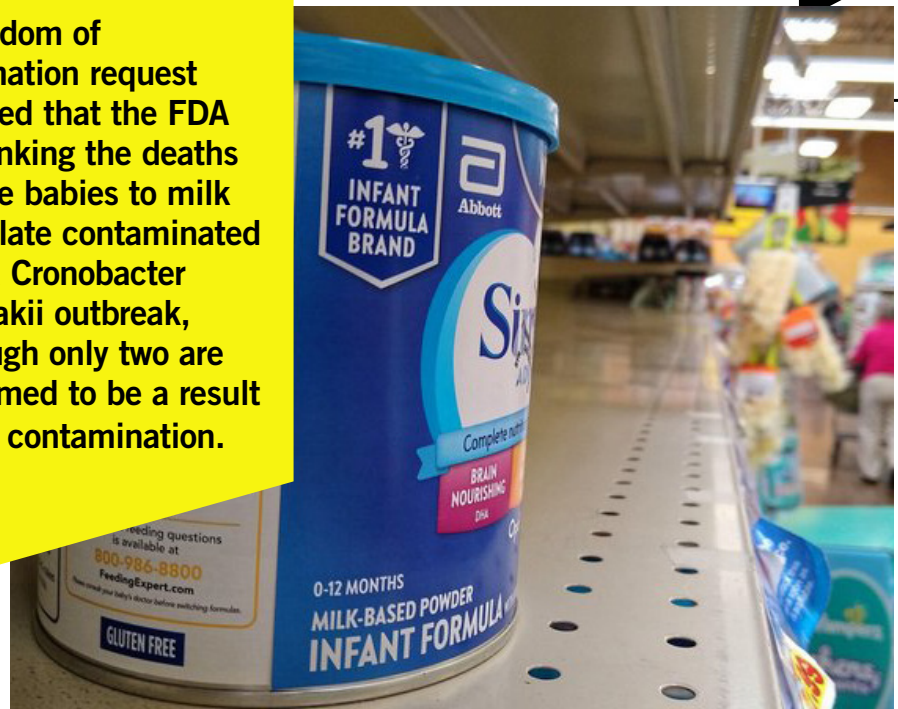
Abbott and Reckitt dominate the market, with other players like Nestlé far behind in market share. In response to the shut-down and related shortages the Federal Trade Commission announced an investigation into whether corporate mergers contributed to the national shortages through market concentration. Abbott's shares are down around 15% since the investigation was announced. There has also been a greater focus on the role of private equity in driving concentration.

In Q3 PIRC undertook engagements with three companies in the sector to explore the scandal and competition policy risks. There was acknowledgement of the immediate impact on market share but also a general expectation, not only from Abbott, that this would recover. More broadly whilst companies were obviously alert to the political commentary regarding market concentration this appeared to be viewed as low risk.

An argument common across the baby formula manufacturers was that, in a highly regulated sector with complex production and extended supply chains, the barriers to entry for potential new entrants are prohibitive. Differing regulatory regimes across jurisdictions also mean that different players dominate in certain markets. It may be desirable for there to be greater competition but in reality this may require greater cross-border regulatory co-operation. For now it seems that most expect the structure of US baby formula market to continue relatively unchanged.

And this is not specific to this sector. There has been little progress on market structure across any sectors in the US since Biden assumed office. For example, four meat processors (Cargill, Tyson, JBS SA and National Beef Packing Co) control between 55-88% of the hog, cattle and chicken sectors and have been

**A freedom of information request revealed that the FDA was linking the deaths of nine babies to milk formulate contaminated with a Cronobacter sakazakii outbreak, although only two are confirmed to be a result of the contamination.**



targeted over unsafe working conditions in the past. The Biden administration promised to toughen up competition laws and provided USD 1 billion to support independent meat processors. This was even pitched as an anti-inflation measure. But antitrust researcher Austin Frerick doubted whether the plan “will meaningfully change concentration numbers”.

Again, our past engagements with companies in the sector pointed to a scepticism that market structure would be meaningfully changed. Rather there was an expectation that even if there were new entrants over time they would struggle and therefore would be likely to be taken over. Thus the market would return to a handful of competitors. Perhaps this is the complacency of incumbents, but unless and until the Biden administration adopts a more aggressive posture we share the view that sectoral competition policy is relatively low risk.

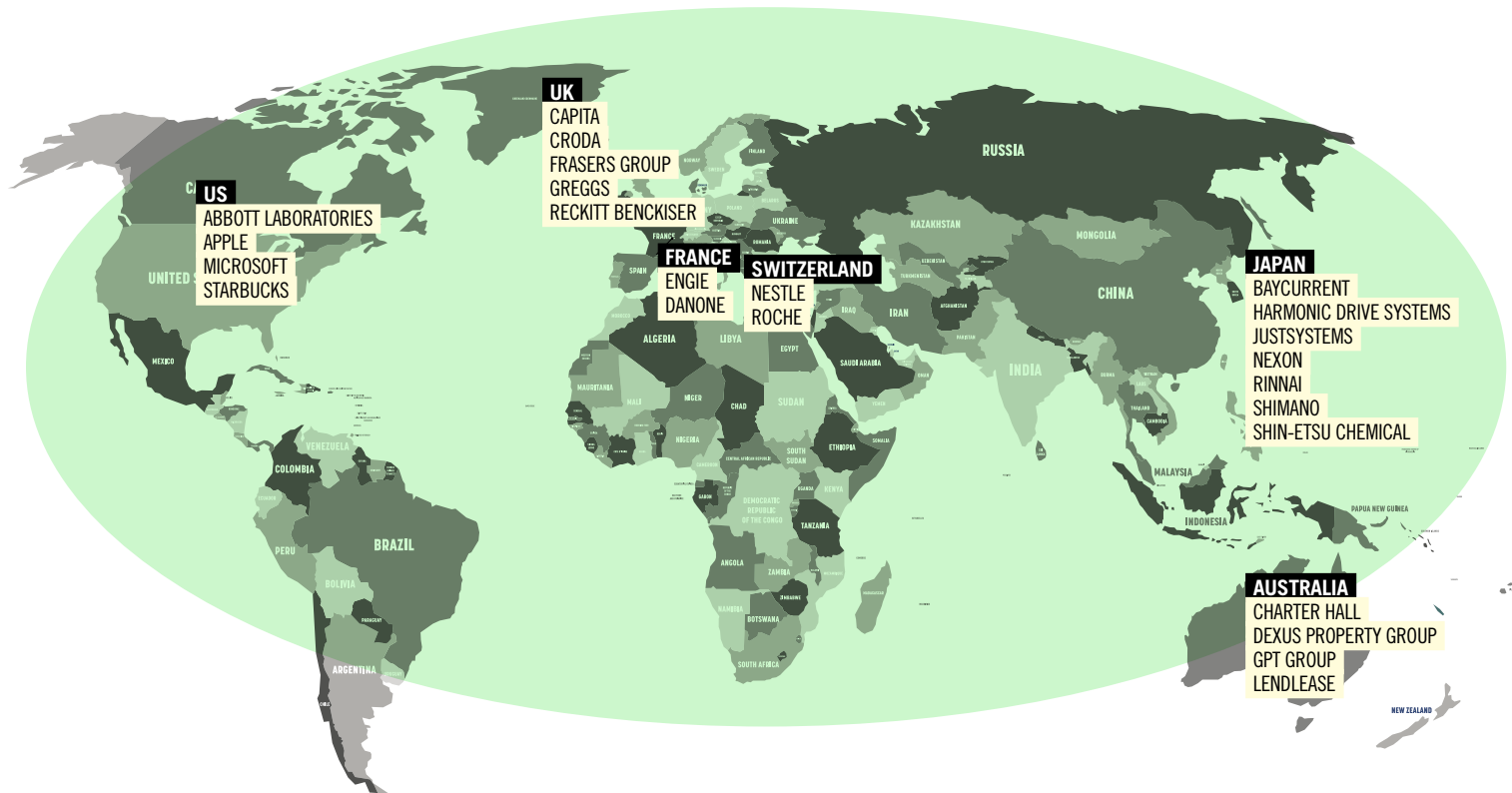
In practice then we have seen more direct impacts of competition policy at the level of company-specific enforcement activity. For example, on home turf, the Competition and Markets Authority (CMA) has ordered the JD Sports and Meta to sell off Footasylum and Giphy respectively after finding that their takeovers compromised competition. The British regulator has been unafraid to issue fines and/or investigate giants like Meta, Alphabet, Amazon and Apple over alleged anti-competitive practices. In July this year, pharmaceutical giants Pfizer and Flynn were hit with fines of £63 million and £7 million respectively in a case dating

back over ten years investigating the overcharging of the NHS through taking advantage of market domination.

Stern enforcement and more frequent fines for companies in sectors where competition concerns are frequently raised seem to be a more likely issues for investors to grapple with. Currently these may seem too small to consider material in many cases but in our view it is an important risk to manage. .

Asset managers need to be alert to competition challenges of their own. The question of ‘common ownership’, where the same investors hold stock in a group of companies in a concentrated industrial sector, continues to crop up in antitrust circles. Blackrock has disclosed this as a risk in its filings for several years now. It’s interesting to note that Warren Buffett, who popularised the concept of an ‘economic moat’ – the ability of a company to maintain market share and profits – was until the pandemic an investor in the major US airlines. This is a sector where the common ownership issue has been most scrutinised.

It is interesting to see moves by Blackrock and others to open up options for voting by underlying clients in this light. In our view this is undoubtedly a good thing for asset owners. It also addresses the concentrated potential power that concerns some, and also feeds the anti-ESG backlash in the US. We expect to see this trend for managers to open up voting to grow further. We also plan to contact asset managers to seek views on common ownership.



## MARKET CONCENTRATION

### Abbott Laboratories

**Overview:** Abbott Laboratories is an Illinois-based corporation with business activities primarily relating to the discovery, development, manufacture, and sale of a broad and diversified line of health care products. Abbott Nutrition is the division of Abbott Laboratories that manufactures infant formula. Baby formula is sold under the Similac, Elecare, Metabolic, and Alimantum brands.

**Issue Arising:** In February, the U.S Food and Drug Administration (FDA) issued a warning to consumers to stop using powdered infant formula produced at an Abbott Nutrition facility in Michigan after concerns of bacterial contamination baby formula products. This led to a shutdown of the facility, as the FDA investigated the potential link between contaminated

formula and the death of two babies. The shutdown of the plant, which accounted for approximately 15% of domestic infant formula production, led to significant shortages and compelled President Biden to take emergency measures in order to secure supply, including enacting Operation Fly Formula through which the Pentagon flew infant formula in from abroad. The FDA has also cut red tape to increase the supply of formula through increased imports. The shortage remains an issue today.

Concerns have been raised by law makers regarding the harmful economic effects of monopolies within the US, with some pointing to the infant formula shortage as an example.

**Engagement:** PIRC met with Abbott to discuss the company's response to the ongoing formula shortage, the health and safety concerns raised by a whistle-blower and the potential for regulatory response to the highly concentrated domestic baby formula market. The

company outlined that it had significantly increased the volume of Similac Advance powder formula produced at its Ireland plant for the US market in order to help alleviate the shortages. In addition, the company is prioritising infant formula production at its Ohio plant. With regards to former employee allegations that the Michigan plant equipment was defective, and formula shipped without adequate safety assurances, the company argued that the whistle-blower was a disgruntled former employee and the allegation unsubstantiated. The Company outlined it was cooperating with the FDA in its investigation and that its own probe found no conclusive evidence that the bacterial infection that led to the death of two infants was a result of contaminated formula. Abbott indicated that it did not consider the high market concentration in the baby formula sector to be a contributing factor to the existing shortages and that any regulatory changes emerging from the crisis will orientate towards levels of reserves.



**Outcome and follow ups:** Abbott believed that subsequent FDA action would not significantly impact existing market shares. The Company argued that new entrants to the market would have to evidence they had the resource and scale to meet demand, placing them at a significant disadvantage. We believe that sectoral competition policy is a relatively low risk but will keep the sector under review.

## Reckitt Benckiser

**Overview:** Reckitt Benckiser Group plc is a multinational consumer goods company headquartered in Berkshire. It is a major producer of health, hygiene, and nutrition products. Reckitt moved into the infant nutrition business by acquiring Mead Johnson, including its Enfamil product, in 2017. Its baby formula brands are Enfa: Enfamil, Enfagrow, and Enfinita.

**Issues arising:** Despite the contaminated baby formula emanating from an Abbott plant, Reckitt has been identified as a dominant player in the market, alongside Abbott, Nestlé and Perrigo. This raises a number of potential concerns, including the argument that a lack of competition has in turn resulted in a lack of innova-

tion and subpar safety protocols, with consumers severely limited in alternatives. In addition, the fact that the production of the formula is concentrated to a small number of facilities, itself a symptom of high market concentration, has piled significant pressure on the domestic baby formula market.

**Engagement:** PIRC met with the Company to discuss the ongoing infant formula shortages and the extent to which market concentration is considered a factor. The company outlined its response to the shortage has included, operating their plants 24/7, streamlining their product portfolio to maximise production capacity and working with the United States government on securing additional manufacturing inputs. This has resulted in a year-on-year formula production increase of 30%.

With regards to market concentration, the company did not consider this issue to be a contributing factor to the shortage but did outline the high barriers to entry in the market, owing largely to regulatory thresholds and the scale needed to compete for WIC contracts – contracts that are competitively bid between state agencies and manufacturers for the right to provide supplemental nutrition services based on nutritional risk and income eligibility. They repre-

sent a considerable revenue stream for participants in the infant formula market. The company further outlined potential regulatory responses to the shortage but did not consider there a significant risk to market share on this basis.

**Outcome and follow ups:** Similarly to Abbott, Reckitt did not believe that its share of the market was under threat, either from regulation or new entrants. The demands placed on prospective competitors in order to win profitable WIC contracts were thought to be too high.

## Nestlé

**Overview:** Nestlé S.A. is a multinational food and beverage company headquartered in Vevey, Switzerland. It is the largest food company in the world measured by revenues.

**Issues arising:** With Nestlé another big player in the baby formula market, the risk to investors is that the Biden administration, which has consistently voiced concerns over market concentration within the US more broadly, seeks to break-up the incumbents, diminishing market share and profitability. PIRC met with the Company to discuss

the company response to the ongoing shortage as well as any likely regulatory responses to the crisis.

**Engagement:** Throughout Q3 PIRC engaged with Nestlé regarding its response to the infant formula shortage in the US, as well as the company's view on potential structural and regulatory alterations to the industry in response to the issues. The company outlined that it had worked with the FDA to increase supply of infant formula into the US market, an increase equivalent to approximately 42 million eight-ounce bottles. The company further outlined it had pulled stock out of reserves to increase supply into the market. With regards to the extent to which the shortage is related to market concentration, the company indicated that it was likely a factor but that given the high barriers to entry in the market, specifically high regulatory thresholds for the import of formula, the company did not envisage a shift from the existing market duopoly in the US. In addition, the company called for a level playing field with regards to enforcement of breaches to the International Code of Marketing of Breast-milk Substitutes, an international health policy framework for breastfeeding promotion adopted by the World Health Assembly (WHA) of the World Health Organization (WHO) in 1981. The company argued that a lack of enforcement across the market made competing in the market even more difficult.

**Outcomes and follow ups:** In response to the shortage the FDA did, in July, announce plans to support overseas producers which had contributed to easing the formula shortage to secure long-term access to the U.S formula market. The FDA announced it will provide a way for producers temporarily selling in the U.S. to meet existing regulatory requirements in order to stay on the market. The overall consensus from Nestlé, and from engagements across the sector, was that this would not significantly impact existing market shares.

## TAX

### Engie

**Overview:** Engie SA is a French multinational utility company operating in energy transition, electricity generation and distribution, natural gas, nuclear, petroleum, renewable energy and the energy transition.

**Issues arising:** The company currently has a Tax Policy Statement that briefly outlines the governance of tax issues and approach to legislation. However, it does not meet the GRI Tax Standard as it does not publish an assessment of risks, or country-by-country reporting (CbCR).

**Engagement:** PIRC met with the Investor Relations team and the Global Head of Tax for the organisation. PIRC asked whether the company has discussed the implementation of the GRI Tax Standard, and specifically the publication of CbCR. They responded by saying that this has been discussed at audit committee level, but they currently have no plans to publish CbCR; they believe that it wasn't set up as an instrument for the public, but rather as an instrument for tax authorities.

PIRC highlighted our support for public CbCR and peer uptake of the Standard. The company stated that ongoing litigation and investigations are in regards to older tax practices that they have since reformed, and that a more prudent approach to transfer pricing is taken than it was 10 years ago. This is due to pressure from its major shareholder, the French government. They confirmed that they lobby at an EU and national level on tax issues impacting their business.

**Outcome and follow ups:** PIRC highlighted that, according to our tax brief regarding our expectations for companies regarding tax practices and disclosures, the publication of country-by-country reporting will be taken into account when deciding whether to recommend voting for or against a company's financial statement.

## Roche AG

**Overview:** Roche AG is a Swiss multinational healthcare company that in two divisions: pharmaceuticals and diagnostics.

**Issues arising:** PIRC has been engaging Roche as part of a broader engagement on tax transparency and responsible tax. The company currently reports in line with GRI Tax standard 207-1 and 207-2, but not 207-4: the publication of CbCR. Headquartered in Switzerland, the company receives significant tax concessions for R&D, but it has not been associated with recent tax controversies.

**Engagement:** PIRC met with the Roche's Area Tax Director, its Head of International Trade Affairs & Customs Regulations, and the Investor Relations team to discuss the company's overall approach to tax. The focus of the meeting was on how the company's tax strategy was aligned with its business and sustainability strategies, its approach to tax risks and tax governance frameworks.

The company confirmed that the introduction of public CbCR has been discussed at a board level, but the company has no intention or timeline to disclose such data at this stage. Similarly to Engie, they argued that they do not believe that public CbCR provides useful for information for investors, as it was a tool designed by and for tax authorities. They confirmed that tax authorities have stepped up their auditing of how company distributes profits between jurisdictions.

**Outcome and follow ups:** PIRC highlighted that, according to the tax brief regarding expectations for companies' tax practices and disclosures, the publication of CbCR will be taken into account when deciding whether to recommend voting for or against a company's financial statement.



## Microsoft

**Overview:** Microsoft Corporation is an American multinational technology giant, producing computer software, consumer electronics, personal computers, and related services. It also provides public, private and hybrid server products and cloud services. It is incorporated in Ireland.

**Issues arising:** Currently, Microsoft does not disclose revenues or profits in non-US markets, and foreign tax payments are not disaggregated. This makes it much more difficult for investors to evaluate Microsoft's risks from taxation reforms, or whether the company is engaged in responsible tax practices that ensure long term value creation for the company and the communities in which it operates.

A recent report by the Centre for International Tax Accountability and Research (CICTAR) traced "billions of dollars in financial flows between [Microsoft subsidiaries] that have zero employees and claim residency in known secrecy jurisdictions including Luxembourg, Singapore, Bermuda, Ireland, and the Netherlands." This includes an Irish subsidiary, which in 2020 recorded profits of \$315 billion, despite having no employees.

**Engagement:** In June 2022, PIRC supported and coordinated the filing of a shareholder proposal calling on Microsoft to produce a tax transparency report in line with the GRI Tax Standard.

The proposal was filed by AkademikerPension, Nordea Asset Management, PenSam, Greater Manchester Pension Fund and OIP Trust.

**Outcome and follow ups:** PIRC will be engaging Microsoft shareholders and proxy advisors to encourage them to vote in favour of the shareholder proposal. Microsoft subsequently wrote to PIRC confirming that it would not challenge the tax transparency shareholder proposal filed, with shareholders given the chance to vote on the proposal at the AGM in November 2022.

## HEALTHY PRODUCTS

### Danone

**Overview:** Danone SA is a French multinational food-products corporation based in Paris. It has four business lines: Fresh Dairy products, Waters, Early Life Nutrition and Medical Nutrition. Danone specialises in dairy products, dairy alternatives, water and coffee. Its brands include Activia, Alpro, Actimel, and Silk.

**Issues arising:** There is a growing public health crisis linked to obesity and diet-related ill health. This represents a material risk to companies that manufacture and market consumables high in fats, salt and sugar. Regulatory and consumer trends towards healthier diets have accelerated, and it is increasingly clear that the food and drink environment, flooded with less healthy products with high calorie counts, has been a significant driver of broader diet-related public health issues.

Food companies responsible for shaping this environment, like Danone, have a responsibility to ensure they are contributing positively toward public health.

**Engagement:** As part of Share Action's Healthy Markets Initiative, PIRC met with Danone to discuss its work on health and receive an update on its commitments. During the call the company was asked if it would report its sales revenue from healthier products, in part to supplement a commitment made by the company to increase sales and consumption of its healthy products made during 2020. The investor group pressed the company to

disclose its sales revenue and set long-term targets on this basis. The company stopped short of committing to long-term targets increasing the share of healthy products by revenue, but did provide further detail on its overall strategy of driving better health outcomes for consumers.

**Outcome and follow ups:** The company has reported that almost 90% of the volume of products sold during 2021 were 'healthy', as defined by government-endorsed definitions. In addition, the Access to Nutrition Initiative found that 65% of Danone's revenue derives from healthy products, making it one of the highest performing companies compared to other global manufacturers. This performance is largely driven by the company's portfolio, which is tilted towards dairy, waters and nutrition-based drinks.

### Britvic

**Overview:** Britvic plc is a soft drinks company with operations in Great Britain, Ireland, France and Brazil. Headquartered in Hertfordshire, its brands include Robinsons, J2O, Tango, and Fruit Shoot, amongst others. The Company has a partnership with PepsiCo, dating back to 1987, making and selling a number of PepsiCo brands.

**Issues arising:** Obesity rates continue to rise across the UK, particularly amongst children. As referenced for Danone, regulatory pressures facing companies which manufacture products high in sugar, fat and salt are increasing. It is imperative that companies exposed to these risks should take both responsibility for shaping consumer health and take action to improve access to healthy soft drinks.

Furthermore, the soft drinks industry faces a range of environmental issues. These include the GHG emissions associated with producing the packaging, the impact on biodiversity of said packaging, and the water intensive nature of soft drink production. Ensuring companies in this sector have plans in place to mitigate these risks is critical in both ensuring effective management of twin physical and regulatory risks associated with climate change, but also with regards to preserving brand equity.



**Engagement:** On public health, the company outlined its newly-introduced target to reduce the calorie content by 30 per 250ml serving by 2025. It has already achieved an average reduction of 25 calories through reformulation, based on initial calorie content of each product.

The company also outlined its ambition to set a science-based emissions reduction target, notwithstanding its existing targets to reduce Scopes 1 and 2 carbon emissions by 50% by 2025 (against a 2017 baseline) and Scope 3 carbon emissions by 35% in the same timeframe. On water stewardship, the company aims to reduce its manufacturing water intensity ratio by 20% (against a 2020 baseline). PIRC welcomed the existing targets and goals but asked the company to consider setting a more robust water-related goal that was context-based and includes the ingredient supply chain.

**Outcome and follow ups:** The company recognised the importance of water stewardship without making formal commitments to improve its existing approach. PIRC will continue to monitor how the company manages water risk.

## DIVERSITY AND INCLUSION

### Board Composition in Japan

**Overview:** In July 2022, PIRC sent a series of engagement letters to a set of Japanese companies with no female directors on their Board. PIRC identified seven companies to engage with: Baycurrent

Consulting Inc; Shin-Etsu Chemical Co Ltd; Shimano, Inc; JustSystems Corporation; Rinnai Corporation; Nexon Co Ltd; and Harmonic Drive Systems Inc.

**Issues arising:** PIRC has noted ongoing concern over corporate governance and the severe gender imbalance at the top of businesses in Japan. According to an article from Eaton Vance, 11.6% of Japanese boards have zero women directors while 50.58% only have one.

**Engagement:** PIRC sent all seven companies a letter explaining our expectations regarding board diversity, and reached

out for engagement. The expectations listed were to see an increase in female representation on the board. Only Baycurrent Holdings responded to the letter stating that it is 'an ongoing consideration' for them.

**Outcome and follow ups:** For all companies, if female representation at board level doesn't improve then PIRC will recommend votes against the Chairs of these companies.

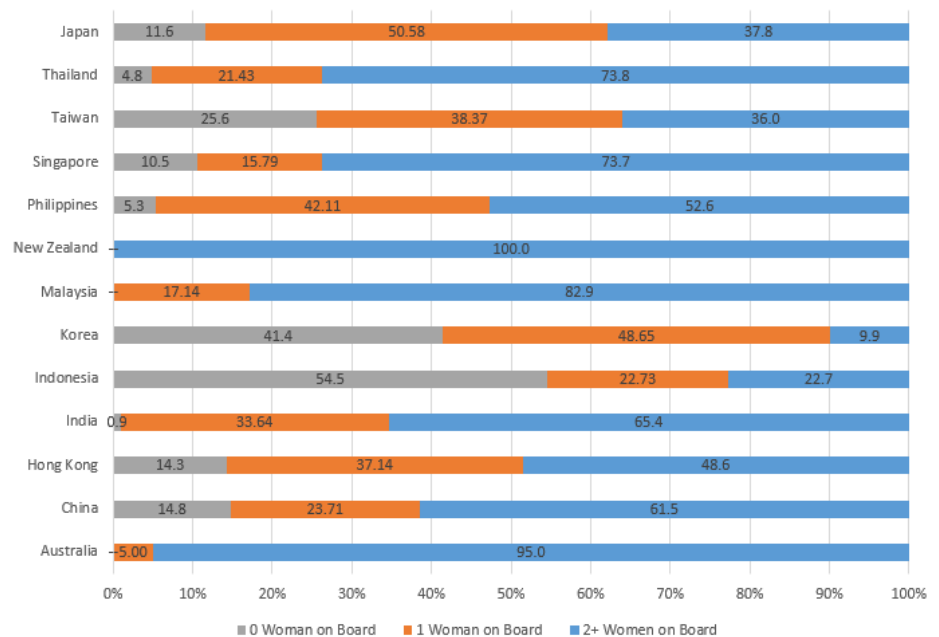
## M&A STEWARDSHIP AND VOTING TURNOUT

### Meggitt and Go-Ahead

**Overview:** As part of work on corporate governance issues PIRC has been looking at stewardship in relation to merger and acquisition (M&A) activity. There has been a particular focus on the impact of funds undertaking merger arbitrage trades. PIRC contacted two public limited companies subject to takeover bids to seek more information on voting results.

Meggitt plc is a UK-based components and sub-systems provider for the aerospace and defence sectors. At the time of engagement, Meggitt was in the process of being acquired by American company

Female Board Representation in the Asia-Pacific Region



Source: Eaton Vance



Parker Hannifin.

Go-Ahead Group plc is a public transport company providing contracted rail and bus services in the UK, Singapore and Europe. At the time of engagement, the company was in the process of being taken over by a consortium comprised of Australia’s Kinetic Group (51% stake) and Spain’s Globalvia (49%).

**Issues arising:** PIRC believes that the widespread use of equity derivatives by such funds may be having a negative impact on voting turnout. With that comes less scrutiny of corporate decision making and less accountability for company decision-makers to shareholders. Turnout at Meggitt’s AGM in 2022 was 25% compared to 81% in 2021.

At Go-Ahead Group there was a 21% vote against the scheme of arrangement required to progress its takeover. Under the UK Corporate Governance Code companies are expected to respond to votes against of 20% or more.

**Engagement:** PIRC met with the company secretary at Meggitt to discuss turnout at its AGM, which took place during the

**“To inspire and nurture the human spirit.”**

Starbucks slogan

**“It ruined me.”**

Maddie Duran, Starbucks barista speaking on effects of Starbucks’ anti-union activities.

bidding process. A number of hedge funds have built up significant derivative positions. The company had been advised that, due to changes in its share register during the bid, it should expect turnout to drop. The reduction in voter turnout however was particularly sharp. There was also a significant vote against one of the directors due to concerns about over-boarding. The company stated in response to this result that the reduction in turnout may have been a factor in the result.

PIRC contacted Go-Ahead regarding the 21% vote against the scheme of arrangement for clarification on the factors behind the vote. To date however, the company has not responded.

**Outcomes and follow ups:** Our work on stewardship activity in relation to M&A has raised a number of concerns. Therefore, we have published a client note summarising our findings and making recommendations for research. There is more information on this paper later in this report.

## FREEDOM OF ASSOCIATION

### Starbucks and Apple

**Overview:** Starbucks Corporation and Apple Inc are both large, multinational, American companies with hundreds of locations across the US. Both have fostered a reputation for supporting

social justice causes, but have come under fire for union-busting and anti-collective bargaining tactics.

**Issues arising:** PIRC been engaging with a wide range of US-listed companies over issues relating to employment practices including fundamental rights at work. During Q3 we continued our participation in an investor group engaging US-listed companies over freedom of association rights. This group includes New York City pension funds, Trillium Asset Management, Parnassus Investments, SOC Investment Group and PIRC.

The main focus for these engagements this year have been Starbucks Corporation and Apple Inc. In both cases there have been high-profile efforts by employees in the US to seek independent representation through a trade union, with over 200 Starbucks stores in the US voting to unionise.

Apple and Starbucks both refer in their human rights policies to their support for ILO fundamental conventions on Freedom of Association and Collective Bargaining. According to the ILO, “Freedom of association refers to the right of workers . . . to create and join organisations of their choice freely and without fear of reprisal or interference”. However it is questionable whether these rights area always respected in practice.

In the case of Starbucks the National Labor Relations Board has now issued numerous complaints against the company relating to dozens of violations of the National Labor Relations Act. Allegations include firing of pro-union employees and the withholding pay and benefit improvements from union members.

**Engagement:** The group has sought to engage meaningfully with both companies over their approach to Freedom of Association; however, this has not been successful. Therefore, the group decided to escalate engagement at both companies by filing shareholder resolutions. The proposals ask that companies commission independent third-party reviews of the implementation of their commitments on freedom of association and collective bargaining. PIRC clients have supported the filing of these resolutions.

**Outcomes and follow ups:** PIRC will report in more detail on the progress of the resolutions in the next quarter.

## WORKFORCE ENGAGEMENT

### Frasers Group

**Overview:** Frasers Group plc is a retailer of sports and leisure clothing, footwear and equipment, headquartered in Shirebrook, Derbyshire. It operates through four segments: UK Sports Retail, International Sports Retail, Premium Lifestyle, and Brands.

**Issues arising:** As part of our ongoing work in relation to companies’ approaches to workforce engagement PIRC has sought to engage with companies that have chosen different models under the UK Corporate Governance Code. Frasers Group is one of a handful of publicly listed companies that has sought to appoint an employee director. Therefore, PIRC arranged a meeting with the director to better understand how the model works in practice.

**Engagement:** The first part of the discussion focused on how the role is filled. Frasers explained that potential candidates applied for the position, and were subsequently interviewed and screen tested before a final candidate was chosen for appointment by Frasers management. The workforce, including indirect employees, had the opportunity to vote on the final candidate. The appointed employee director, who is a store manager, has one day per week dedicated to the role.

The appointee at Frasers began on the shopfloor in the retail side of the business and has chosen to commit to a career within the company. No doubt because of her experience working for the company, she appeared to be very focused on practical workforce issues. She has, for example, intervened on commission rates for certain products, as well as taking a view on the appropriateness of uniforms. As with other employee directors, it was clear that direct knowledge of working practices, and the issues that matter to the workforce, was valuable to the board. She did not express having a relationship with unions and there is no recognised union in the company.

It appears that the model is primarily geared towards providing the board with practical insights from the workforce

that might benefit the business. Whilst this is desirable to the company and its investors, it is important to distinguish this from a role which is conceived as primarily focusing on employee interests. This was a factor detected in the JD Wetherspoons model too. Whilst in many cases improvements for the workforce will be beneficial to the business and its investors in some cases there will be tension. This is why clarity about such roles is important.

Emphasising this distinction, it also appeared that the role provides an opportunity for seniority and progression within the company, due to interaction with those at the highest level of within the business. This is unsurprising as the appointment process is run by the company rather than by the workforce, though Frasers workers do have a say at the final stage of the process. It was also noted that the company has agreed to extend the post with no timeframe given for reappointment.

**Outcomes and follow ups:** Across our engagements on this topic we have found that employee directors offer a more credible method of workforce engagement than the designated NED model. The issues highlighted and nature of the discussion feels much more grounded in the experience of employees, and boards appear to value the information that such roles generate. PIRC considers that such roles could be improved by their mandate being provided by the workforce in a more democratic manner. PIRC will be developing policy proposals on this topic.

### Capita

**Overview:** Capita plc is a UK-based consultancy firm which also provides digital services and software solutions.

**Issues arising:** As part of our ongoing work in relation to companies’ approaches to workforce engagement PIRC is also seeking to monitor how investors interact with boards. Regrettably, a vote in excess of 20% against one of the two employee directors on the board of Capita at its AGM was recorded. In response the company noted that some investors consider employee directors non-independent and had voted against this director as they were a member of the



remuneration committee.

PIRC was concerned that significant votes against any of the small number of employee directors have the potential to dissuade other boards from adopting this model.

**Engagement:** PIRC wrote to the chair of Capita PLC to express our ongoing supporting for employee representation at board level and to make clear that we believe employees can be incorporated with unitary boards without compromising independence.

**Outcomes and follow ups:** PIRC continues to review investors' policies and practices in relation to employee voice at work.

## WORKER-DRIVEN SOCIAL RESPONSIBILITY/SUPPLY CHAIN DUE DILIGENCE AND CLEANING

Business supply chains always face operational risks of forced labour, more so as those chains extend across borders. Decades of research has found that private compliance initiatives (PCIs) are insufficient to effectively manage these business and operational risks from labour violations. These often use vague mechanisms such as codes of conduct, auditing, certification schemes or other self-reporting mechanisms. This research shows that the only effective workplace compliance initiatives are those which include a formal role for workers and trade unions in compliance, otherwise known as “worker driven social responsibility initiatives”.

This quarter PIRC conducted research into the due diligence policies and practices that Australian Securities Exchange-listed Real Estate Investment Trusts (REIT) have put in place to address

modern slavery and labour non-compliance risks in their commercial cleaning supply chains.

PIRC produced a research report that analysed the second round of modern slavery reporting by nine listed property owners. Cleaning up their Act? Modern Slavery Due Diligence in the Australian Property Sector, focused on commercial cleaning supply chains for two reasons. First, cleaning is one of the domestic sectors at highest risk of modern slavery. Second, it is a sector where property owners have some of the greatest leverage, as they have direct oversight of procurement, the work takes place in their own buildings, and it is a high spend area. It is also a sector where a globally pioneering due diligence pilot has been established to deal with supply chain risks. This mechanism is known as the Cleaning Accountability Framework (CAF).

PIRC reviewed reporting of the following companies: Cromwell Property Group (CMW), Charter Hall (CHC), Dexus (DXS), GPT (GPT), Lendlease Group (LLC), Mirvac (MGR), Scentre Group (SCG), Stockland (SGP), Vicinity Centres (VCX). Companies were given the opportunity to review the

data and to meet with PIRC prior and following publication of our report.

## Charter Hall Group

**Overview:** Charter Hall Group is a fully integrated property group, with long-leased assets across the office, industrial & logistics, retail and social infrastructure sectors. Its business operations include property development, property management (including asset management) and investment management, corporate services and operations.

**Issues arising:** Charter Hall is a member of the Cleaning Accountability Framework. They have certified two buildings, and have committed to certify two more. They have not indicated whether they intend to pursue portfolio certification or certify additional buildings under the framework. Outside of CAF buildings, PIRC's research identified a number of areas where the company was lagging on the disclosure of due diligence processes.

**Engagement:** PIRC met with the Head of Sustainability at Charter Hall following the launch of the cleaning report. The company did not engage with PIRC prior to the report launch and did not provide feedback on our analysis. However, there was no disagreement with the content of the report or PIRC's analysis.

**Outcome and follow ups:** The Head of Sustainability stated that she would provide the report and additional PIRC feedback to the relevant Charter Hall operations teams for internal discussion.

## Dexus Property Group

**Overview:** Dexus is an Australian REIT that owns office, industrial and health-care properties. The directly owned portfolio consists primarily of office properties located across Sydney, Melbourne, Brisbane and Perth.

**Issues arising:** Dexus is not a member of the CAF and has not certified any buildings through this scheme. The company performed relatively poorly compared to other listed property owners across almost all report indicators.

**Engagement:** PIRC met twice with company investor relations, sustainability and procurement teams regarding the due diligence report. The initial meeting was held to discuss PIRC's analysis of Dexus's supply chain and procurement policies relating to the cleaning supply chains. Overall, Dexus thought that PIRC's assessment was fair, but pointed to commitments to begin a pilot of building audits through CAF in 2023.

Dexus arranged a follow-up meeting to discuss the report findings. During engagement, the company was focused on how to improve disclosure to shift company scores across a number of categories from 'basic' to 'improving'. However, there was no engagement with the specific practices required to move performance to 'leading' – namely, to have a formal role for the union or undertake CAF certification in supply chain due diligence.

**Outcome and follow ups:** The company indicated that it intends to begin a pilot of building certification through CAF in 2023. PIRC will monitor this and engage the company further in 2023 regarding certification progress.

## GPT Group

**Overview:** The GPT Group is an Australian REIT that owns retail, office, logistics, and business park assets. It also undertakes fund management and some development.

**Issues arising:** GPT is a member of the CAF. Two buildings have been certified, with a commitment to certify two more. The company has indicated that it intends to undertake portfolio certification through CAF once it is launched in 2023.

**Engagement:** PIRC met the company twice regarding our cleaning report. The first meeting was held with GPT's Director of Reporting to discuss analysis of its modern slavery reporting, specifically GPT's disclosures regarding due diligence in its cleaning supply chains.

PIRC held a follow-up meeting with the investor relations and procurement teams to discuss the findings of the report. The company confirmed that the report had been raised at board level. GPT confirmed that the new modern

slavery report published in October 2022 addresses some of the issues that were identified in the PIRC report. The company raised confidentiality and commercial concerns about PIRC's request for greater disclosure regarding suppliers, disclosure of grievances, and provision of due diligence case studies. PIRC identified that these disclosures are common in other sectors, and that the recommendations put forward reflect research commissioned by the peak body for the Australian property industry.

**Outcome and follow ups:** GPT has indicated in reporting that it intends to pursue CAF portfolio certification once the pilot is complete. In the meantime, it has put forward two additional buildings for certification. The company also highlighted that many of the issues raised were addressed in their 2022 Modern Slavery report, to be released in October 2022. PIRC will monitor progress on certification and will engage again ahead of its AGM in April.

## Lendlease

**Overview:** Lendlease Group is an Australian multinational construction, property, investment and infrastructure company.

**Issues arising:** Lendlease has been a member of the CAF for a number of years. However, it has not moved to certify any of its buildings under the framework. As such, the company did not score highly in the report; there was a lack of formal processes to engage cleaning suppliers' workforces in modern slavery due diligence.

**Engagement:** PIRC met with the Head of Sustainability prior to the publication of the report to discuss PIRC's analysis of Lendlease's reporting. The company largely agreed with the report's assessment of disclosure. Lendlease noted selected instances where company practices that would have met some of the assessment requirements were not disclosed. Following the release of the report, PIRC met with the broader operations and investor relations team to present on the findings of the report and how these may be embedded into company procurement practices going forward.

**Outcome and follow ups:** The company disclosed that it has secured a slot to begin the certification process for one of their commercial office buildings under the CAF. PIRC encouraged Lendlease to make a public commitment to certifying its entire portfolio, once CAF launches portfolio certification in 2023. PIRC will monitor the launch of portfolio certification in 2023, and will engage Lendlease again regarding broader certification.

## HEALTH AND SAFETY

PIRC is undertaking a series of engagements with FTSE350 companies that have received notices from the Health and Safety Executive (HSE). The purpose of this series of engagements is to see how companies respond to HSE notices and what actions they take to mitigate safety risks. Occupational health and safety (OHS) is first and foremost about protecting the people employed by companies and therefore the primary focus must be on ensuring that safety risks are managed effectively. It is now also recognised at the International Labour Organisation as a fundamental right at work. OHS is also a financially material risk for investors, with the potential to bring regulatory action and fines and severe reputational damage. PIRC's research and engagement on this topic is likely to expand in future.

## Barclays

**Overview:** Barclays plc is one of the largest banks in Europe, headquartered in London.

**Issues arising:** Barclays' cases trace back to a number of small companies in the Business Growth Fund (BGF) between 2018 and 2021. The company's pay and working conditions were also discussed.

**Engagement:** PIRC discussed Barclays' responses to the HSE notices and what the company is doing to ensure good standards of OHS across its business. The bank stated that any notices the smaller BGF companies receive are down to that company to deal with, and not Barclays. With regard to the company's own OHS approach, there were discussions around the recent

focus on mental health and the launch of the 'This is me' campaign for employees which they continue to develop. All colleagues have completed mandatory mental health training. There was also some conversation on pay and conditions at the company, with staff welfare important for workers' own mental health. Staff turnover has been a key issue for many companies and Barclays said that whilst it has increased in recent times, all of the big banks are seeing a rise as well. It is not a KPI, but rather a performance measure that is assessed by the board on a quarterly basis and are trying to gather as much information on the issue as possible. The company's gender pay gap also increased during 2021 due to a change in the reward structure.

**Outcome and follow ups:** PIRC encouraged the company to disclose more data alongside their WDI reporting, the example being improving ethnicity pay gap reporting to align with CIPD recommendations.

## Croda International

**Overview:** Croda International plc is a UK-based speciality chemicals company, listed on the London Stock Exchange.

**Issues arising:** Croda received a HSE notice in 2019. Wider workforce issues were also discussed.

**Engagement:** Regarding the 2019 notice, Croda stated it was asked by the HSE to update a tank farm at a site in the UK within 12 months following an inspection. Croda had planned to fix this issue prior to the visit but was subsequently told to upgrade the tank farm quicker than the company's original scheduling. PIRC also requested an update on the 2018 chemical leak in Delaware; the company said there were no injuries or damages to the plant. The site was closed for 3-6 months, with around \$60 million spent to improve the site since. In relation to turnover rate, the percentage did increase slightly last year due to Covid. The company feels it has quite a high turnover rate, despite it being lower than comparative peers. However, it has always been difficult for them to hire and retain in the more technically demanding positions. The company feels they offer competi-

tive bonus and payment schemes. Croda believes its bonus and payment schemes are competitive.

**Outcome and follow ups:** PIRC encouraged the company to participate in the WDI and provide a full breakdown of H&S data, including by employment type. PIRC will monitor progress.

## Greggs

**Overview:** Greggs plc is a British bakery chain, based in Newcastle upon Tyne. It is listed on the London Stock Exchange.

**Issues arising:** PIRC discussed Greggs' approach to OHS as well as the recent industrial action by couriers of Stuart Delivery (a Just Eat contractor). Workforce composition was also discussed.

**Engagement:** With regards to OHS, Greggs does not disclose any data about safety outcomes of its workforce. All incidents, including frequency rate for lost time injuries and RIDDOR, are reported internally and benchmarked against other food producers. The company did not see a need to disclose these publicly as it felt its own rates were generally good. However, without publication and the ability to meaningfully compare, such claims cannot be verified. Given that the company describes 'Compliance and Fines', including from the HSE, as a 'Principal Risk' to the business in its 2021/2022 annual report, PIRC shared the expectation that OHS disclosures were made public so that stakeholders can monitor progress against this risk.

The industrial action by couriers in dispute with Stuart Delivery presents reputational risk to Greggs. The company has primarily responded by liaising with Just Eat, who hold the food delivery contract with Greggs, to seek confirmation that their working standards are acceptable. The company has also met informally with members of the IWGB union representing the couriers but prefers not to be involved in discussions within the supply chain. Food delivery is expected to reach 10% of the business in the next two years, meaning disruption among this workforce is financially material. PIRC encouraged Greggs to liaise with all stakeholders,

including unions, to resolve the issues.

Finally, in relation to workforce composition, the company informed us that there are only a small number (around 500) of contingent workers among the 28,000-strong workforce. These include people on fixed-term contracts in management areas such as IT and support areas, as well as approximately 50-200 agency hires working in manufacturing and logistics, dependent on demand.

**Outcome and follow ups:** PIRC stressed that investors would be keen to see the OHS data that is produced internally and will monitor whether the company releases data in the next annual report.

## PIRC PUBLICATIONS

During Q3 PIRC published two policy reports: one on derivatives, and the other on modern slavery due diligence.

Our analysis found that investor stewardship in relation to mergers and acquisitions is a “black hole” in the UK’s governance framework. Democratic Deficit: Takeovers, Derivatives and Stewardship highlights the role of derivatives and its impact on voter turnout during mergers and acquisitions (M&A). Having reviewed shareholder voting at company meetings held during a takeover, PIRC has found turnout dropping by an average of almost 25%. At a string of company meetings, less than half the shares were voted even when the meeting was seeking approval to proceed with the takeover. In three cases, less than a third of shares were voted.

Cleaning up Their Act? is the second in an annual series of reports that assesses the due diligence policies and procedures that nine large, listed office and retail property owners in Australia have put in place to prevent modern slavery and labour exploitation in one of their highest risk sectors: commercial cleaning. It is clear from this analysis that companies are still falling short when it comes to due diligence in their cleaning supply chains.

As in 2021, the analysis found that property owners were relying on reporting and oversight mechanisms that decades of evidence show are not fit-for-purpose and that have regularly failed to pick up instances of modern slavery and labour abuse in their supply chains.

PIRC also published our full response to the Australian Treasury’s consultation on tax transparency. It called on the Australian government to mandate CbCR tax reporting by large multinational companies. In our submission to the Australian Treasury’s Consultation on Multinational Tax Integrity and Enhanced Tax Transparency, we recommend that the government require multinationals headquartered or operating in Australia to publish tax and financial information for each jurisdiction where they operate. Mandating this information would provide shareholders with much needed financial information to judge the financial performance and risk profile of the companies in which they invest. PIRC asks Treasury to align reporting requirements to the existing, global GRI Tax Standard. The Standard was developed through a robust consultation process and was supported by some of the world’s largest asset owners and managers.

## PIRC EVENTS

Following the filing of a tax transparency shareholder resolution at Microsoft, our tax lead, Dr Katie Hepworth, spoke at the FACT Coalition’s launch of its report, [A Material Concern: The Investor Case for Country-by-Country Reporting](#). Dr Hepworth spoke alongside Senator Chris Van Hollen on the importance of public CbCR for investors and regulators. PIRC was also present at the UNPRI Tax Reference Group Meeting.

At the end of September PIRC held a further webinar on human and labour rights risks in the rubber glove industry. This focused both on ongoing labour concerns in the sector and some of the remedies, including active use of public procurement.

PIRC spoke at a variety of events across different sectors, including on labour standards, as well as the Corporate Governance Forum, speaking about the cost-of-living crisis and PIRC’s research on work-related ESG issues. Our labour specialist, Alice Martin, attended the first global meeting of the Task Force on Inequality-related financial disclosures, a risk management framework seeking to reduce inequality within the private sector. It will provide metrics, targets and guidance about inequality reduction

within the context of climate limits and human rights.

## PRESS

### Shareholder Resolutions

[Shareholders slam MNEs with GRI transparency proposals | International Tax Review](#)

[Corporate Tax Reporting Now a “Mainstream” Issue for Investors – ESG Investor](#)

[NYC Retirement Systems places order at Starbucks for review of workers' rights | Pensions & Investments \(pionline.com\)](#)

[Les investisseurs de Starbucks demandent un examen de la façon dont l'entreprise gère les activités syndicales - Crumpe](#)

### Due Diligence

[Major investors call on UK government to implement due diligence legislation | Responsible Investor \(responsible-investor.com\)](#)

[Australian Property Firms Fall Short on Modern Slavery – ESG Investor](#)

### Workplace Safety

[Make them count: ‘Huge gaps’ exposed in safety reporting and accountability - Hazards magazine](#)

### Pay

[Sainsbury’s and M&S to face shareholder pressure over employee pay - Retail Gazette](#)

[City forecast: Sainsbury’s set to face shareholder pressure to pay National Living Wage | The Scotsman](#)

[Vodafone investors urged to vote against its chief executive’s pay | This is Money](#)

<https://www.telegraph.co.uk/business/2022/07/25/fewer-mobile-networks-would-healthier-uk-says-vodafone-boss/>

[Boris Johnson rules out windfall tax on electricity firms | Energy industry | The Guardian](#)

[Water Companies Risk Bonus Backlash as Sewage Taints UK Beaches - Bloomberg](#)

<https://www.theguardian.com/business/2022/sep/11/ryanair-investors-urged-to-vote-down-excessive-bonus-payouts>

[Wizzing Revolt: £100m Bonus For CEO Causes Revolt at Wizz Air - AviationSource \(aviationsourcenews.com\)](#)

[Diageo boss Ivan Menezes is 'overpaid', claims shareholder adviser - Independent.ie](#)

[CITY WHISPERS: Outspoken Dechra boss Ian Page takes £1m pay hit | This is Money](#)

[New investor fury at Wizz Air boss's £100m bonanza | This is Money](#)

#### Tax

[SEC Should Require Public Tax Reporting by U.S. Multinationals, Advocacy Group Says \(thomsonreuters.com\)](#)

[How investors are tackling tax avoidance - Capital Monitor](#)

<https://news.bloombergtax.com/daily-tax-report/group-urges-australia-to-require-country-by-country-reporting>

[Cisco urges shareholders to reject tax transparency proposal | Financial Times \(ft.com\)](#)

[Cisco to Put Tax Transparency Proposal to Vote – ESG Investor](#)

[Greater Manchester's tax transparency proposal for Cisco to be put to vote | News | IPE](#)

[Cisco insta a los accionistas a rechazar la propuesta de transparencia fiscal \(yahoo.com\)](#)

[Cisco Allows Vote On Public Country-By-Country Reporting - Law360](#)

[Cisco asks shareholders to vote against global tax transparency • The Register](#)

#### Strikes

[Forget the 1970s — strikes signal a dysfunctional labour market | Financial Times \(ft.com\)](#)

#### Governance

[Ryanair apologises for blocking media from attending AGM | Reuters](#)

Syndicated in: [Ryanair apologises for blocking media from attending AGM \(irishexaminer.com\)](#)

& Yahoo: [Ryanair apologises for blocking media from attending AGM \(yahoo.com\)](#)

[PIRC: UK Stewardship Code Should Extend to M&A – ESG Investor](#)

## Q3 Engagements

PIRC engaged with several hundred companies over issues relating to meetings that took place during the quarter. The table below lists further stewardship engagements with companies on ESG issues. In a number of cases, we engaged with a company more than once during the quarter.

Company	Domicile	Issue	Collaborative
ABBOTT LABORATORIES	USA	Competition policy, reputational risk	
AMAZON.COM INC.	USA	Tax	
APPLE INC	USA	Freedom of association, collective bargaining	Y
BARCLAYS BANK PLC	GBR	Employment Standards	
BARRICK GOLD CORPORATION	CAN	Environmental Risk	
BAYCURRENT CONSULTING INC	JPN	Board diversity	
BRITVIC PLC	GBR	Environmental Risk	
BURBERRY GROUP PLC	GBR	Environmental Risk	
CAPITA PLC	GBR	Workforce engagement, board composition	
CHARTER HALL GROUP	AUS	Supply Chain Management	
CRODA INTERNATIONAL PLC	GBR	Employment Standards, social risk	
CROMWELL PROPERTY GROUP	AUS	Supply Chain Management	
DANONE	FRA	Public Health	Y
DEXUS PROPERTY GROUP	AUS	Supply Chain Management	
ENGIE SA.	FRA	Tax	
ESSENTRA PLC	GBR	Governance	
FORTECUE METALS GROUP	AUS	Employment Standards	
FRASERS GROUP PLC	GBR	Workforce engagement, board composition	
GLAXO SMITH KLINE	GBR	Employment Standards	
GLENORE PLC	JEY	Climate Change	
GO-AHEAD GROUP PLC	GBR	Shareholder Rights	
GPT GROUP	AUS	Supply Chain Management	
GREGGS PLC	GBR	Employment Standards, social risk	
HARMONIC DRIVE SYSTEMS INC	JPN	Board diversity	
JD SPORTS FASHION PLC	GBR	Competition policy, reputational risk	
JUSTSYSTEMS CORP	JPN	Board diversity	
KIMBERLY-CLARK CORPORATION	USA	Human Rights	
LENLEASE GROUP	AUS	Supply Chain Management	
MARKS & SPENCER GROUP PLC	GBR	Employment Standards, social risk	
MEGGITT PLC	GBR	Shareholder Rights	
MICROSOFT CORPORATION	USA	Tax	
MIRVAC GROUP	AUS	Supply Chain Management	
NESTLE SA	CHE	Competition policy, reputational risk	
NEXON CO LTD	JPN	Board diversity	
RECKITT BENCKISER GROUP PLC	GBR	Competition policy, reputational risk	
RINNAI CORP	JPN	Board diversity	
ROCHE HOLDING AG	CHE	Tax	
RYANAIR HOLDINGS PLC	IRL	Shareholder Rights, board composition	
SCENTRE GROUP	AUS	Supply Chain Management	
SHIMANO INC	JPN	Board diversity	
SHIN-ETSU CHEMICAL CO LTD	JPN	Board diversity	
STARBUCKS CORPORATION	USA	Freedom of association, collective bargaining	Y
STOCKLAND	AUS	Supply Chain Management	
VICINITY CENTRES REIT	AUS	Supply Chain Management	

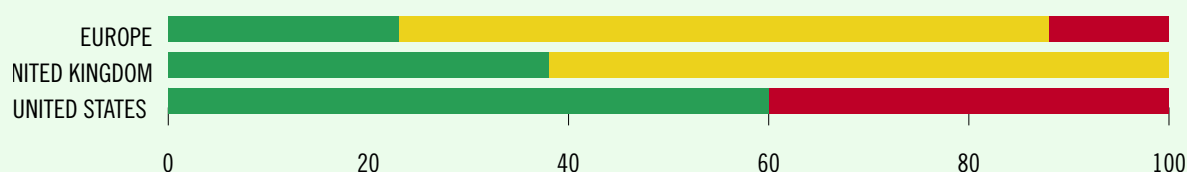
## STAKEHOLDER ENGAGEMENT

During 2022 PIRC has begun to log engagements with affected stakeholders undertaken as preparation for stewardship meetings. Below we list companies where we have held stakeholder engagement and the topics that these focused on. We will now include a summary of stakeholder engagements in each Voice report.

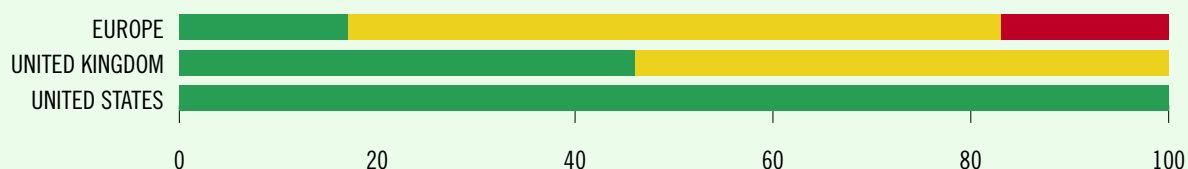
Topic	Companies
Deforestation	SUZANO SA
Climate change	CREDIT SUISSE GROUP, BARCLAYS PLC, HSBC HOLDINGS PLC
Airline industry standards	WIZZ AIR HOLDINGS PLC, RYANAIR HOLDINGS PLC, INTERNATIONAL CONSOLIDATED AIRLINES GROUP SA
Human and labour rights	ANSELL LTD, SUPERMAX CORP, APPLE INC, STARBUCKS CORPORATION, WHITBREAD PLC
Pay and benefits	ASDA, SAINSBURY'S
Industrial disputes	CK HUTCHISON HOLDINGS LTD, BT GROUP PLC, GREGGS PLC, JUST EAT TAKEAWAY.COM N.V.

## Q3 VOTING RECOMMENDATIONS

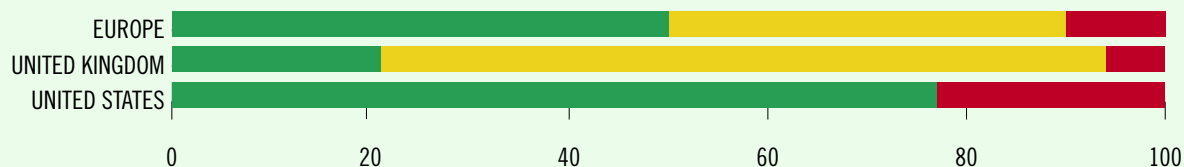
### Remuneration advisory (%)



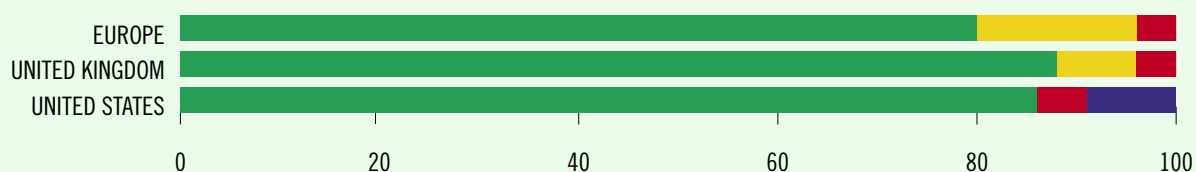
### Remuneration binding (%)



### Auditor appointments (%)



### Director elections (%)



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