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ESG Now Podcast

“Climate infuses proxy strategy and South Korea ponders 69-hour work week”

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Hello and welcome to the weekly edition of ESG Now, the show that explores how the environment, our society, and corporate governance affect and are affected by our economy. I'm Bentley Kaplan, your host for this episode. On today's show, we're going to get into two stories. First, we're going to take a look at a proposal by South Korea's government to make some changes to the country's laws governing work hours. There will be a little bit of maths involved, but I promise to keep it light. And then we'll take a quick look at CalPERS recap of its 2022 proxy season, particularly over its voting on climate strategy. Thanks for sticking around. Let's do this.

First up, we're going to talk about South Korea, and that's because the national government has proposed potential changes to the company's laws governing working hours, specifically its Labor Standards Act. And when a government wants to change how companies can manage their workforces, there are a lot of stakeholders that take notice, not only companies and workers, but investors too because a workforce is all important in senior company's strategy come to life. The better managed and incentivized workers are, the better positioned a company is to benefit from their efforts. But that cuts both ways because if workers feel disengaged or poorly motivated, they might not feel like going above and beyond for their employer. And ESG researchers will also be watching what happens in South Korea because a change in regulation can mean changes in the underlying risks a company might face or in what tools it can use to manage those risks.

Suffice it to say, that when the South Korean government propose the change in the country's working hours, a lot of ears pricked up. Now, as things currently stand, a work week is restricted to a maximum of 52 hours, which is made up of 40 hours of regular work and then a maximum of 12 hours overtime. So that can mean an employee is working 10 hours a day total on average, pitching up at eight in the morning and leaving it around six at night. And this current system was introduced in 2018. The change was brought about in response to the very long hours that were typical for many South Koreans at the time. For reference, in 2016, the country's workers were putting in an annual average of about 2070 hours, which is 300 more than the OECD average at the time. Before the law changed in 2018, a work week could technically add up to 68 hours, and that's a 40-hour work week, Monday to Friday and 12 hours per week of overtime.

But there was also no explicit prevention of weekend work. So you technically add up eight hours on Saturday and Sunday and you end up with a maximum of 68 and keep that number 68 in the back of your mind just for a few minutes because now the government has proposed a reform of this 2018 law. The idea is that a working week will still be restricted to a maximum of 52 hours on average, which is a key asterisk, but the maximum work week, including overtime, will be bumped up to 69 hours. So in a busy time, the argument goes, companies would've flexibility to keep their employees at work for longer days, a weekly maximum of 69 hours, and then in quieter periods to drop those hours or extend vacation time so that overall, workers are doing 52 hours per week on average. And companies can choose the time period over which these hours would be averaged all the way up to one year.

So taken one way, this wouldn't necessarily see workers having longer total hours, a maximum of 52 hours per week currently, and a proposed maximum of 52 hours per week averaged out over X many weeks. You'll be glad to know that's pretty much all the maths we'll need to do. Now, the proposal is currently under public review and the government had hoped to pass it through the National Assembly

near the middle of the year, but there has been fairly outspoken resistance to this proposed reform, at least from some stakeholders in South Korea. So to get a better handle on what's happening, why this change is being proposed and why it's facing resistance despite theoretically offering better flexibility, I called up SK Kim from MSCI's Seoul office.

SK Kim:

It's a four dimension I would say like stakeholders where we have different voices regarding this topic. Firstly, it's on the young and the elderly. The second is on the blue collar and white collar, and also it's also between the corporates and unions and also unions between the unions itself because there are different voices raised by different unions. The main aim for this policy is to give more flexibility for the companies as well as the employees to focus more on production in the peak times and allowing for, let's say more of a longer time vacation at the times of less works to be done.

But then I think the problem or the resistance come because of more of a fundamental cultural issue or a working culture if I could put it that way, in Korea where employees tend to have lesser voice as to when they can take time off. Firstly, it's a teamwork environment where many of the Korean companies value teamwork, much of the cultural sense where if you have to deliver the work that needs to be done as a team, therefore it also could mean that you have less liberty to have a perfect work-life balance. And that's probably the reason why people are not very happy about the new proposal by the government.

Bentley Kaplan:

Right. So there has been some backlash to the government's proposal, and as SK sees it, at the heart of it is the question of whether this new approach takes into account the actual social dynamics of the country's workplace. You see, a strong sense of teamwork or loyalty to one's colleagues may make it difficult for someone to actually scale back their hours in quieter periods being seen or even feeling as though they're letting the team down. So you could end up with a maximum work week of 69 hours, but with this pressure to work, to produce, there seems to be the very real possibility that workers won't recoup their personal time during quieter periods.

In fact, per one of the government's own surveys, workers at only 40% of Korean companies actually took their full quota of leave in 2020. And our own ESG data points to potential shortcomings in how well South Korean companies might be managing their labor related risks, which includes things like boosting employee engagement and offering things like parental benefits, employee stock options, and pension funds, efforts that might help companies steer their workforces through a substantial change in working hours.

Looking at the two key issues in our ESG ratings model that we would use to measure these areas, specifically labor management and human capital development, we found that compared with an average of all markets in our coverage, South Korean companies scored about 10% lower on their management of risks that related businesses relying on more manual labor, more labor intensity, and about 18% lower on their management of risks related to more highly skilled business segments, things like IT or finance. We also found that when it came to more labor-intensive businesses, South Korean companies had 30% more controversies or incidents related to their workforce, things like employee lawsuits, regulatory findings and penalties. SK also told me about the example of COVID-19 where employees were given the flexibility of being able to work from home, being able to take their laptops home with them, but instead, this flexibility actually meant people became time poor and suffered from burnout syndrome.

They struggled to draw a line between work and life and overwork or burnout is an issue that has been well documented in South Korea, one where employees suffer from physical and mental fatigue and in more extreme cases, illness and death. And not only does this raise questions about worker welfare, but also whether this is actually a sustainable way of boosting productivity for the company itself. But even entertaining the idea that shifting employee work hours around clustering them in periods of high demand would not adversely affect employee welfare, it seems that not all businesses can actually use this approach. As SK tells it, not all things are equal for all companies.

SK Kim:

There could be a huge difference between large companies as opposed to SMEs. For large companies, they tend to showcase and in fact, leading this regard as to implementing and allowing employees to choose how many hours they can work per week, per month. More challenge comes to smaller companies where they have labor shortage. They do not have enough resources to apply that system because it has some procedural bottlenecks. I think the big issue is the labor shortage, attracting talent and high turnover rates among the small medium companies that kind of makes the companies worry about the effectiveness of the system. Would it really work for them? Would it really boost productivity, which is the main aim for this policy.

Bentley Kaplan:

So this potential change in working hours seems to be something that is going to be easier for larger companies to implement. And it all comes down to how well the company can run when employees are clawing back their personal time. The flip side of that maximum 69 hour work week, smaller firms, SMEs can't necessarily operate when a few of their workers take a long vacation, but larger companies have a bit of extra flex, more buffer in their workforce. But another part of this is also which industries will be looking at this option of pushing the workforce hours up when it's really needed. And as SK told me, this question really puts the cat amongst the pigeons.

SK Kim:

The economy is transitioning from labor-intensive sectors to more really adding industries like IT. The important thing is the change in demographics in terms of the workforce. So we call it MZ generation, which represents millennials and Gen Z and the commerce that are tech-savvy, meaning that the talent that goes into IT industry, they tend to be very vocal as in what they want as opposed to the team culture that I just mentioned before. So the industry transitioning economy to high-tech industry and what it entails in terms of the workforce, the different demographics in the workforce, it's also the reasons behind why this proposal may or may not get through in the end. And the IT companies, even if the policies is introduced, there are more challenges ahead as to how they're going to implement it. They have to be very careful. I think they have to have some sort of kind of minimum nets saying they can assure their employees to take really sabbatical leave, like long-term vacation and those kind of compensating mechanisms in place if they decide to apply this.

Bentley Kaplan:

Right. So here is really where the story gets interesting because while South Korean companies are reporting low productivity, the country is also squaring up with a growing demographic challenge, an aging population with a negative birth rate, a trend that would threaten productivity even further. Now, one potential tailwind is that the country has been transitioning its economic activities from industrial manufacturing to things like semiconductors and services and broader IT applications, businesses with higher margins that lets companies generate more revenue with fewer working hours. And while this broader economic shift might provide potential answers to the challenge of falling productivity, there's a catch because the workers that would be driving the shift are young and at risk of painting an entire generation or two with a single brush. Younger South Koreans are a stakeholder group that seems quite firmly opposed to the government's proposed labor reform.

SK Kim:

I talked about the younger generation being more vocal and there is the employee community. When somebody asks about the new opportunity that they got, the question is it's more than the figure, that's a seller figure. They ask more about, "What's the working culture? Is it rewarding to work there? Does the company provide any development opportunity?" The changing in concept from the baby boomers thinking like the stable job is the best, "We want to work in a place where I can retire," and that's really not the case anymore. For companies, they have to think more than pay more. I would say a good shock for them to think about will be this newly introduced policy. It will provide a good reflection point and to revisit what's the best way to actually make the employees happy and retaining talent.

Bentley Kaplan:

A good shock is definitely one way to describe it because this proposed reform might not go ahead, but just by floating the idea, the South Korean government has seen all stakeholders tip their hand.

Companies and big companies in particular might see the potential of having flex in their workforce as enticing and might be willing to concede longer vacations and more downtime and quieter periods. But it's not necessarily clear that all South Korean workers would be on board with that approach because mathematically averaging out these longer hours to give you a sense of a typical workday makes sense.

Sure, you have some busy weeks with very long hours, but averaged out over a year, it doesn't seem that bad. Where their thinking falls short, is human beings may not be made to average out over the year like their hours can. And if the country's economy is going to move more towards IT and rely on its younger workers to boost productivity, it does seem that companies may have to take a more nuanced approach to how they manage their workforces. As our ESG data shows, South Korean companies are falling behind global peers on their management of labor related risks. And this was especially true for businesses, more reliant on highly skilled workers, the kind that would drive an IT industry boom. And for this type of worker, the tried and tested method of throwing more hours at the problem of low productivity might need to be shelved for now.

For our next story, we are going to head to the Golden State, California where a couple of days ago, the California Public Employee's Retirement System or CalPERS published its proxy voting and corporate engagement update. And in it, the asset owner reported that it had voted against 95 directors at 26 companies for climate risk oversight in 2022. Incidentally, these 26 companies were part of the climate action 100+, a group of large investors that aim to "ensure the world's largest corporate greenhouse gas emitters take necessary action on climate change." And CalPERS also reported its intent to expand its voting practice in 2023 to also focus on high emitting companies. Now, we've been looking more and more closely at how investors are looking to engage companies on their climate strategy, their emissions' performance, and their climate commitments. My most excellent corporate governance colleagues have published quite a bit of work looking at different engagement options.

And Florian Sommer out of our London office has focused in particular on say on climate proposals, where a company will put forward its climate strategy for a shareholder vote. We actually had Florian on the show way back in September 2021 when I was still a young man, and he took us through what was then a relatively new development. He's published more on the topic in the interim, including in our ESG and climate trends to watch for 2023. But today I dragged Florian back behind the mic to unpack the difference between direct to votes and a say on climate proposal and how investors might be thinking about these two options when they're looking to affect change at companies.

Florian Sommer:

I think that really depends on your preferences as an investor. Both of those things voting against directors, withholding votes on director elections, and say on climate voting, both of these concepts can be used to engage with companies on climate change, but they send a very different message. So on the director elections, it's one of the most important rights of shareholders to elect directors to have their say on who should sit on the board, who sits on the board and what their backgrounds are and skills are. That's really vital to any company because it's the board who decides the company's strategy. So if an investor is unhappy with the board, they have different options, they can withhold the vote, they could vote against a company candidate, or they could even nominate their own candidate under certain conditions.

Say on climate, on the other hand, is actually quite focused. It's quite a focused specialized vote. Typically, what happens is that the company will ask shareholders to give their opinion on its climate strategy, including any climate targets. But opinion I think is very important here because these votes are mostly what we call advisory so non-binding, and that means if the company loses the vote, technically they don't have to change the climate strategy.

The other point to make, I think just on the practical level is that say on climate votes are just not that frequent yet. So we have seen the number of these votes increased over the last couple of years, and there's some big names that are doing this, especially in Europe and Australia, but we're still talking about relatively small numbers. We're talking about 44 companies in our ratings coverage in 2022. So

compared to the whole coverage that we have, it's relatively small. And so that means if you are an investor that's focused on climate change and that wants to send a message to the company on climate change, you might not have the opportunity to do that through a say on climate road, which means you have to look at other options including director elections.

Bentley Kaplan:

Right. So a say on climate vote is more like a suggestion on climate vote and voting against directors might send a much stronger message. But to outsiders, it's difficult to know how much of these directive votes may have to do with climate strategy or other factors as well. And it's really important to stress here that these are only two of many options that investors have at their disposal. And much of these actual engagement efforts might be taking place behind closed doors where investors are using soft pressure discussions and letters rather than going straight for the more combative proxy battles.

One thing that has become apparent is how quickly these investor engagements on climate change have become more common. We have these examples of company boards being under pressure over their climate strategy with high profile cases being at Exxon and AGL and pressure increasing on some of the larger oil and gas companies like Shell and BP. But this announcement from CalPERS felt a little different, moving from anecdotal examples to a more systematic approach to proxy voting over climate hinting at a potential sea change. So I put my naive impression to Florian and his take was a little more measured, which is probably the reason that I'm interviewing him rather than the other way around.

Florian Sommer:

Again, it really depends on what kind of investor we're talking about. I think having this increased focus on holding directors accountable through voting is something that we've seen in quite a few cases now for investors that have a focus on ESG and climate change. So going back to the different engagement options that you have, if you're an investor that really cares about how your portfolio companies are doing and what their climate track record is, then having this increased focus on director elections essentially sends the message that you are going to focus on it in your engagements. But that doesn't mean that all investors are going to do it to the same extent or even that all investors are going to do it across their whole portfolio. Typically, what you have is that you have investors focusing on specific companies and looking at their portfolio and identifying engagement targets.

Bentley Kaplan:

So we may see some shareholders taking a more systematic approach to proxy voting over climate, but this is only because for some investors, climate has become a more integral part of their investment strategy and company engagement is already a well-trodden path. Say on climate proposals are a new avenue to explore, but their effectiveness in driving company changes is probably still relatively untested. As Florian tells it, it's really about what message an investor wants to send to a company and the best way that they can send that message.

For SK, South Korea's working hours still have a lot of unanswered questions. It's clear that there is tension on both sides of the company employee divide, and it might be hard to see how current setups can evolve when you're stuck in ever more complicated equations moving around work hours like a Rubik's Cube. But as a new generation of workers move through the country's workforce, it might require more innovative approaches by companies if they're hoping to compete for an increasingly prized talent pool. And investors might well be watching which companies learn from their "good shock" to land on the right side of this emerging trend.

And that is it for the week. A massive thanks to SK and Florian for their take on the news with an ESG twist. Thank you very much for tuning in. We're going to be taking a break next week, but we'll be back with a fresh episode for you on the 31st of March. So take it easy until then, and as always, if you have the strength to give us some stars on your platform of choice, please feel free to do so. It does give us some superficial vindication, but really helps other people to find this show. Thanks again and talk to you again next time.

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