Trade Union Advisory Committee to the OECD
Commission syndicale consultative auprès de l'OCDE

committee on workers' capital

INVESTOR BRIEF ON THE DIGITALISATION OF THE ECONOMY

Why it matters for long-term investors and what to look for

The digitalisation of the economy refers to the process whereby business models become increasingly based and/or dependent on digital technologies. Because of the rapid uptake of digital technologies, the distinction between traditional economy and digital economy is becoming less relevant. In a first section, this briefing describes how digitalisation is transforming the world of work overall and the challenges that workers are now facing. It also looks specifically at highly digitalised companies, such as online platforms, and the challenges they raise in terms of fair competition, corporate governance and tax.

The second section of this briefing summarises in a checklist issues that long-term investors should look for. Long-term investors have a special responsibility to maintain a high level of scrutiny, especially as many of the appropriate responses to digital transformation should be found at company level.

WHY IT MATTERS FOR LONG-TERM INVESTORS

While the digital economy cannot be "ring fenced", as the entire economy will undergo digitalisation, there are certain features that characterise digital activities. In a recent report, the OECD has identified:

- Scale without mass: Digitalisation gives greater opportunities for businesses to enjoy "local presence" without physical establishment. Digital services have marginal costs close to zero.
- Heavy reliance on intangible assets. Brands, software and algorithms are central to digital business models. These intangible assets are hard to value and hard to price under current accounting and tax rules.
- Importance of data and user participation in value creation. With users becoming

SOME TERMINOLOGY

Digitisation is the conversion of analogue data and processes – i.e. "physical data" - into a machine-readable format. **Digitalisation** is the use of digital technologies and data as well as their interconnection which results in new or changes to existing activities (OECD, 2018).

For the purpose of this brief, **highly digitalised companies** refers to companies which receive the majority of their revenue through digital interactions and transactions.

Online platforms are defined as a digital service that facilitates interactions between two or more distinct but interdependent sets of users who interact through the service via the Internet (OECD, 2018). **Platform work** is understood as the matching of the supply of and demand for paid work through an online platform. (Eurofound 2017)

Unicorns usually refers to privately held start-up companies with a valuation of US$1 billion or more. In 2013, there were 39 reported unicorns worldwide. In 2018, the number of unicorns has soared to 376, most of them being highly digitalised companies.

themselves "producers" of data via social network, the traditional distinction between consumers and producers becomes blurred.

The social impact of the digital transformation is considerable. Yet, technological developments and new business models are so fast changing that policy-makers often struggle to keep the pace. A distinctive feature of this revolution is that it is not only about the quantity of jobs affected (new jobs created vs old jobs destroyed and displaced workers). There is also a qualitative dimension when digitalisation affects the employment relationship—as seen in the rise of precarious "non-standard" forms of work in the platform economy —or when new technology requires intensive consultation with workers of the company to anticipate new skills and new methods of production.

More broadly, digitalisation is a serious challenge to a wide spectrum of regulations, including employment rights, data privacy, competition law, corporate governance and tax.

The specific implications for long-term investors, such as pension funds, include:

- At the portfolio level: digitalisation may raise environmental, social and governance (ESG) concerns related to the quantitative and qualitative transformation of working conditions in specific companies across asset classes. These ESG concerns may produce reputational, operational, or legal risks.
- At the pension system level: digitalisation, including non-standard forms of work and higher risks of aggressive corporate tax planning, may contribute to the erosion of tax bases and a decline in public funds for existing pension systems.
- At the systemic level: the transformations associated with digitalisation, such as the polarisation of the labour market and corporate tax policies, hold the potential to exacerbate social inequalities and social instability, which—in turn—may negatively impact institutional investors' whole portfolios over time (PRI, 2018).

Employment impact: how digitalisation is transforming the world of work

Digital transformation changes the world of work in at least three ways: workers can be replaced or their tasks complemented by automation processes, working conditions are changing, and platform work gives rise to non-standard forms of work.

How should long-term investors address the pending Lyft and Uber IPOs?

The two competing ride-hailing apps Lyft and Uber launched their Initial Public Offerings (IPO) in the spring of 2019. These were significant announcements as both companies are fast growing. Uber in particular was one of the largest IPO in history with a capital raise estimated goal of over USD 10 billion (Financial Times, 2019). IPOs are not the only reason why Lyft and Uber are hitting the headlines. Legal proceedings around the world are raising serious questions about the employment practices of ride-hailing apps.

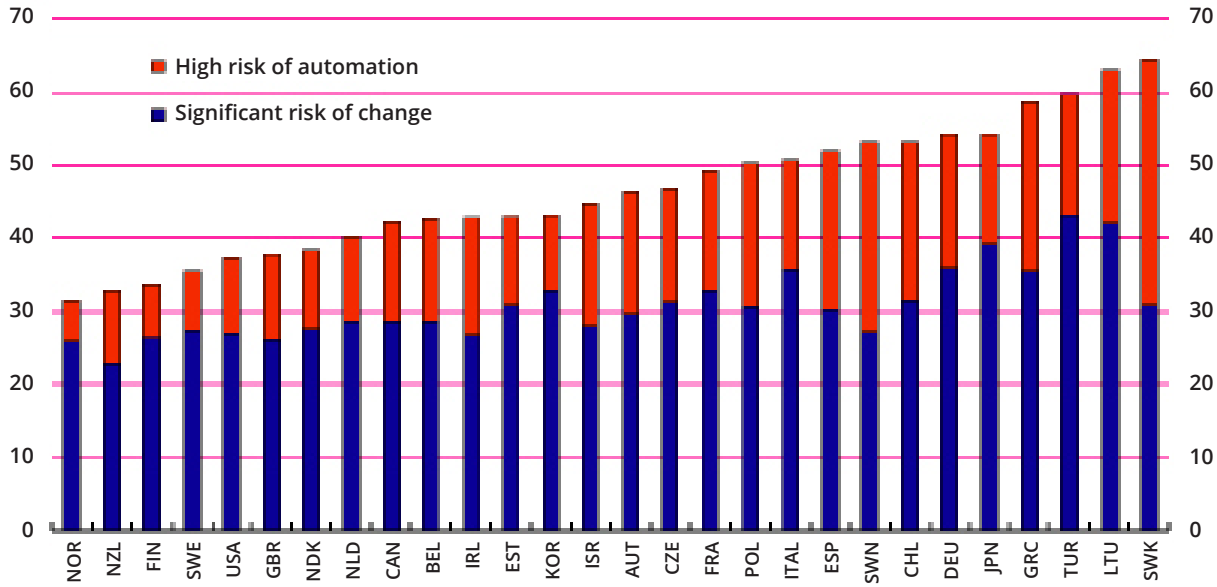
When digital "unicorn" companies such as Lyft and Uber issue IPOs, the long-term investor should research whether the business operating model aligns with social value. What is the impact of the operating model on jobs and working conditions? Does the announced corporate governance, in particular in case of non-voting shares, enable sufficient scrutiny to take place? Are there indicators of aggressive tax optimisation schemes?

Some jobs will be destroyed and different jobs or tasks will be created. Digital transformation is also altering work organisation: production and service processes get automated or are redesigned, and workplaces can be more and more remote (e.g.: telework, outsourced tasks and production). There is as a result an increasing mismatch between, on the one hand, the responsibility of the employer and, on the other hand, the contractual relationship with the employee.

The tasks of many jobs are changing. According to OECD estimates, more than half of the jobs in the OECD countries will experience significant change as a result of automation in the next 15-20 years. Low skilled and middle skilled workers are likely to be negatively impacted to the extent that they are least likely to adapt to new technologies and working practices. Digitalisation is therefore likely to increase the polarisation of the labour market.

Another concern is the increase in non-standard forms of work, in particular in the context of online platforms. Non-standard forms of work are departing from the full time permanent employment contract model. They give rise to many concerns on job quality in particular for the respect of employment rights, social security and social protection. In most platform work, workers are assimilated to self-employment: they are deemed to be working for themselves for a fee instead of working for an employer in exchange of a salary. Some of these are bogus self-employment arrangements as workers should in reality be treated as

Percentage of jobs at high risk of automation and at risk of significant change



Source: OECD (2018), "The Framework for Policy Action on Inclusive Growth", OECD Publishing, Paris.

employees and therefore be fully covered by labour laws. For others, the distinction between employed and self-employed is blurred. Such hybrid statuses and lack of enforcement of the employment relationship often lead to precarious working conditions, remuneration levels set below minimum or living wages, and insufficient social protection coverage because of the transfer of social and fiscal responsibilities from the employer to the worker.

The digital economy raises many challenges for policy-makers in areas such as labour protection, employment transitions, training, and tax policies. But responses at the enterprise-level are also crucial. Trade unions everywhere are developing demands and strategies to deal with digital transformation (TUAC, 2018). Social dialogue and collective bargaining must become key mechanisms towards a just transition and the creation and safeguarding of quality jobs. This means that an enabling environment has to be in place, allowing trade unions to reach out and organise workers. This aspect is particularly challenging for platform workers. Furthermore, companies have a special responsibility to undertake due diligence procedure, that is to say to identify and address any violation of human rights or other negative impacts on workers. Many issues need to be identified and addressed, including potential misclassification of workers with the result of depriving them of labour and social rights, jobs losses and shifts, change in the nature of the tasks, etc.

Artificial Intelligence

Artificial Intelligence (AI) is the simulation of human intelligence by machines. AI applications and processes are diffusing at an unprecedented scale and investments into AI companies has grown tremendously in the past few years. Direct impacts from AI on working conditions range from new safety and operational parameters when processes are managed through sensors or algorithms, to the issue of enhanced monitoring. New challenges also arise from automated and insufficiently transparent management decisions through algorithms influencing amongst other the supply and pay of tasks as amongst other seen with online platform jobs (Eurofound, 2018). The need is growing for new or revised industry standards and technological agreements towards reliable, safe and productive workplaces. The European Economic and Social Committee recommended for "*stakeholders to work together on complementary AI systems and their co-creation in the workplace, such as human-machine teams, where AI complements and improves the human being's performance.*"(European Economic and Social Committee, 2017)

Information, consultation and collective bargaining are therefore needed at the firm-level to fully involve employees in the decisions to introduce new systems, having regard in particular to health & safety, working conditions, wages and working time. It is also important to keep in mind that overall AI

can and should bring benefits to workers by inducing safer and effective systems.

Impact on data privacy and protection

As human resource management and business planning increasingly rely on employee data extracted from big data and algorithms, investors should look into how data collection and processing changes working conditions and employment prospects. Data is collected from applications, fingerprints, wearables and sensors indicating in real time the location and work pace of an employee. In one sector, an analytics software measured performance upon the friendliness of the employees' tone. This can bear significant challenges to the quality of work affected by heightened control and less transparency regarding the collection of information on employees as documented by several workers' experiences (Uni Global, 2018).

Social partner agreements on workers' data and the right to disconnect are underway, one of the first being between the French telecommunications company Orange France Telecom and five trade union centers (CFDT, FO, CGT, CFE and SUD). The agreement contains commitments on employee data protection (including transparency over use and full disclosure). Provisions on workers' data could establish data governance bodies in companies and include accountability clauses regarding employee data use, data portability, explanation and the right to be forgotten (UNI Global Union, 2018). Lastly, in human resources, the use of algorithms might result in bias in hiring (e.g. selection of candidates based on key words) unless principles are put in place to ensure a degree of transparency. A Carnegie Mellon study exploring patterns of online job postings showed that an ad for higher-paid executives was displayed 1,816 times to men and just 311 times to women.

Impact on competition: emergence of all-powerful companies

Market concentration is a key feature of the digital economy. OECD research indicates that the market concentration is increasing in sectors that are more exposed to digitalisation (OECD, July 2018). It is sometimes argued that the level of investment in Research & Development is such that a position of economic power is required. However, as far as online platforms are concerned, digital production features near-zero marginal costs. Dominant positions can be the natural consequence of new business models. Online platforms enjoy bigger scale returns than ordinary businesses: the bigger the network and data volumes, the more consumers and suppliers will be willing to access the platform. Furthermore, smaller digital companies tend to be squeezed out partly due to an aggressive mergers & acquisitions strategy by larger rivals, partly because of their difficulty to find sufficient financing for research and development.

Market concentration of digital companies is a challenge that most competition authorities have yet to tackle. Whilst the existence of dominant position is not per se unlawful, market power can lead to a number of abuses towards the consumer (e.g. algorithm tracking consumers' behaviour to adapt the price strategy) and towards workers. High market power, and as a result scarce employers, are indeed linked to precarious working conditions and wage loss (TUAC, 2018).

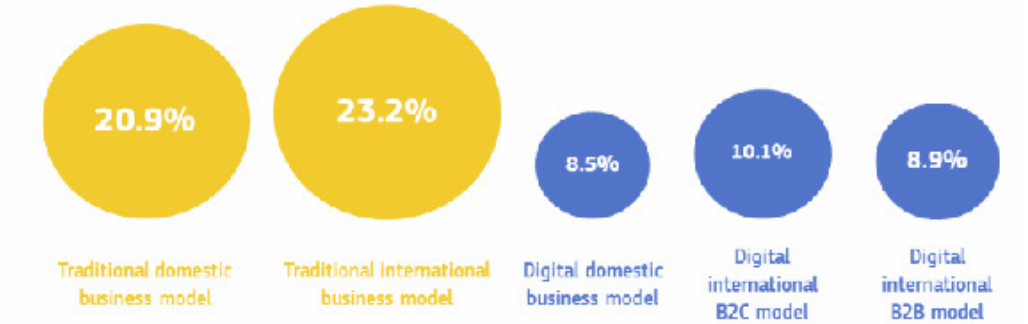
Impact on corporate governance: opacity and diminishing accountability

There is a lasting decline in the listing of large businesses. The term "unicorn" originally illustrated the rarity of such ventures. The number of "unicorn" businesses has grown from 39 in 2013 to 376 in 2018, most of them being highly digitalised companies[1]. This has a non-negligible impact on transparency, and therefore investors' scrutiny, as unlisted companies face significantly less reporting requirements. This becomes a particularly acute problem given the difficulty in measuring the value and risks associated with digital intangibles.

In parallel, digital companies develop new models of corporate governance designed to shield founders' and managers' decisions from the scrutiny of investors. For instance, there is in highly digitalised companies a clear trend towards dual class voting structures, with insiders and owners enjoying higher voting rights than outside investors. The boards of these companies are also becoming more entrenched, with board members and managers holding three times more shares than the average in large listed companies. As a result, shareholders' engagement in highly digitalised companies is substantially lower than in other businesses. (Fenwick, 2017)

1. https://techcrunch.com/2018/11/11/age-of-the-unicorn/?guccounter=1

The effective tax rate of digital companies in the EU is estimated to be half that of traditional companies.



Source: EU Commission, March 2018

Impact on tax: the challenges of taxing digital activities

"Aggressive" tax planning should alert long-term investors. Corporate tax revenues are an indispensable part of a fair and inclusive tax system, enabling governments to invest in sustainable development. Furthermore, consumers and workers should not bear the burden of insufficient corporate revenue. In 2015, the G20 countries adopted an action plan to curb aggressive tax planning. This 'BEPS package' represents so far the most far-reaching attempt to reform the taxation of multinationals. Yet, the rules applicable to "traditional" businesses are unfit for highly digitalised business models.

In April 2018, the OECD published a report on tax challenges arising from digitalisation (OECD, 2018) and is currently considering new tax rules (on transfer pricing, on permanent establishment) to account for the digitalisation of the economy. It is argues that the three distinctive features of digital activities as mentioned above combine together to allow digital businesses to generate profits without a physical, and therefore taxable presence. For instance, the European Commission estimates the effective tax rate of digital companies in the EU at half that of traditional companies.

WHAT INVESTORS SHOULD LOOK FOR AND WHAT TO ASK

Investors can take proactive steps to measure the extent to which the company is exposed to risks that are exacerbated by digitalisation. When it comes specifically to digital companies, long-term investors such as pension funds may think holistically about digitalisation and capital allocation, and whether the potential investment is aligned with their responsible investment policies.

The following section provides some examples of the types of questions and issues investors may wish to raise when considering investments and exercising stewardship in digitalised companies.

Indicators to assess corporate governance

Overall:

- Access to financial statements and proxy statements
- Record and rationale for share buy-backs and dividend policy
- Board composition and independence vis à vis the company and the controlling shareholder and the founders
- Separation of CEO and chair positions
- Dual class voting structures

In particular for highly digitalised businesses:

- Is there a record of shareholder engagement on governance and social issues?
- Rationale for the founder of the digital company for maintaining control-enhancing mechanisms (dual classes of shares, shareholder pacts)?

Indicators to measure risks to employment:

- Collective bargaining coverage within the company's perimeter
- Indicator of exposure to the platform businesses
- Policy for information and consultation of workers on digitalisation impact
- Policy for reskilling and for compensation of displaced workers
- Due diligence procedures, identifying and addressing any violation of human rights or other negative impacts on workers

Indicators to measure risks to data privacy, protection & Artificial Intelligence (AI):

- Policy for information, consultation and negotiation with workers on data privacy, protection and AI
- Disclosure of parameters of employees' data collection (including the collection methods, the storage of the data including the location, security and level of anonymization, re-use etc.)
- Provisions on transparency and right to explanation on data collection and the use of algorithms, including rights to data portability and the right to be forgotten

Indicators to identify tax avoidance practices

Request access to Country by Country reports and transfer pricing documentation

All multinational enterprises ('MNES') with annual consolidated group revenue equal to or exceeding EUR€750 million should deliver Country by Country reports to tax authorities. Investors should request access to these reports because the information contained in them is highly relevant for a full and comprehensive picture of the multinational activities and any associated risk factors.

Investors should also ask for the two transfer pricing documents that multinationals are to provide to tax administrations: (i) the "master file", containing high-level information regarding their global business operations and transfer pricing policies; and (ii) the "local file", containing detailed and specific information on the subsidiary and its relationship with the rest of the MNE group.

Request annual reporting on the OECD BEPS indicators (Action 11)

Action 11 of the BEPS package lists some firm-levels indicators that can help measure the overall level of engagement in aggressive tax planning:

- The profit rates of the MNE affiliates located in lower-tax countries are higher than the group's average worldwide profit rate.
- The effective tax rate paid by the MNE is lower than the corporate income tax rate applicable to similar enterprises with domestic-only operations.
- With respect to intangible assets (for instance royalties, IP rights), taxable profits are reported in different locations than the value creating activity.
- Debt from related parties and/ or third-parties is more concentrated in higher-tax countries.

Example of just transition policies

In 2016, a collective agreement on digital transition was signed at enterprise level in the French Group Orange. In this agreement, the social partners negotiated in particular:

- new working methods and working spaces;
- detailed training programmes;
- a series of provisions to strengthen the right to privacy, and reconciliation between personal and professional life.

Example of shareholders' engagement at Amazon

In 2019, a coalition of investors filed shareholder resolutions at US online retail giant Amazon.com. The coalition is presenting a broad range of demands to the company, including enhanced workforce management. Amazon.com is pursuing an aggressive automation strategy combined with ongoing critiques on its treatment of workers. For instance, the company declared a record in ordered items during holiday season 2018 combined with lower part-time worker hires compared to previous years.[1] Meanwhile, Amazon.com workers took to the streets in countries like Germany and Spain during Black Friday.[2] Some responsible investors are thus using stewardship tools like engagement and shareholder resolutions to seek a better management of Amazon's workforce in line with the ILO Fundamental Rights and Principles at Work.

1. https://gizmodo.com/the-biggest-sign-yet-that-automation-is-taking-over-at-1831460994
2. https://www.reuters.com/article/us-amazon-com-strikes-germany/amazon-workers-strike-in-germany-spain-on-black-friday-idUSKCN1NS1AU

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Forbes (December 2018), *Uber IPO: what can we expect?*

OECD (2015), *Measuring and Monitoring BEPS, Action 11 - 2015 Final Report*

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