

Assess the “S”: Measuring Corporate Social Performance in the Wake of Non-Traditional ESG Risks

ESG FORUM: INVESTING FOR THE FUTURE
FRIDAY, 5 JUNE 2015

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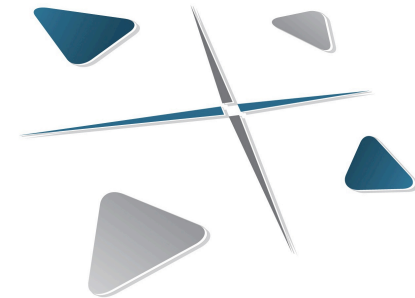
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enodo rights
human rights consulting for business

INTRODUCTION TO ENODO

corporate human rights strategy
→ with a legal edge



Unique insight

Legal Expertise + Stakeholder Engagement

→ Structured and Precise Solutions

Built to collaborate

[Risk Management Firms]

[Law Firms]

[Public Relations Firms]

enodo +

[Management Consultants]

[CSR Consultants]

[Investment Firms]

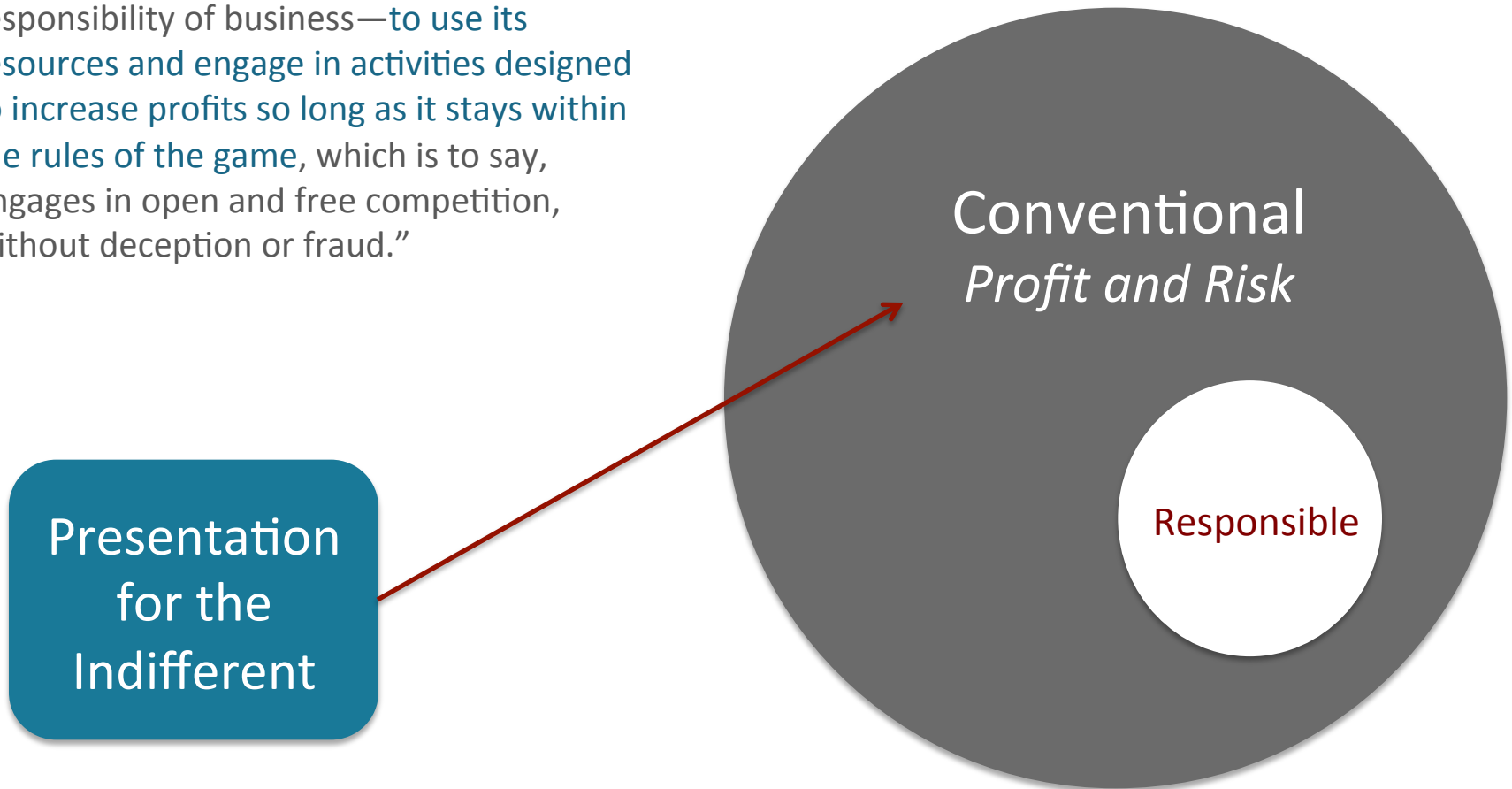
SESSION OVERVIEW

1. Introduction to **cold-blooded approach**.
2. Understanding the **“Social” in context**.
3. Three **relevant questions**:
 1. Which “S” issues are material?
 2. How to respond with an eye to reporting?
 3. How can investors assess the “S”?
4. Positive **externalities of effective human rights strategy**.

TALKING TO FRIEDMAN*

*Milton Friedman, *Capitalism and Freedom* (1962): “[T]here is one and only one social responsibility of business—to use its resources and engage in activities designed to increase profits so long as it stays within the rules of the game, which is to say, engages in open and free competition, without deception or fraud.”

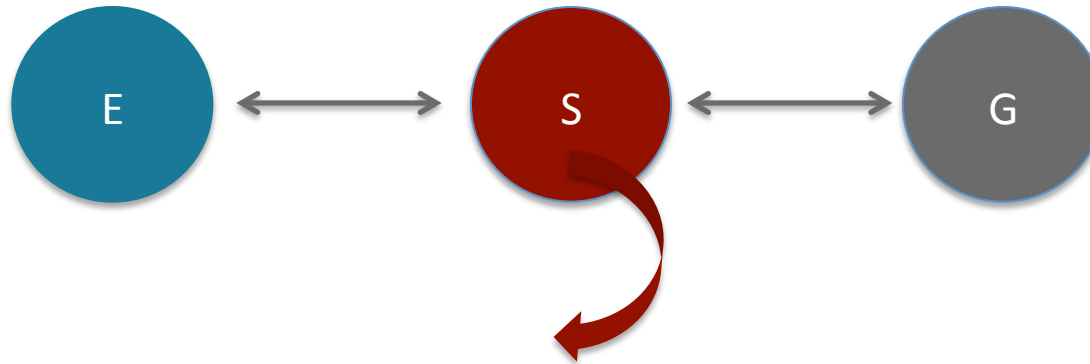
Investment Strategy



A CONVINCING RETORT

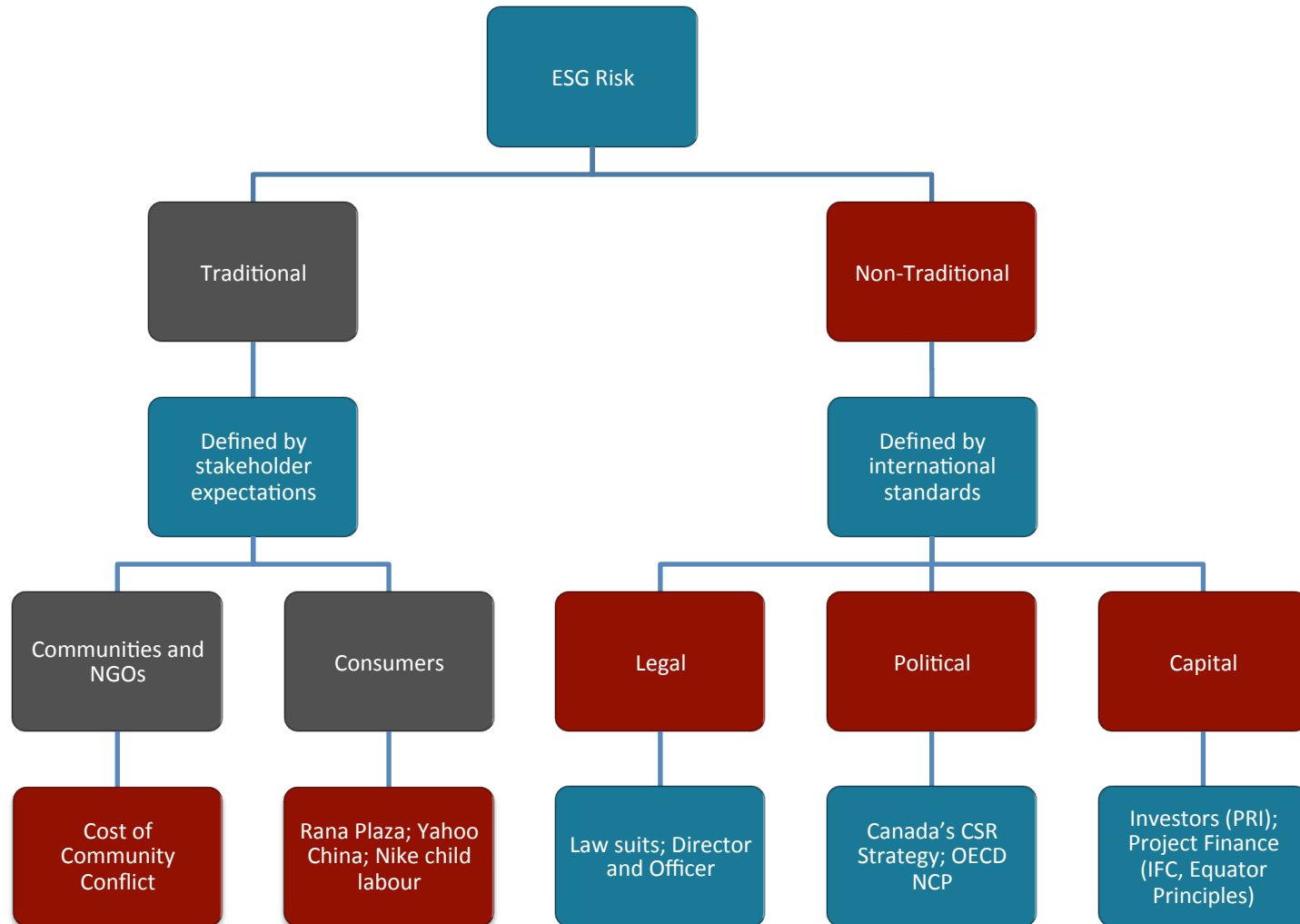
- Recent study by three **Harvard Business School academics**:
 - “Firms making investments on **material ESG issues outperform their peers in the future in terms of risk-adjusted stock price performance, sales growth, and profitability margin growth**. In contrast, firms making investments on immaterial ESG issues have very similar performance to their peers[,] suggesting that such investments are not value relevant on average.”
 - Mozaffar Khan, George Serafeim and Aaron Yoon, "Corporate Sustainability: First Evidence on Materiality" (March 9, 2015) available at SSRN: <http://ssrn.com/abstract=2575912>
- Strategic Implications:
 - Companies need to identify “**which ESG issues are strategically important**” (i.e. truly material).
 - Companies need to understand **how to improve performance to report effectively** on these issues.
 - **Investors** need to understand these material ESG issues to “**manage hidden risk**”.

FOCUS ON THE SOCIAL



- The **forgotten frontier** of ESG.
- No longer indeterminate: ***Guiding Principles on Business and Human Rights.***
- Source of tremendous **non-traditional ESG risk: legal, financial, political.**
- Addressing the “S” is critical to **efficient and comprehensive risk management.**

WHY BOTHER WITH THE SOCIAL? (A COLD-BLOODED RESPONSE.)



THE *GUIDING PRINCIPLES* (RE)DEFINE “S”

- ***Guiding Principles on Business and Human Rights*** are the dominant standard. Only sector-wide and rights-wide business and human rights framework. Broad public-sector and private-sector endorsement.
 - ✓ UN Human Rights Council.
 - ✓ International Chamber of Commerce.
 - ✓ OECD Guidelines on Multinational Enterprises.
 - ✓ IFC Performance Standards.
 - ✓ International Council on Mining and Metals.
 - ✓ IPIECA.
 - ✓ American Bar Association.
 - ✓ Equator Principles.
 - ✓ Thun Group of Banks.
 - ✓ Canada’s CSR Strategy for the Extractive Sector.
 - ✓ UN Global Compact.
 - ✓ UN PRI.
- *Guiding Principles* framework **defines “business respect for human rights” for businesses in every industry.**

THE *GUIDING PRINCIPLES* AS AN ANALYTICAL LENS

- **Not about new corporate obligations.**
- Structured and systematic way to **process social impacts** in a way that can be explained to independent observers.

What to look for

Human rights
impacts
(distinct from
all social
grievance)

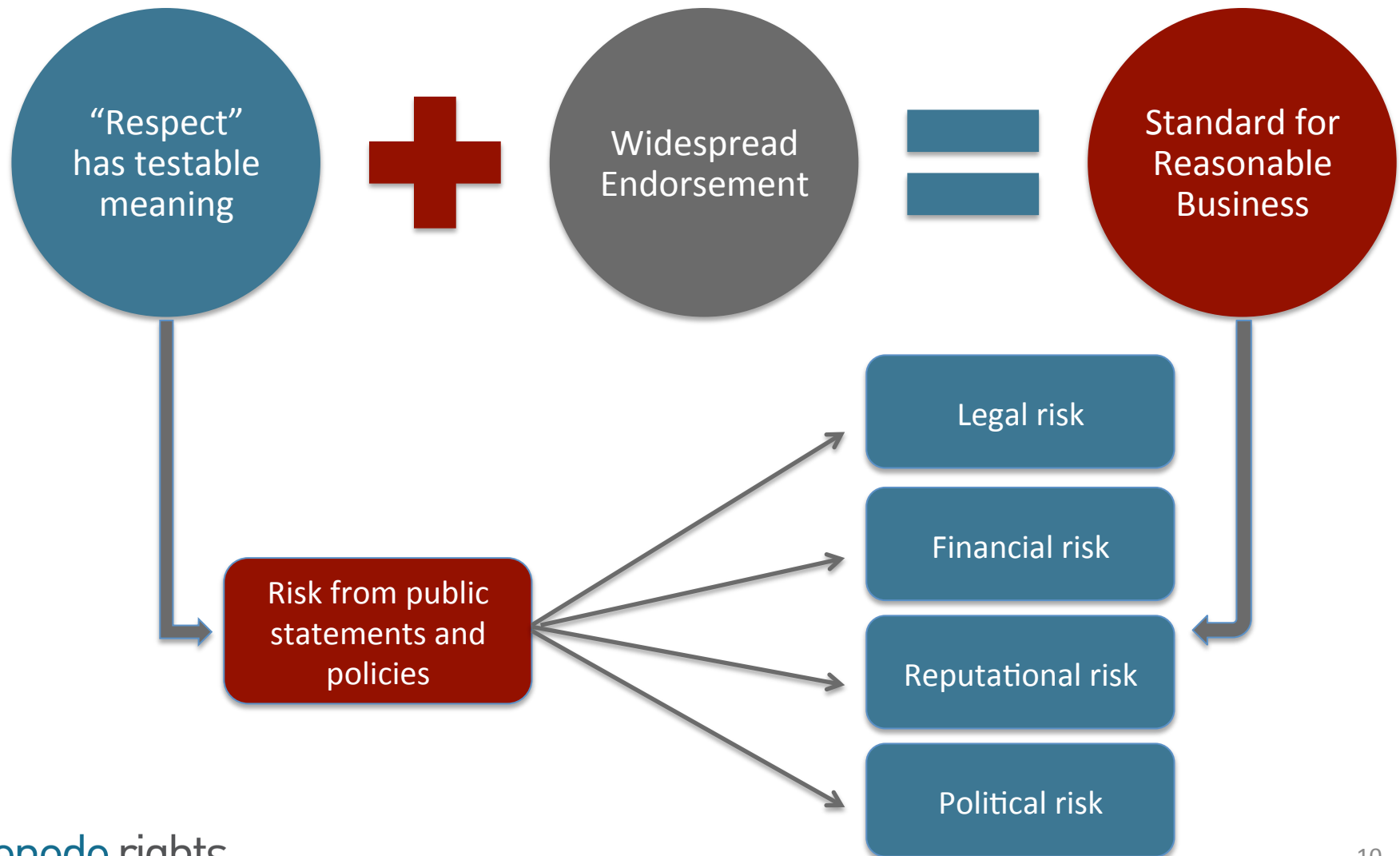
How far to look

With which
the company
is involved

How to respond

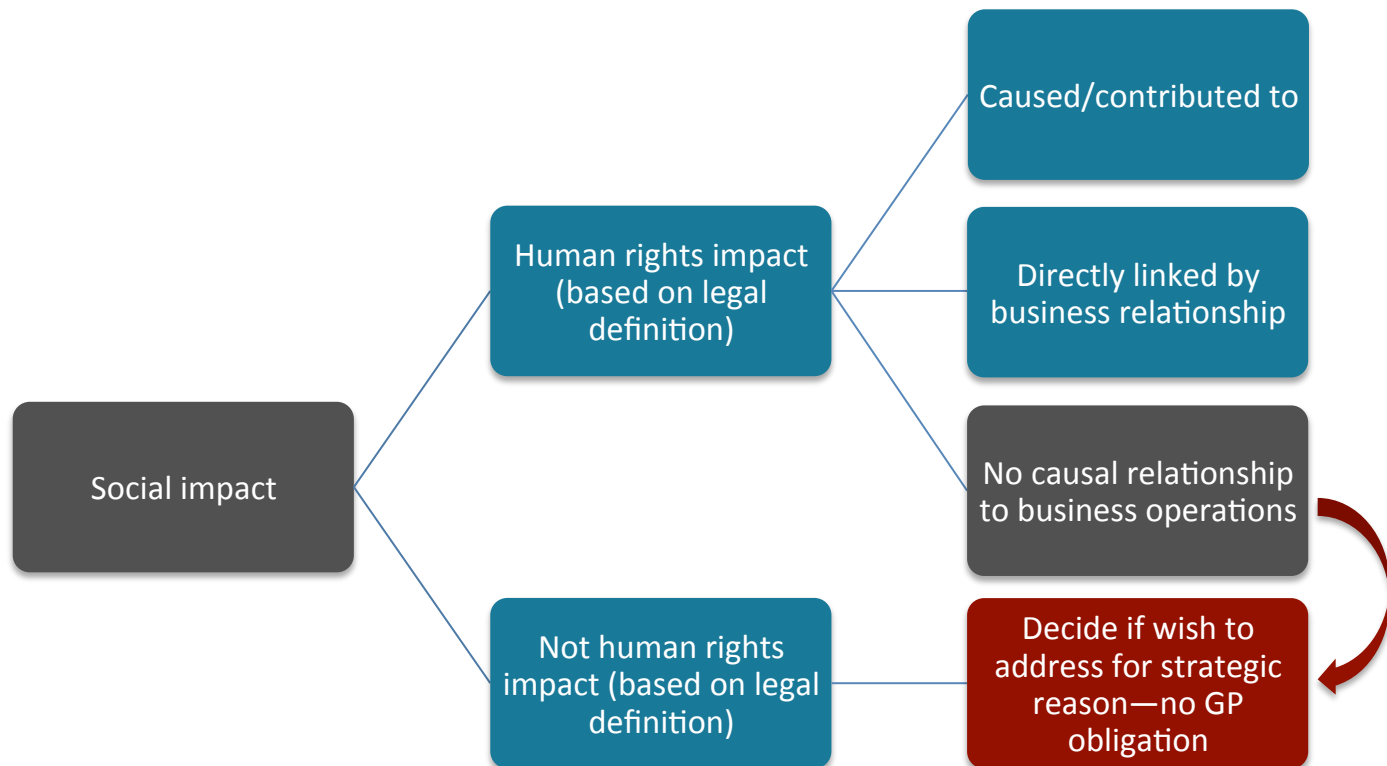
Based on
involvement,
operating
context and
risk

THE *GUIDING PRINCIPLES* ARE SOURCE OF NON-TRADITIONAL ESG RISK



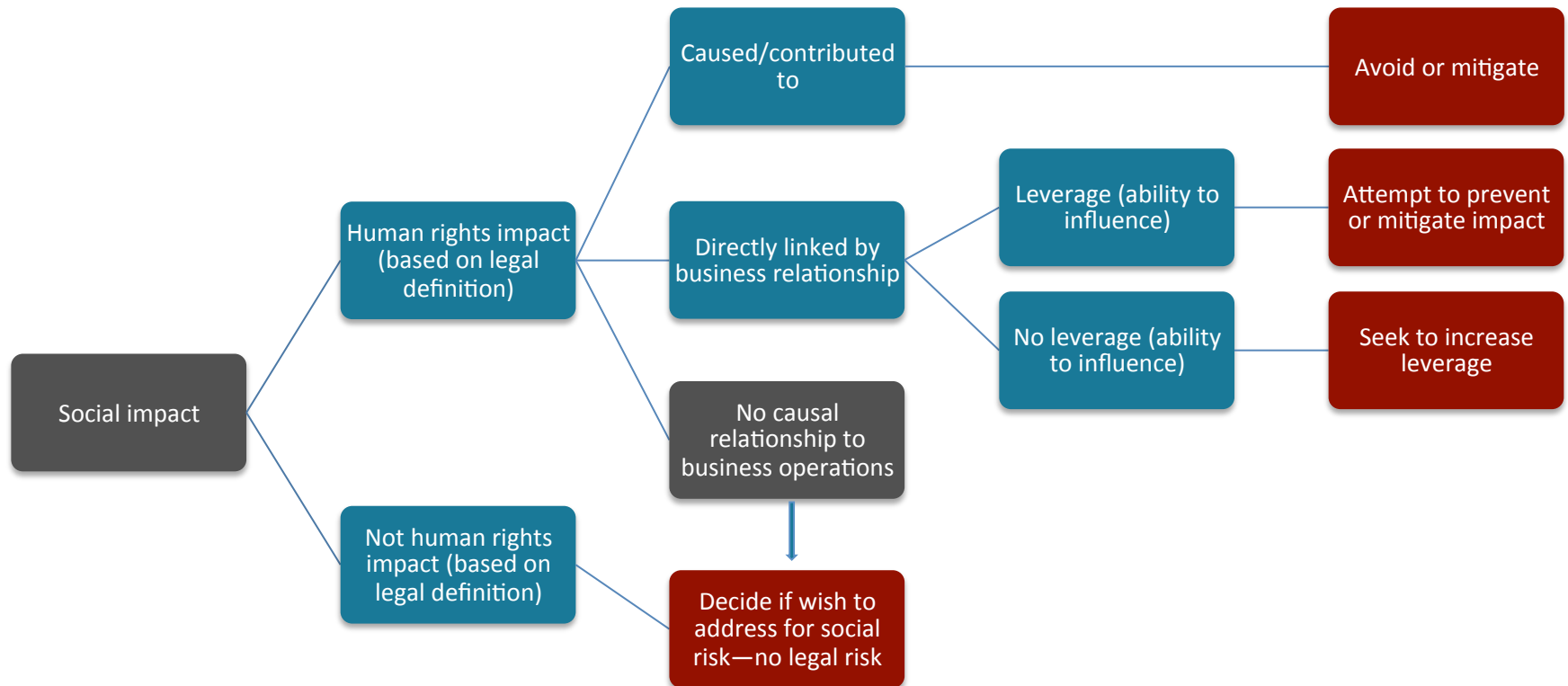
QUESTION 1: WHICH “S” ISSUES ARE MATERIAL?

- Social has evolved from philanthropic model to **impact-driven model**. Increasingly about **objective impact** rather than stakeholder grievance.
- Material social issues = **human rights impacts with which the company is involved**.
- Result is a much more **structured and systematic way** to anticipate and address risks.



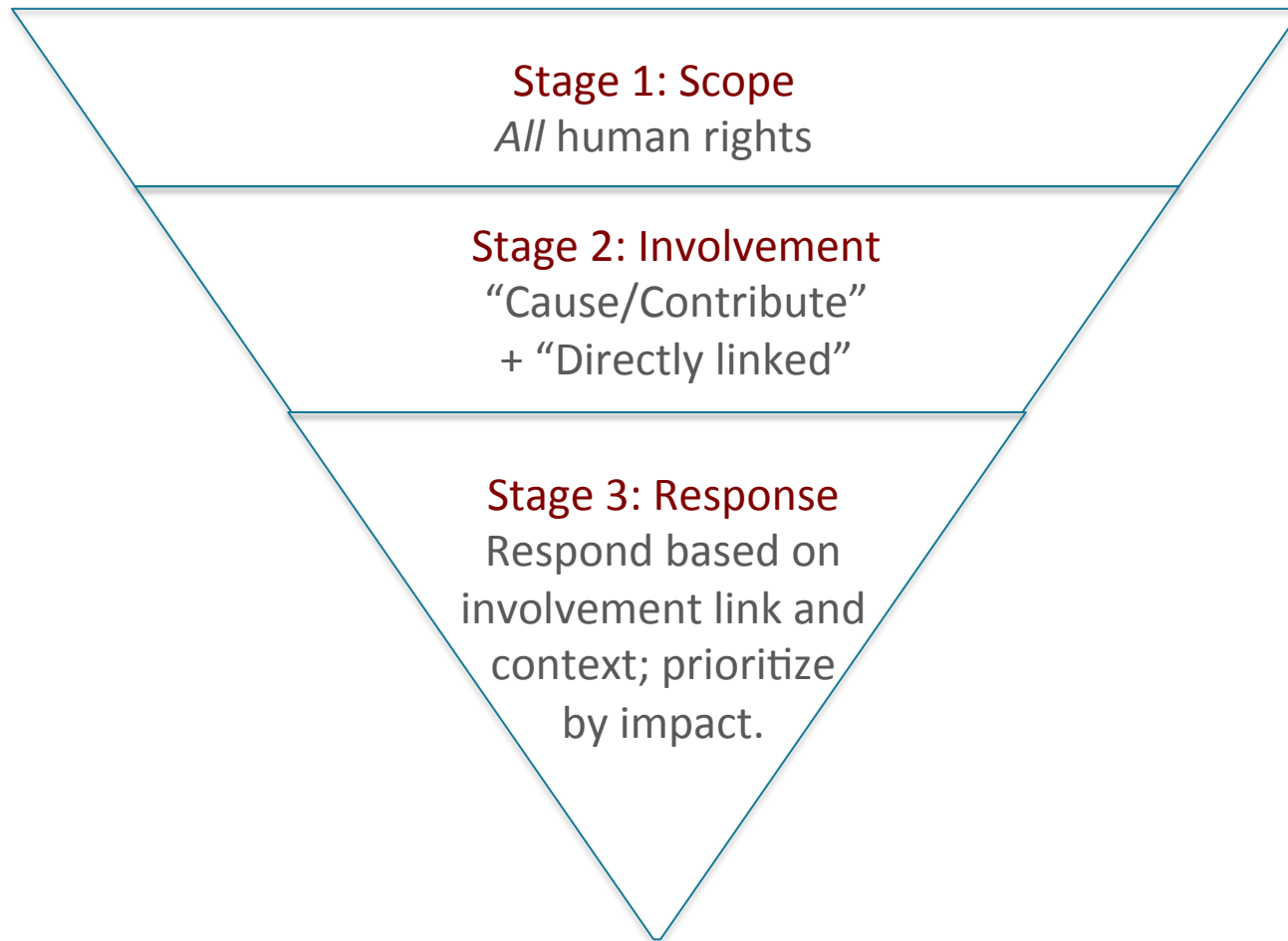
QUESTION 2: HOW TO RESPOND WITH EYE TO REPORTING?

- Instead of an *ad hoc*, crisis-driven response, companies should determine what to do based on **level of involvement**.
- *Guiding Principles* provide **a decision matrix for efficient management of hidden risks**.



EXPECTED RESPONSE IS SENSITIVE TO OPERATING CONTEXT

- Virtue of *Guiding Principles* is practicality: process for **prioritization of risks and scalable response is built into expectations.**



EFFECTIVE REPORTING IS SYSTEM DEPENDENT

The Reporting Assurance Framework Initiative illustrates the **system focus of corporate human rights compliance.**

(shiftproject.org/project/human-rights-reporting-and-assurance-frameworks-initiative-rafi)

POLICY COMMITMENT

A1. What does the company say publicly about its **commitment to respect** human rights?

EMBEDDING RESPECT FOR HUMAN RIGHTS

A2. How does the company **demonstrate the importance** it attaches to implementation of its human rights commitment?

C1. Does the company have any **specific policies** to address each salient risk and, if so, what are they?

ASSESSING IMPACTS

- B1. Statement of salient risks
- B2. Determination of salient risks
- B3. Choice of focal geographies
- B4. Isolated severe impacts

C3. How does the company **identify any changes** in the nature of each salient risk over time?

INTEGRATING AND TAKING ACTION

C4. How does the company **integrate its findings** about each salient risk into its decision-making processes and actions?

C2. What is the company's approach to engagement with **stakeholders** in relation to each salient risk?

TRACKING PERFORMANCE

C5. How does the company know if its efforts to address each salient risk are **effective in practice**?

C2. What is the company's approach to engagement with **stakeholders** in relation to each salient risk?

COMMUNICATING PERFORMANCE

Application of the **UN Guiding Principles Reporting Framework**

C2. What is the company's approach to engagement with **stakeholders** in relation to each salient risk?

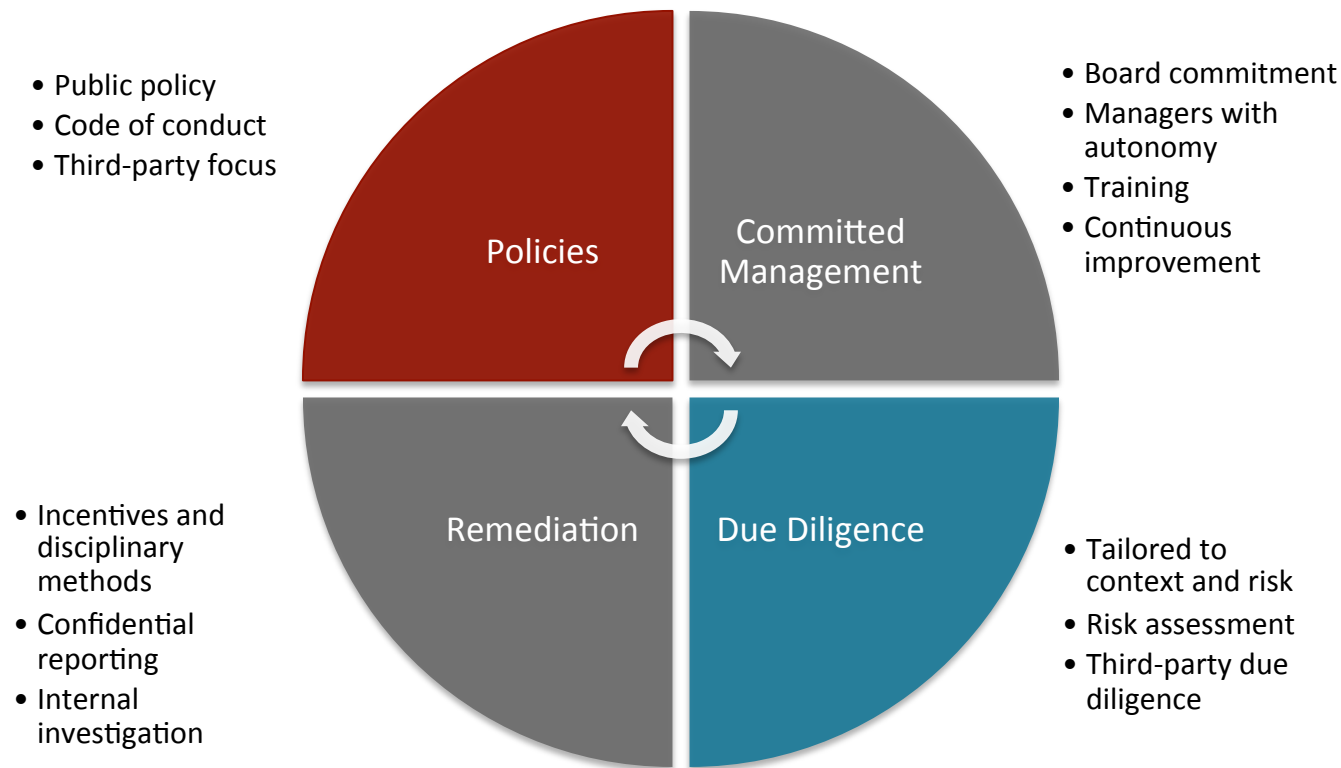
REMEDATION

C6. Through what processes can the company **address harms** to individuals if it causes or contributes to an impact in relation to each salient risk?

C2. What is the company's approach to engagement with **stakeholders** in relation to each salient risk?

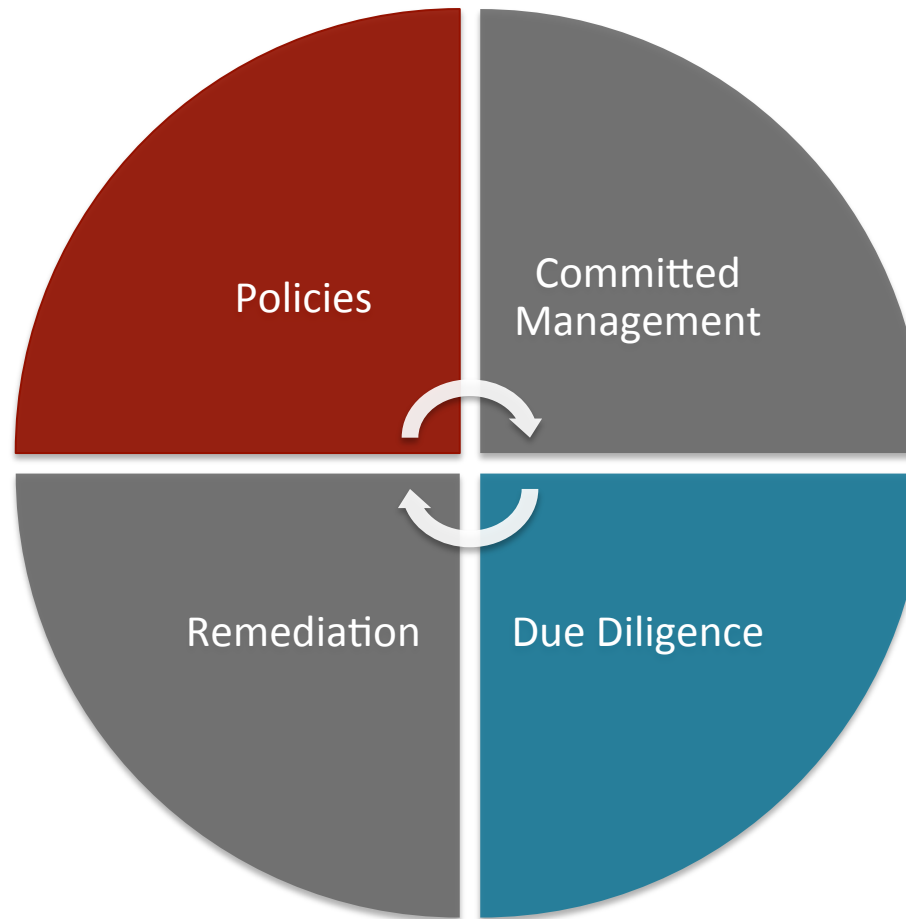
QUESTION 3: HOW CAN INVESTORS ASSESS THE “S”?

- Learn from how **regulators assess corporate compliance with anticorruption regulation. Similar evolution** from government focus to business focus.
- **Companies need to be ready to explain their ESG strategy with reference to their system.**



HOW INVESTORS CAN ASSESS A CORPORATE HUMAN RIGHTS SYSTEM

- Public policy incorporating *Guiding Principles*
- Code of conduct
- Third-party focus
- Committed to all human rights



- Board commitment
- Managers with business and human rights expertise
- Training
- Continuous improvement

- Incentives and disciplinary methods
- Confidential reporting
- Grievance mechanism
- Response framework based on involvement link
- Prioritization process based on risk to rights holders

- Tailored to context and risk
- Rights-focused Impact assessment, using involvement links
- Third-party due diligence on business relationships
- Reporting

THE IMPORTANCE OF INVESTOR HUMAN RIGHTS STRATEGY

- *Guiding Principles* **apply directly to investors** and financial institutions.
 - See, e.g., Thun Group of Banks—initiative by leading European banks to integrate *Guiding Principles* throughout their operations.
- National Contact Point processes under the **OECD Guidelines on Multinational Enterprises** have emphasized the importance of investor human rights strategy:
 - Norwegian Bank Investment Management and POSCO (Norwegian NCP): “NBIM’s **lack of an internal process to address human rights impacts is perceived as problematic** by the NCP. ... The NCP finds that NBIM’s Responsible Investor Policy and strategies are too narrowly focused and are therefore deemed not to be consistent with the Guidelines.”

BENEFITS BEYOND RISK MANAGEMENT: HABIT MATTERS

- Economist Intelligence Unit, *The Road from Principles to Practice: Today's Challenges for Business in Respecting Human Rights* (2015):
 - Ed Potter, Director of Workplace Rights, **Coca Cola**: Commitment to human rights has strengthened relationships with stakeholders so that issues can **be resolved outside the spotlight**, thereby protecting the brand.
 - Jan Klawitter, Government Relations Manager, **Anglo American**: “positive stakeholder relations arising from a good track record in human rights **improve access to resources**—not just to raw materials, where government and community relations matter, but also to talented employees who prefer to work for such a firm.”
- Henisz, et al, “Spinning Gold: The Financial Returns to Stakeholder Engagement”, *Strategic Management Journal* (2014)
 - Analysis of 19 publicly traded gold companies revealed that up to **70 percent of valuation dependent on stakeholder engagement**
- **The ALCOA example: focus on safety boosted all conventional metrics of business success by instilling culture and communication channels with tremendous positive externalities.**

QUESTIONS?

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The science of corporate responsibility
