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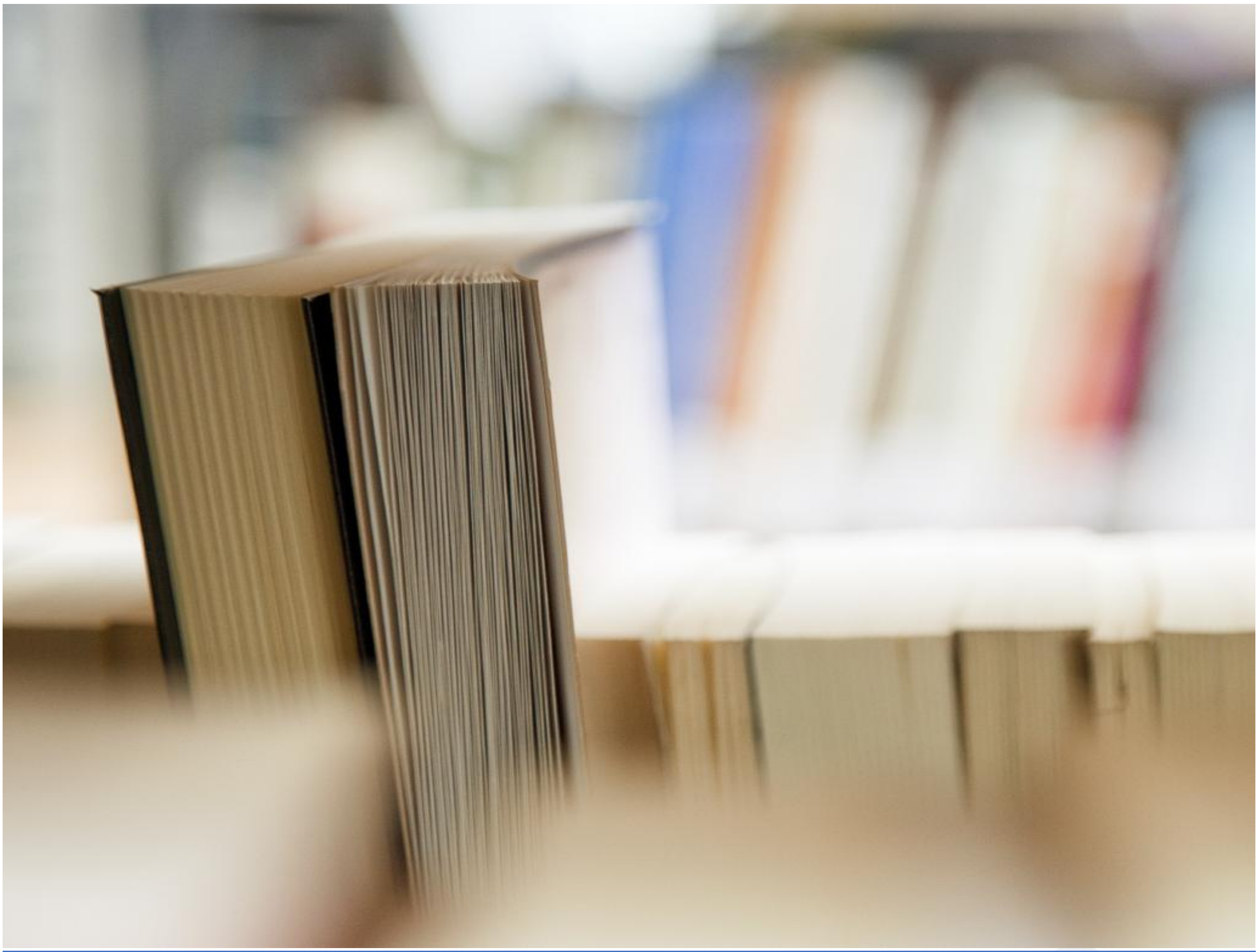

Considering Internal Social Factors Under Pillar 'S' In ESG for Corporate Analysis

ESG & Sustainability Transformation

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Considering Internal Social Factors Under Pillar ‘S’ In ESG for Corporate Analysis

The S-pillar of ESG encompasses a range of factors that can be classified as internal and external to a business. In this article, we will provide an overview of the key internal social factors that may be of interest to investors or other stakeholders.

Human Resource Development

A company's long-term strategy should include the development of its workforce. This ensures that the workforce is:

- well equipped to perform its duties and responsibilities;
- operating in accordance with the latest standards and regulations; and
- motivated.

Good human resource management creates a culture and behaviour where the workforce is actively and productively cared for, rather than taking excessive risks or personnel harming customer relationships. Human resource management enhances social inclusion, active citizenship and personal development, while increasing competitiveness and job security.

For an investor, the following business requirements can be evaluated when analyzing a company for human resource development.

Questions should include:

Does this business have...

- Identify the skills or competencies required for the company to deliver its strategy, as well as identify gaps within the company and areas of skill shortage in the industry (‘leading to a war for talent’)?
- Develop a compelling proposition to attract talent, as well as ways to develop internal employee competencies to retain talent?
- Develop measures to monitor investment in human resource development (e.g. hours of training, coaching) and return on investment (key performance indicators, or KPIs, such as employee engagement, turnover and ability to fill vacancies with internal candidates)?

Working Conditions, Health and Safety

One of the most widely perceived social factors that institutional investors have incorporated is health and safety. Its focus is on protecting the workforce from accidents and fatalities. A sub-theme is occupational health, which is about reducing the risk of occupational diseases (such as silicosis) or injuries (such as vibrating white fingers).

An example of the health and safety factor can be seen in the Rana Plaza disaster, which we examine in the following case study.

Case Study

Rana Plaza Disaster

On April 24, 2013, a structural failure led to the collapse of Rana Plaza, an eight-story commercial building in Dhaka, Bangladesh. It resulted in a death toll of 1,134 people.

Approximately 2,500 injured people were rescued from the building. It is considered the deadliest structural accident in modern human history. The building's owners ignored warnings to avoid using the building after cracks appeared the day before. Garment workers were ordered to return the next day, and the building collapsed during the morning rush hour.

The high death toll of the disaster was at least partly due to the decision of managers to send workers back to the factory despite knowing the risks. Managers claimed they ignored warnings due to pressure to meet orders for the buyer on time. Some have argued that the demand for fast fashion and cheap clothing promotes minimal oversight of clothing brands, and that organized unions may have caved in to management pressure.

This major tragedy has drawn attention to widespread human rights abuses in the garment sector, as well as the failures of the Bangladeshi government and the corporations that source there. The need to create workplaces that respect and protect the lives of workers, and to reduce risks for companies and their investors. In the aftermath of the Rana Plaza disaster, more than 175 brands, such as Adidas, Marks and Spencer, and H&M, signed the Bangladesh Accord, where they committed to higher health, safety, and fire standards in Bangladesh.

Led by the Interfaith Center on Corporate Responsibility, the Bangladesh Investor Initiative, an investor coalition of 250 institutional investors representing over US$4.5 trillion in assets under management, was formed in May 2013 to urge a strong corporate response to Rana Plaza, including joining the Accord.

Sadly, similar egregious incidents continue to occur in the capital of Bangladesh, raising serious questions about the government's accountability and governance, as well as the practical effectiveness of a range of collective initiatives.

On July 8-9, 2021, a fire broke out in a six-storey building of the Hashem Food and Beverage Factory in an industrial town on the outskirts of the capital Dhaka, killing at least 52 people trapped in the fire, many of whom jumped to their deaths. Fire department spokesman Debashish Bardhan said: "The workers could not go to the roof because the stairway was locked. They could not go down because the lower floors were engulfed in fire." Initial information said the fire broke out more strongly because the factory's warehouse contained many flammable chemicals and plastics. Factory workers revealed that in recent years, there have been small fires at this factory and there are only two staircases for thousands of workers to escape in case of emergency.

Most recently, on the evening of February 29, 2024, a serious fire in a 7-storey building in the center of the capital Dhaka, Bangladesh, killed at least 43 people, including 33 women and children, and injured 22 others. According to the head of the fire department, the fire broke out in a restaurant on the first floor of the building and quickly spread to the upper floors, which are home to many restaurants and garment shops. "It was a dangerous building with gas cylinders on every floor, even on the stairs," he said. Witnesses said that to escape the fire, people rushed to the upper floors. While many people were lucky to be rescued by firefighters using ladders, many were forced to risk their lives jumping down to escape.

Health and safety performance indicators should be assessed for both permanent, temporary and contract employees. For example, some oil and gas companies only report fatalities among their permanent employees, not their contract employees. Given the volume of contract workers in the sector, it is important for investors to understand whether the company provides a safe place to work. This is particularly relevant in companies operating in emerging markets.

In addition to reducing accidents and fatalities, health and safety has evolved into a broader concept of working conditions that promote employee well-being, for example through ergonomic workplaces and flexible working hours. There is also a growing focus on mental health (such as burnout risks in the finance industry) and other employee benefits to promote employee well-being outside of the workplace (including medical screenings, sponsored gym memberships, and nutrition-related risk training programs). Another example is "financial wellness," a term that has become quite well-established among US employers and HR departments. Support for personal financial issues such as personal budgeting and retirement planning/savings leads to less distracted and less stressed workers.

Human Rights

Another important social factor for analysts is human rights. These are rights that are inherent to all people, regardless of:

- race;
- gender;
- nationality;
- ethnicity;
- language;
- religion; or
- any other status (e.g., age, ability, socioeconomic status, or gender identity).

Human rights include:

- the right to life and liberty;
- freedom from slavery and torture;
- freedom of opinion and expression; and
- the right to work and education.

Everyone is entitled to these rights, without discrimination.

The most important foundation for international human rights is the Universal Declaration of Human Rights (UDHR). This declaration was proclaimed by the United Nations General Assembly on 10 December 1948 by General Assembly resolution 217A and is a common standard of achievement for all peoples and all nations.

Human rights violations often occur deep in the supply chain. The companies with which major investors have the most direct contact, and even their first- and second-tier suppliers, are less likely to be directly involved in such activities. In the garment industry, for example, human rights violations are more likely to occur in emerging countries where clothes are made, rather than in the stores where clothes are sold. However, both customers and governments expect companies to be responsible for their supply chain practices.

There are many different guidelines relating to human rights. However, two frameworks have a direct impact on companies and investors:

Enterprises (Hướng dẫn của OECD cho các doanh nghiệp đa quốc gia - MNE)

- The United Nations Guiding Principles on Business and Human Rights (UNGPs)
- The OECD Guidelines for Multinational Enterprises (MNE)

The United Nations Guiding Principles on Business and Human Rights (UNGPs)

The UNGPs are a set of guidelines for implementing the United Nations "Protect, Respect and Remedy" framework for the responsibilities of transnational corporations and other business enterprises with respect to human rights. Developed by the Special Representative of the Secretary-General (SRSG) John Ruggie, the Guiding Principles provide the first global standard for preventing and addressing the risk of adverse human rights impacts related to business activities. They also continue to provide an internationally accepted framework for strengthening standards and practices related to business and human rights.

The UNGPs consist of three pillars that outline how states and businesses should implement the framework:

- State obligations to protect human rights
- Business responsibilities to respect human rights
- Access to remedy for victims of business-related abuses

OECD Guidelines for Multinational Enterprises

The OECD Guidelines for Multinational Enterprises - MNEs are a comprehensive set of government-supported recommendations on responsible business conduct. Governments follow the Guidelines to encourage and maximise the positive impact that MNEs can have on sustainable development and long-term social progress. The Guidelines are key recommendations issued by governments to multinational enterprises operating in or from countries that follow them. They provide voluntary principles and standards for responsible business conduct in areas such as:

- employment and labour relations;
- human rights;
- environment;
- disclosure;
- anti-bribery;
- consumer interests;
- science and technology;
- competition; and
- taxation.

The study, Responsible Business Conduct for Institutional Investors, helps institutional investors implement the due diligence recommendations of the OECD Guidelines for MNEs to prevent or address adverse impacts related to human and labor rights, the environment and corruption in their portfolios.

It is important to note that these guidelines do not focus on the impact that social factors may have on investments (financial materiality) but rather on the responsibility of investors for the adverse impacts that their investments/companies may have on society. Today, many investors believe that they should take ESG factors into account, but these guidelines require governments and investors to adopt a so-called double (dual) materiality approach and take into account the "social return on investment" (both positive and negative).

The OECD and UNGP guidelines are further supported by the European Union (EU) corporate social responsibility (CSR) strategy, which regulates sustainability-related disclosures in the financial services sector and classifies minimum social safeguards for sustainable activities.

In the Netherlands, the government, non-governmental organizations (NGOs) and institutional investors have signed a Responsible Investment Agreement, in which investors agree to adopt this dual-materiality approach, follow OECD guidelines and take responsibility for trying to minimize the negative impacts of their investments.

Corporate Human Rights Benchmark (CHRB)

The Human Rights Benchmark for Businesses (CHRB) is a partnership led by investors and civil society dedicated to creating the first open and public benchmark for corporate human rights performance.

The CHRB provides an annual snapshot of the world's largest companies, examining the policies, processes and practices they have in place to systematize their approach to human rights and how they respond to serious allegations. Initially, only companies from three industries – agricultural products, apparel and mining – were selected based on their size and revenue. The themes and metrics in the CHRB provide a truly rigorous and reliable proxy measure of a company's human rights performance, which can be used by analysts and investors. The themes cover a range of questions listed in the report. These questions address:

- governance and policy commitment;
- Embedding respect for and due diligence on human rights;
- remedies and grievance mechanisms;
- performance – the company's human rights practices;
- performance – responding to serious allegations; and
- transparency.

Human Rights 100+

Following on from Climate Action 100+, Principles for Responsible Investment (PRI) recently launched a new collaborative initiative for investors to address human rights and social issues through their governance: Human Rights 100+. The initiative acts as a platform that can cover a range of social issues, allowing investors to prioritize the most serious human rights risks and outcomes in their governance. It includes collaborative investor engagement with companies, with the ability to push further where necessary, and also supports investor engagement with policymakers and other stakeholders to make progress towards the overall goal.

Labour Rights

Evaluating how companies maintain labor rights is important for investors to gain a better understanding of their corporate culture and employee satisfaction. The most important labor rights are summarized in the International Labor Standards. These aim to promote opportunities for women and men to obtain decent and productive work in freedom, fairness, security and dignity. These standards are contained in eight core conventions of the International Labor Organization (ILO):

• Freedom of Association and Protection of the Right to Organize

• Right to Organize and Collective Bargaining

• Forced Labor

• Abolition of Forced Labor

• Minimum Age

• Worst Forms of Child Labor

• Equal Remuneration

• Discrimination (Employment and Occupation) We will now explore some of these conventions in more detail.

Freedom of Association and Labor Relations

A company operates most efficiently when its workforce is engaged and productive. This ensures that the costs of turnover, absenteeism, or strike action are reduced. To ensure that workers' rights are well served, workers should have the freedom to form or join an association or union that protects their interests.

In some countries or industries, this right is limited. For example, some companies in the retail industry are notorious for their anti-union stance. Walmart has been urged by some international institutional investors to adopt a more pro-union stance. When freedom of association is established, other labor rights violations – such as forced labor, child labor, and discrimination – are often better protected.

A lack of freedom of association may occur directly at the level of the investee companies, but it is more likely to be an issue in the supply chain of the companies. By engaging with their investee companies on this issue, investors can promote better labor relations in a particular sector or country.

Modern Slavery and Forced Labour

Two topics that are rarely addressed in responsible investment policies are modern slavery and forced labour.

Modern slavery refers to situations of exploitation where a person is unable to refuse or leave because of threats, violence, coercion, deception and/or abuse of power. It is considered an umbrella term that includes practices such as forced labour, debt bondage (debt bondage), forced marriage and human trafficking.

Forced labour is defined by the ILO as: "All work or service which is exacted from any person under the menace of any penalty and to which the said person has not offered himself voluntarily."

Modern slavery and forced labour can occur in any type of work or service, in the private, public, informal or formal markets, but it is most common in poorly regulated industries and where production processes are labour intensive. In total, it is estimated that no less than 25 million people are in forced labour globally.

It is often hidden in the supply chain at the second-tier supplier level and beyond. However, most companies addressing modern slavery and forced labour begin and end their due diligence by focusing on their first-tier suppliers and contractors. In addition to modern slavery, forced labour can take subtle forms, making it difficult to detect. The use or threat of physical violence is not required to describe a labour relationship as forced labour. Debt bondage, threats to report a worker to immigration authorities or withholding identity documents can also ‘coerce’ workers. The increasing complexity and international nature of supply chains makes transparency essential.

In 2015, the UK Parliament passed the Modern Slavery Act, designed to combat modern slavery.

Living Wages

In sectors that rely heavily on manual labour (such as apparel and footwear, food and beverage, consumer electronics or retail), wages are often insufficient to cover workers’ basic living costs (food, clothing, housing, healthcare and education).

The benefits of paying a living wage are clear. Workers who earn a living wage are able to meet their own and their families’ basic needs and set aside savings, and are therefore more likely to find a way out of poverty. They work regular hours rather than excessive overtime to ‘get by’ and are more likely to send their children to school rather than work.

In short, a focus on living wages also promotes respect for a number of other basic human rights in global supply chains.

EXAMPLE

Platform Living Wage Financials (PLWF)

PLWF was founded in late 2018. It is a coalition of financial institutions (mostly Dutch) that encourages and monitors investee companies to address non-payment of living wages in their global supply chains. The investor coalition has over €2.6 trillion in assets under management and uses its influence and leverage to engage with investee companies. They:

• measure their performance on living wages;

• discuss the results of the assessment; and

• Support innovative experiments. Ultimately, they make sustainable investment decisions based on (lack of) improvement depending on the individual choices and policy preferences of each investor.

To learn more about ESG and sustainability-related models, please contact: **YTT Consulting**!