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Three Levels of Analysis of Social Issues Critical to Businesses and Investors

ESG & Sustainability Transformation

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ESG Transformation

Three Levels of Analysis of Social Issues Critical to Businesses and Investors

With a range of social trends and factors that can influence both risks and opportunities for businesses and in an investor's portfolio, these issues should be considered by investors.

To date, these issues and trends have been discussed in general terms, as if they would have the same impact on each country, sector or company; however, this is not the case.

Analyzing which social factors are material from an investment perspective should begin with an understanding of materiality at both a geographic and industry level.

Once this is established, the level of risk at the company level can be determined by considering the sector in which it operates and the countries/regions in which it primarily operates, as well as the locations of its key suppliers, factories, customers and key tax jurisdictions.

Country Level Analysis:

The importance or relevance of a particular social issue depends on the regional or national context, including the level of economic development, the legal framework (e.g. where local labour laws do not fully comply with ILO principles), and cultural or historical factors. For example, population ageing is an important issue in developed countries, but it is less of a concern in emerging markets.

Furthermore, rural-urban disparities are greater in emerging markets than in developed markets. Government regulation also plays an increasing role, as in certain jurisdictions (national/regional) companies are required to take legal responsibility and audit the conditions in their supply chains. Examples include the UK Modern Slavery Act, the French Corporate Duty of Vigilance Law, the EU Conflict Minerals Regulation and the Dutch Child Labour Due Diligence Law. Investors should carefully consider how social factors and trends impact their investee companies in the different countries where they operate.

Case Studies:

Two examples of local legal frameworks are the EU taxonomy for sustainable activities and the UK Modern Slavery Act.

EU Taxonomy for Sustainable Activities

The EU classification sets performance thresholds for economic activities that make a significant contribution to one of six environmental objectives:

- climate change mitigation;
- climate change adaptation;
- water and marine sustainability and protection;
- transition to a circular economy;
- pollution prevention; and
- biodiversity and ecosystem protection and restoration.

The activity/project must make a significant contribution to one of the objectives to be eligible for the classification (while not significantly undermining the other five objectives, if relevant) and must comply with minimum safeguards. For example, the OECD Guidelines on MNEs and the UN Guiding Principles on Business and Human Rights.

The European Parliament and the Council have determined that for an economic activity to be linked to such a classification, it must be carried out "in accordance with the OECD Guidelines for Multinational Enterprises and the UN Guiding Principles on Business and Human Rights, including the International Labour Organization's ('ILO') declaration on Fundamental Rights and Principles at Work, the eight core ILO conventions and the International Bill of Human Rights." Where applicable, the more stringent requirements in EU law still apply.

UK Modern Slavery Act - UK

The Modern Slavery Act requires both medium and large companies to provide an annual slavery and human trafficking report, outlining the steps they have taken to ensure modern slavery is not occurring in their business or supply chain. Many of these reports go beyond general information to include specific numeric data, such as audited reports on high-risk suppliers or the number of suppliers with established remediation action plans, which can help investors assess materiality.

The regulatory pressure on companies to provide useful social data is likely to increase further. In the United States, for example, the Human Capital Management Coalition, which includes influential investors such as leading U.S. pension funds, has petitioned the Securities and Exchange Commission to require issuers to disclose information about their human capital management policies, practices, and performance. International cooperation is also key. The International Organization of Securities Commissions (IOSCO) connects regulators around the world and provides global frameworks to support worldwide standardization, which regulators in each country can use as a basis for their own regulations.

Sector-Level Analysis:

It is important to identify what the most important social factors and trends are for each sector/industry.

Certain sectors have more profound social risks, for example, due to child labor in the supply chain (minerals, clothing/cotton) or the nature of the business (mining).

Social trends also impact different sectors. For example, automation and artificial intelligence (AI) will have very different impacts on transportation (self-driving cars) than maintenance (which is harder to automate). However, demographic changes, increasing life expectancy or an aging population will have a particular impact on healthcare.

Technological developments can also help address injustices in certain sectors, for example, satellite imagery can help identify illegal deforestation.

Enterprise-Level Analysis:

Companies within the same sector may not all be exposed to social trends and factors in the same way. Much will depend on the company’s culture, systems, operations, and governance. For example, more traditional, established companies may have better systems in place to manage social risk in their supply chains, but at the same time they may find it harder to react when a company with a disruptive business model (e.g. Tesla or UBER) enters their market.

Most of the social issues mentioned above can:

- impact a company’s bottom line;
- increase workforce issues (including supply chains); and

• reduce corporate responsibility (human rights) and consumer expectations (e.g. animal welfare).

Case Study:

Thai Union

Thai Union is a Thailand-based seafood food products manufacturer with a global workforce of over 49,000. The company's global brand portfolio includes international brands such as Chicken of the Sea, John West, Sealect, and Petit Navire. In 2015, Greenpeace accused Thai Union of being "involved in serious human rights and environmental violations" and warned shareholders and investors "of the financial risks associated with these destructive practices": Such controversies have resulted in lost sales as consumers and supermarkets boycotted the products. This has forced the termination of cooperation with subcontractors, thus accelerating the transition and future costs.

In 2015, Thai Union issued new codes of conduct and announced that it had terminated relationships with 17 suppliers for forced labor or human trafficking violations since the beginning of 2015. The company also ended the use of employment brokers to source workers for its seafood processing plants to prevent debt bondage.

In a statement released on 10 December 2015, Thai Union announced that it would stop working with all shrimp processing subcontractors by the end of 2015 and bring all shrimp processing operations in-house for full oversight. All processing operations will be directly controlled by Thai Union Group to ensure that all workers, whether migrants or Thais, will have safe, legal employment and be treated fairly and with dignity.

In December 2016, Thai Union and the World Tuna Purse Seine Organization (WTPO) signed a memorandum of understanding (MOU) to establish a framework to ensure fair labor practices.

In May 2018, Thai Union announced that it had reached an agreement with Greenpeace, in which both parties stated that they had made significant, positive progress in their commitment to address illegal fishing and overfishing and had also improved the livelihoods of hundreds of thousands of workers throughout their supply chains. According to Greenpeace: "There is still much work to be done, but it is clear that the company takes its commitments seriously and is making progress towards implementing them."

Following the agreement, Thai Union issued the Vessel Code of Conduct, developed in partnership with Greenpeace and the International Transport Workers' Federation.

When assessing the financial materiality of such factors to a company's investment, both the social risks, the extent to which they are mitigated, and how they are managed need to be considered. Where such issues persist, consumer boycotts or investor divestments are possible, which could impact the company's share price. However, if performance on these issues can be improved, it could lead to increased brand strength and could increase or justify future revenues.

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