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Analyzing Major Social and Environmental Trends Impacting Business Today

ESG & Sustainability Transformation

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Social factors are relevant from both a business and an investment perspective and are increasingly being incorporated into business analysis and investment decisions. In many cases, investors expect companies to manage these issues using a best-in-class approach, whereby a company outperforms its industry peers on some important issue relevant to its sector (e.g. occupational health and safety or managing its impact on local communities). In other cases, a social issue may be the focus of an investible opportunity (e.g. a gender equity fund). Companies are increasingly expected to engage with their stakeholders in an open, transparent and responsive manner.

Investors need to be aware of various major social trends that may impact the businesses of their investee companies. We will examine the systemic relationships between these major social trends and the businesses of companies, and elaborate on the material impacts of these trends on potential investment opportunities.

What are the big social trends?
Big social trends are permanent changes to society over the long term, affecting government, society, and the economy over a long period of time.

The following major trends will be described in this section:

1. Globalization
2. Automation and artificial intelligence (AI)
3. Inequality and wealth creation
4. Digital disruption, social media and access to electronic devices
5. Changes in work, leisure and education
6. Changes in individual rights and responsibilities and family structures
7. Demographic changes, including health and longevity
8. Urbanization
9. Religion

Some major environmental trends also have serious social impacts. These include the following:

- Climate change and transition risks
- Water scarcity
- Mass migration

All of this could, in extreme cases, lead to mass migration. These major social trends will change the way we live, work, consume and perceive.

Globalization:

One of the biggest trends is the integration of local and national economies into a global (and less regulated) market economy. The growth in global interactions has increased international trade and the exchange of ideas and cultures. This process is also known as globalization.

Globalization is caused by the rapid increase in the cross-border movement of goods, services, technology, people and capital. Depending on the perspective, it can be seen as a positive or negative phenomenon. On the one hand, it is said to have led to increased efficiency in markets, leading to wider availability of products at lower costs. On the other hand, it is said to be detrimental to social welfare due to structural social inequality.

Examples of its meaning include:

• Outsourcing. Due to lower wages for garment workers in developing countries, clothing is now largely produced in countries such as Vietnam, Bangladesh and China. This has led to the disappearance of the textile industry in Western countries. Offshoring also occurs in other sectors.

• Dependence. As US and Asian-based companies dominate the mobile phone, computer and other IT product industries, European countries are increasingly dependent on these suppliers.

Automation and Artificial Intelligence (AI):

Associated with increased economic globalization is the trend toward automation, which is technology that enables a process or procedure to be performed with minimal human assistance. Some of the biggest advantages of automation in industry are:

• associated with faster production and lower labor costs; and it

• Replaces heavy, physical, or monotonous work.

However, the biggest downside (socially) is that it displaces workers by replacing jobs, as technology makes their skills or experience no longer necessary. This trend is expected to increase due to the rise of AI.

AI is expected to have a significant impact on areas such as:

1. Healthcare;

2. Automotive;

3. Financial services, auditing;

4. Security (including military); and

5. Creative (especially advertising and video games).

EXAMPLE:

Implications for investors

The transport industry is on the brink of becoming more automated, and it is expected that some driver jobs (such as taxis, buses and trucks) will disappear due to self-driving cars. This will benefit the companies that are best at developing self-driving cars, but less so for traditional heavy transport (HGV) companies that are not innovating. One of the biggest expected impacts of this is that the automation of the transport industry will result in massive job losses. One possible solution is to invest in upskilling employees to enable them to transition to a more AI-enabled world. Investors should take this into account when assessing the risk of an investee company.

Inequality and Wealth Creation:

The Organisation for Economic Co-operation and Development (OECD) analyses trends in inequality and poverty for advanced and emerging economies. It examines the drivers of rising inequality, such as globalization, skill-biased technological change, and changing policy approaches across countries. It also assesses the effectiveness and efficiency of a range of policies, including education, labour market, and social policies, in tackling poverty and promoting more inclusive growth.

According to a 2015 report by the OECD Centre for Opportunity and Equality (COPE), the average income of the richest 10% of the population in the OECD is about nine times that of the poorest 10%. This is also known as economic or income inequality. There is growing evidence that rising inequality affects economies and societies. Educational opportunities and social mobility may be reduced, leading to a less skilled and less healthy society with lower and middle class purchasing power. This limits overall economic growth.

A related issue to the inequality theme is corporate tax strategy and whether companies are being too aggressive in their tax optimization strategies. As regulators have focused more on this issue, some companies (for example, in the technology sector) have had to pay huge fines. Others will need to adopt more conservative tax strategies in the future, which will affect their profits.

Digital Disruption, Social Media and Access to Electronic Devices:

Another important societal trend is the rise of digital disruption, which is the change that occurs when new digital technologies and business models impact the value proposition of existing goods and services. This trend is closely related to the rise of automation and the rise of AI discussed above.

Some notable examples of disruptive companies include Amazon, Uber and Airbnb. They have managed to penetrate an existing market but with more digital business approaches than their competitors, effectively challenging existing business models. There are many opportunities for investors to invest, preferably at an early stage, in such companies, although such investments can carry a high risk profile.

A related consequence of digital technology is the enormous amount of data that can be collected, stored and processed (big data) as well as the ownership or use of the data (including data privacy, data monetization, etc.).

Big data has many opportunities, including more personalized services, products and (medical) treatments. However, controversy has arisen as some data is being used and sold in more extreme or socially unacceptable ways. Examples include social media companies such as Facebook, Twitter and LinkedIn selling data for political or marketing campaigns (e.g. the Cambridge Analytica case where Facebook data was allegedly used to try to manipulate elections). As a result of these scandals, there is a growing debate around the need to regulate the industry. This could impact the profitability of these companies and should be considered by investors.

Finally, electronic devices are now ubiquitous. Almost everyone, in both developed and emerging economies, owns a mobile phone (in many cases a smartphone) and a tablet. The Internet of Things (IoT) is the next frontier, where semi-intelligent devices (known as 'embedded systems') communicate directly with each other and the internet and make decisions on their own.

For investors, disruption represents both risk and opportunity. Analysts need to take a forward-looking approach to determine which sectors and companies will thrive and which will struggle in a digital society.

Changes in work, leisure and education:

The way we spend our lives has changed dramatically over the past few decades. Various measures have emerged that aim to provide a broad sense of the state of our societies and how people's lives are developing. The OECD looks at well-being issues in its Better Life Index, which assesses a range of developed and emerging economies across a number of areas, including life satisfaction.

Most countries in the developed world have seen a significant reduction in average working hours. In the UK, the average annual working hours per person fell from 1,775 in 1970 to 1,538 in 2019. This is partly due to the rise in automation and part-time work.

New technologies increasingly allow workers to connect to their jobs from remote locations. This creates opportunities for employers and employees to adopt more flexible working models. However, constant connectivity also makes the concept of work-life balance more difficult to achieve and can contribute to stress-related illnesses.

While average hours worked have decreased, average educational attainment has increased. The proportion of employees with higher education has increased over the past few decades. However, some sectors are suffering from a shortage of qualified employees and are facing a fierce 'war for talent' to attract the most skilled employees.

Investors who are evaluating companies that rely heavily on employees as a key asset should pay close attention to their human resource management strategies. They should assess how companies are coping with these structural changes in the labor market.

Changing individual rights and responsibilities and family structures:

In recent decades, not only has the way we divide our work and leisure time changed, but also the role and importance of the family (especially in developed countries). Individuals are also less dependent on the family structure for security (more economic and material independence).

The workforce has become more diverse: More women are now entering the labor market, which has given women greater financial independence. However, compared to men, women are still more likely to be unemployed, have fewer opportunities to participate in the labor force, and often have to accept lower-quality jobs when they do secure employment. Women also face a wage gap compared to men.

To improve gender equality, a number of different initiatives have been created, and there is growing evidence that a more diverse workforce leads to better (financial) results for companies. Some of the best hedge funds and impact investors take diversity (gender and other types of diversity) into account in their risk analysis and stock selection.

Demographic changes, including health and longevity:

As a result of improvements in healthcare and changes in lifestyle, we are living longer. For example, the average life expectancy (from birth) for women and men in the UK increased by two years between 2002 and 2010 (to 78.4 years for men and 82.5 for women). As of 2019, this figure stands at 79.4 for men and 83 for women.

This increase in life expectancy, combined with falling birth rates, has caused the populations of many developed countries to age. The median age increased from 28 in 1950 to 41 in 2015 and is projected to increase to 45 by 2050.

Aging populations have significant social impacts:

The ratio of active to inactive parts of the workforce falls, affecting national tax revenues and challenging pension systems, including the impact on pension funds that need to be extended.

Older people have higher cumulative savings per capita than younger people but spend less on consumer goods, which is a business risk for some industries. In some categories, such as health care, spending increases sharply as the population ages.

Case Study

Impact of the global COVID-19 pandemic:

The COVID-19 pandemic is one of the largest global health, economic and social crises in recent history. While it affects all segments of the population, it is particularly detrimental to those in the most vulnerable situations, including those living in poverty, the elderly, people with disabilities, young people and minorities. The health and economic impacts are being felt disproportionately by the poor, especially among the homeless, who lack safe shelter and are therefore more vulnerable to the dangers of the virus. People without access to running water, refugees, migrants or displaced people are also suffering disproportionately both from the pandemic and its aftermath. This can include restrictions on movement, fewer employment opportunities and increased xenophobia.

Other impacts include:

Education: Learning loss may occur due to widespread school and college closures.

Increased inequality: It has been found that low-income people are more likely to contract COVID-19 and die from it. This may be because poorer families are more likely to live in crowded homes and work in low-skilled jobs, such as grocery shopping and elder care, that are considered essential during the crisis. In the United States, millions of low-income people may lack access to health care due to lack of or underinsurance.

Psychological: There is concern about a potential spike in suicides, exacerbated by social isolation due to quarantine and social distancing guidelines, fear, unemployment, and financial factors.

Reshoring: Companies and countries may decide to reduce supply chain risk by relocating strategically important manufacturing back to high-wage countries.

Working environment: There has been a changing demand for office buildings with the increase in working from home.

Investor Initiative: Equitable Distribution of COVID-19

Vaccines To ensure a more equitable global distribution of COVID-19 vaccines, various investor initiatives have been put forward. Pharmaceutical giant Moderna has faced shareholder proposals to expand its COVID-19 vaccine technology to poorer countries and to explain the high prices due to the amount of government support it has received.

Another initiative involves vaccine manufacturers being asked to increase the availability and deployment of vaccines worldwide. A group of 65 institutional investors have requested that global vaccine availability be made part of the remuneration policy of managers and directors. In this way, investors have aimed to hold them accountable for their contribution to solving this global problem.

Urbanisation:

Where we live is also changing. Globally, populations are increasingly moving from rural to urban areas. In the 1950s, around 30% of the world's population lived in urban environments. This is expected to rise to 68% by 2050.

This shift can have a number of implications for society, including:

Economic: Significant increases and cost shifts can often push local workers out of the market

Environmental: 'Urban heat islands', where urban areas produce and retain heat, have become a growing concern.

Social: There has been an increase in mortality from lifestyle-related non-communicable diseases, including cancer and heart disease. Residents of poor urban areas (such as slums) also suffer from "disease, injury, premature death, and the combination of poor health and poverty that entrenches disadvantage over time."

These social impacts provide business opportunities because of the growing need for infrastructure development, but they also require companies to address social and environmental issues associated with urban living (e.g., pollution and waste management systems).

Religion:

As a social factor, the changing religious landscape around the world has consequences for consumer preferences. Religion-based politics and conflicts can also have a profound impact on specific local economies.

All investors (faith-based or not) should therefore assess whether the companies they invest in take these changes into account from a financial perspective. It is important to distinguish between religious practice as a social factor and faith-based investing.

Faith-based investors aim to invest their money in accordance with a specific named faith. The two most common types are:

Christian investors, who aim to align their investment principles with the Bible. This means that they may refrain from investing in certain companies whose activities or processes are deemed inconsistent with Christian values.

Muslim investors who seek to invest in accordance with Shariah principles. They will not invest in companies that profit from alcohol, pornography, gambling, or pork. They will also not own investments that pay interest or invest in companies that derive a significant portion of their revenue from interest.

Standards-based exclusions were one of the first environmental, social, and governance (ESG) investing tools; Many of these early movers were faith-based investors. The Church of England, the Church Investors Group, the Interfaith Center on Corporate Responsibility, and other faith-based investors continue to play an important role in ESG advocacy and corporate engagement and in shareholder resolution submissions.

Environmental megatrends with social implications:

Climate change and transition risks:

Climate change and the associated impacts of transition risks have social implications. There is widespread global call for the transition to be a ‘just’ transition. In the process of adapting to a climate-neutral economy, sectors that employ millions of workers (such as energy, coal, manufacturing, agriculture and forestry) must restructure. There is concern that a period of economic restructuring will result in ordinary workers bearing the costs of the transition, leading to unemployment, poverty and exclusion from the workforce.

Water Scarcity:

Climate change is having a negative impact on the availability of fresh water. High water use by some corporations poses a significant threat to clean and affordable water for communities. Building wastewater treatment plants and reducing the overuse of groundwater may seem like an obvious solution to this global problem. However, this is not as simple as it seems for the following reasons:

Wastewater treatment is capital intensive, so access to this technology is limited in some regions. The rapid population growth of many countries makes this a difficult race to win. There are many costs and skills involved in maintaining wastewater treatment plants, even if they are successfully developed.

Mass Migration:

Freshwater scarcity and desertification due to climate change in some emerging countries are believed to be among the reasons for mass migration from developing countries to developed countries, where these problems are less prevalent. Climate change may lead to an increase in “environmental migrants”, with the most common projection being that the world will have 150 to 200 million climate-related migrants by 2050.

Pollution and loss and/or degradation of natural resources and ecosystem services:

Factors such as pollution and land degradation may also lead to stakeholder resistance, social unrest and/or migration.

Conclusion:

As discussed in this section, various social megatrends present both opportunities and risks for investors and business analysts. It is therefore important to be aware of these trends and take them into account when making investment decisions.

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