impak

The independent impact rating agency™

ESG is not the answer to social inequalities

impak Insight

About the author *impak, the independent impact rating agency, regularly publishes content providing transparent data on the social and environmental impact of companies. By doing so, it aims to accelerate the transformation towards a stakeholder economy generating an overall more positive contribution to society.*

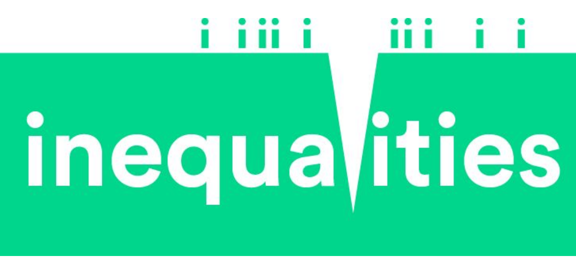
ESG is not the answer to social inequalities

And racism is not an American issue
The events following Georges Floyd's murder, amidst a global pandemic, unveiled America's open social wounds, but also those of the Western world. This structural racism - represented among other things by social inequalities - isn't only an American issue rooted in its own history of slavery, it is a societal problem present in many societies. On both sides of the Atlantic, data on black or minority populations' overrepresentation in COVID-19 victims are sadly similar.

In Michigan, the black community represents 14% of the population, but 40% of deaths related to coronavirus. In the UK, according to a study from the Institute for Fiscal Studies (IFS), people from minority ethnic backgrounds represent 34% of COVID-19 hospitalizations while only representing 13,4% of the population. The sanitary crisis blatantly exposed that low-wage jobs, which are generally more in contact with the public, are usually held by ethnic minorities (healthcare services, grocery stores, restaurants, delivery, taxis).

Let's take another example: France, fundamentally opposed to the U.S. on a social and cultural level, has a free school system and more importantly, universal access to healthcare services. However, it wasn't up until 2011 and the constraint imposed by the Copé-Zimmerman law, that a balanced representation of women on boards of directors was required. Moreover, ethnic statistics are forbidden there since 1978, but a recent report from the National consultative committee for human rights (CNCDH) sheds light on the current situation. According to this report, a black person has 32% fewer chances of finding housing, and close to 50% "of black persons declared having experienced discrimination at work". Even if France is a leader in social protection in Europe, it is not free from such inequalities based on cultural or ethnic considerations.
If the term racist is too excruciating, let's use inequalities, but the time has come to take this matter in our hands in the name of true equality, and also the economy.

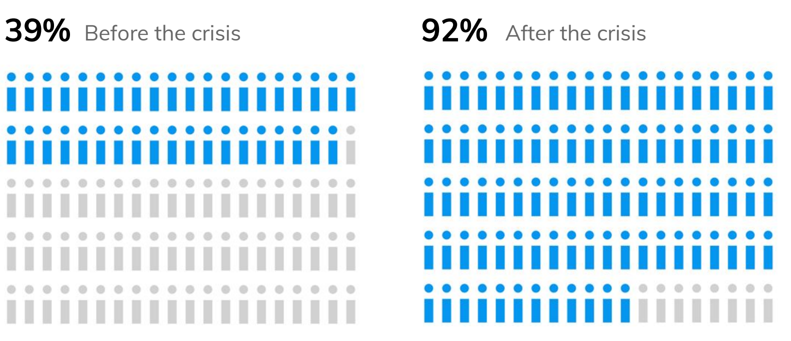
To help these businesses and investors measure and solve these problems efficiently, we ask the question of which tool would be more adequate: an impact analysis based on the Impact Management Project (IMP) and Sustainable Development Goals (SDGs) or the traditional ESG analysis?



Social impact is about economics

According to a BNPP AM study, in collaboration with the Greenwich Associates Institute, in France "social issues are now considered important by 92% of [investor respondents], that being the majority of investors, against 39% before the crisis." Elsewhere in Europe, the same study discovered that social criteria (the S in ESG) are now seen as " extremely/very important" by 70% of respondents, which is an increase of 20 points since the start of the sanitary crisis.

Investors considering social issues as important



In addition, a McKinsey study conducted on more than 1,000 businesses in 12 countries, revealed that businesses with greater ethnic and cultural diversity at the executive level are 33% more likely to overperform on earnings before interest and tax (EBIT).

U.S.

In the U.S., investors are already at work. The Racial Justice Investing Coalition recently called investors to fight racism, and 128 institutional investors committed to excluding investments contributing to structural racism from their portfolios.

ESG analysis vs. impact analysis based on the IMP and SDGs

ESG analysis: small range intentions
On the brink of implementing the European taxonomy, it is crucial to effectively redirect financial capital in order to be compliant with the European Commission's environmental AND social requirements. To contribute towards solving these problems and truly benefit socially and economically, one needs, first of all, to possess the necessary data, which is currently not possible in France for example. Secondly, an investor will need data that are coherent altogether to allow comparability.

Thanks to the crisis, the classic ESG analysis is more popular than ever, but does it highlight adequate data to reach our objectives? Let's have a quick look at the French L'Oréal. How can a company whose impak Score™ is 250/1000 (above the CAC 40's average at 206 but still low), whose positive contributions to SDGs are limited to philanthropy (representing less than 1% of their turnover) and who is offering whitening skin products, reach the first rank of the Covalence Ethical Quote ESG index in 2018 or get a rating of AAA from MSCI? Following the recent social events, L'Oréal announced that it will remove the terms "white", "whitening", "light", and "lightening" from these products' packaging. However, it didn't mention a potential end of commercialization for said products.

The ESG analysis focuses on a company's efforts, policies or procedures instead of focusing on their impacts and the real effects these efforts should produce.

By investigating more than 1,750 social measures coming from 12 different evaluation frameworks, a study from NYU showed that only 8% of the "S" indicators assessed the effects of businesses' "S" practices, while the vast majority (92%) assessed the business's efforts and activities. This means that historically, ESG rating agencies (and therefore investors) have examined the policies and commitments much more than their real impact on stakeholders. Benevolent, an ESG analysis remains at the level of good intentions.

ESG criteria with no 360° vision

ESG criteria tend to be assessed independently one from another, and therefore omit the fact that environmental and governance questions are also social ones.

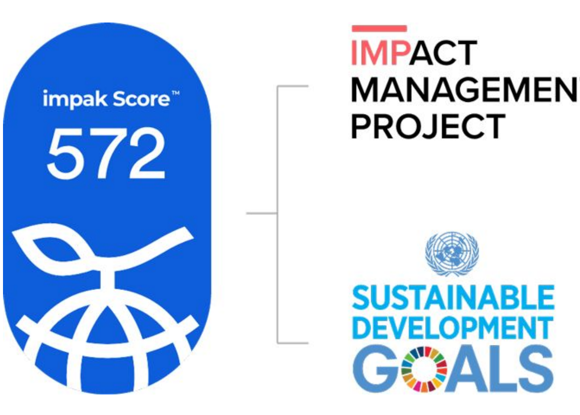
If companies condemn racism through internal structural changes or donations to associations, ESG analysis don't assess their effects on social equality, discrimination, harassment or racial prejudice, neither their contribution to SDG 10 (Reduced Inequalities) and 16 (Peace, Justice and Strong Institutions).

Structural racism and the global pandemic are forcing investors to choose a framework that combines several factors to fully assess companies' positive and negative impacts, rather than highlight their efforts.

Impact analysis: an all stakeholders consideration

The IMP and its five impact categories (What, Who, How Much, Contribution and Risks) analyze the effects of a business' activities through time, on its collaborators, subcontractors, suppliers, and the communities it reaches (What). The collected data allows to contextualize a business as a social, economical, and territorial actor placing the beneficiaries back at the center of the analysis. The company must make sure to consider its beneficiaries' level of needs as well as their vulnerabilities (Who), rather than to limit itself to a consultation with its stakeholders (ESG).

Moreover, the impact analysis identifies precisely to what extent the company is accountable for the obtained result, relative to what the market or other service providers would have done anyway. It then calibrates this result to SDGs in order to determine which of the company's measures truly contribute to solving SDGs. Doing this allows to almost completely eliminate the underlying risks of social or greenwashing.



Impact assessment implies the determination of an acceptable threshold according to recognized indicators. For example, in 2020, Adidas committed to hiring 30% black and Latino people. What is the evolution compared to last year? Are the indicators evolving with the company's goals? Are these goals sufficiently ambitious? Is this a positive impact or only an acceptable minimum? Finally, does the company only wish to hire people from minority backgrounds or will it ensure that these cultural and ethnic differences are welcomed and valued?

What role will you play in the impact economy?

Riding the coattails of the pandemic and the antiracist protests, impact is the most significant element to assess the performance of a business. Society expects businesses will contribute to the greater good. It has now become essential for businesses and their investors to assess the positive and negative impacts of their activities, and not only to be satisfied by the efforts undertaken.

That the demand comes from asset managers, employees, providers (whose brand image could be indirectly affected by inaction and bad decisions), regulators (e.g. the EU taxonomy) or clients and customers, we need to evaluate the work that needs to be done in Europe as well as in North America and elsewhere, and to equip ourselves with adapted financial tools that allows investments to solve these problems. The impact assessment will bring change where change is most needed today.