

# Submission on Human Rights Opportunities in the EU Non-Financial Reporting Directive Review Process

May 2020

## Context

Shift is the leading center of expertise on the UN Guiding Principles on Business and Human Rights (UNGPs). Shift's global team of experts works across all continents and sectors to challenge assumptions, push boundaries, and redefine corporate practice, in order to build a world where business gets done with respect for people's dignity.

We developed the following submission for the revision of the EU non-financial reporting directive (NFRD), drawing on our work over several years to strengthen human rights reporting standards in line with the UNGPs. This includes the development of the UN Guiding Principles Reporting Framework and companion Assurance Guidance as well as our extensive experience working with individual businesses, investors and other stakeholders to put them into practice. It also includes our current flagship Valuing Respect Project, funded by a European investment fund and European governments, on developing better ways to evaluate business respect for human rights.

Our input focuses on the importance of respect for human rights in corporate reporting. Human rights impacts are the most severe impacts a company can have on people. Human rights impacts may be social, economic or environmental impacts but they share the feature of rising to the level where they cause harm to a person's basic dignity, as defined in international human rights standards. They can include impacts on workers right across the value chain, as well as on local communities and on consumers/end-users. If companies are to be transparent about anything regarding the effects on people of how their business is conducted, then it must be on this set of issues, which goes to the heart of tackling inequalities and delivering a more sustainable world.

We have identified five main points that we believe are particularly important to consider as part of the review process in order to strengthen the clarity and robustness of the NFRD with regard to the thematic topic of human rights. They relate to: 1) company business models, 2) corporate governance, 3) companies' materiality processes, 4) the setting of targets and outcomes by companies, and 5) assurance of corporate reporting.

## 1. Business models

The NFRD currently provides that companies should include a "brief description of [their] business model" in their statement. The non-binding guidelines on the directive build on this in stating (at 3.4) that: "Companies are expected to disclose relevant information on their business model, including their strategy and objectives. Disclosures should provide insight into the strategic approach to relevant non-financial issues; what a company does, how and why it does it."

The guidelines provide some further detail (in 4.1) on what companies could say about their business models, but do not clearly indicate whether or how companies are expected to make connections between their business model and specific risks and impacts. By comparison, this message is clearer in the guidance on how a company's business model can be affected by, and can affect, climate change in the Commission's reporting guidelines on climate-related information.<sup>1</sup>

Our extensive research has shown that there are a number of features relating to business models that carry inherent human rights risks, which are not necessarily specific to one sector and which need to be addressed at top management

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<sup>1</sup> See [https://ec.europa.eu/finance/docs/policy/190618-climate-related-information-reporting-guidelines\\_en.pdf](https://ec.europa.eu/finance/docs/policy/190618-climate-related-information-reporting-guidelines_en.pdf) at pp 12-14.

or board level for the risks to be effectively mitigated. If human rights risks are embedded in the business model then they will persist within, or in connection with, the business until tackled at that strategic level – in other words, they cannot be sufficiently addressed by operational efforts alone. As part of our flagship project, Valuing Respect, we have been developing a series of “business model red flags” to precisely highlight these kinds of commonalities across sectors. The beta versions of these have already been tested with experts from the business and investor communities. **Our current working list of business model red flag risks is attached as Annex A.** Each red flag will be accompanied by supporting resources, including key questions for an investor, board member or top management to ask; related risks to the business; examples of mitigation measures; and additional resources. These resources will be undergoing testing and refinement this summer, and we would be pleased to share them with the Commission.

**We recommend that if a company has one or more of these business model features, the regulation should require them to include a description of how they are mitigating the related human rights risks at the top levels of the business.** That description should not simply be about the company’s generic sustainability risk identification and mitigation approaches, but rather its approach to the specific human rights risks stemming from the company’s business model.

The Commission has recommended that companies’ climate-related disclosures should describe how mitigating their most severe negative impacts on the climate can create significant opportunities for positive impact – in both cases, with reference back to the company’s business model. The same logic applies in the context of human rights. As we have explored in our work with the World Business Council for Sustainable Development (WBCSD), companies’ most significant contribution to the human dimension of sustainable development frequently lies in tackling the most severe human rights risks in their own operations and value chains.<sup>2</sup> We would recommend that the Commission apply this logic to the thematic topic of human rights in the revision of the NFRD and its accompanying guidance.

## 2. Governance

The NFRD currently does not address the topic of governance arrangements in relation to the company’s most severe impacts. The non-binding guidelines, in interpreting the Directive’s requirement that statements include “a description of the policies pursued by [the company]” in relation to its significant impacts, states (in 4.2, emphasis added) that: “Companies should disclose material information that provides a fair view of their policies. ... In these disclosures a company *may* explain its management and board’s responsibilities and decisions, and how resource allocations relate to objectives, risk management and intended outcomes. For example, a company *may* explain relevant governance aspects, including board oversight.”

Our research and experience shows that formal governance structures and senior leadership behaviors are crucial to a company’s success in addressing the most critical risks to people.<sup>3</sup> Together, they determine the company’s culture and how people *actually* behave within the business – which may diverge from the terms of policies or processes that set out how people *should* behave. **We recommend the inclusion in the revised NFRD of a requirement that companies disclose key aspects of their governance structures related to risks to people, as well as the ways in which they are embedding respect for human rights into the culture of the organization.**

Certain indicators are emerging from the last two years of our research and consultations as key to understanding whether a company’s governance and leadership are effectively fostering a rights-respecting corporate culture. These are now in the final stages of testing with companies and investors, and we are elaborating some supporting resources. **The**

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<sup>2</sup> See [https://www.shiftproject.org/media/resources/docs/TheHumanRightsOpportunity\\_Shift-07-17-2918.pdf?utm\\_source=website&utm\\_medium=button-SDGs&utm\\_campaign=SDGs\\_Download-PDF](https://www.shiftproject.org/media/resources/docs/TheHumanRightsOpportunity_Shift-07-17-2918.pdf?utm_source=website&utm_medium=button-SDGs&utm_campaign=SDGs_Download-PDF).

<sup>3</sup> Available at: [https://valuingrespect.org/wp-content/uploads/2019/09/VRP\\_LeadershipGov\\_ConceptNote\\_Sept2019.pdf](https://valuingrespect.org/wp-content/uploads/2019/09/VRP_LeadershipGov_ConceptNote_Sept2019.pdf).

current public BETA version of the indicators is attached as Annex B. We will release a refined version in the coming months.

### 3. Materiality

As the Commission guidelines observe (at 3.1, emphasis in original), the NFRD “introduces a new element to be taken into account when assessing the materiality of non-financial information by referring to *information ‘to the extent necessary for an understanding of the [...] impact of (the company’s) activity’*” on environmental, social and employee matters, respect for human rights, anti-corruption and bribery.

The guidelines note that Recital 8 of the NFRD refers to the need for companies to provide “adequate information in relation to the matters that stand out as being most likely to bring about the materialisation of principal risks of severe impacts, along with those that have already materialised”. The guidelines then go on to state that: “Impacts may be positive or adverse. Material disclosures should cover both in a clear and balanced way.” In assessing what is material, the guidelines point to a number of factors, including (emphasis added): “Impact of the activities: Companies are expected to consider the *actual and potential severity and frequency* of impacts. This includes impacts of their products, services, and their business relationships (including supply chain aspects).”

The UN Guiding Principles Reporting Framework is cited as one of the frameworks that the non-binding guidelines build on. We developed this Reporting Framework through a three-year joint initiative with the audit and advisory firm Mazars involving cross-regional, multi-stakeholder consultations. This process highlighted that once the definition of materiality extends – as it must – beyond narrow financial materiality as relevant to shareholder decision-making, the focus on severity of impacts becomes essential. Without this, the conclusion as to what is ‘material’ may fluctuate widely depending on whose interests are considered and end up as an arbitrary trade-off between different (internal or external) stakeholders’ priorities.

To avoid these pitfalls, the process of determining what is ‘material’ should ensure a robust assessment of the relative severity of the impacts on people that result from business activities and relationships, as measured against the yardstick of international human rights standards. This also reflects the expectation of the UN Guiding Principles that, where companies need to prioritize which risks to people they will address first, they should prioritize those where the impact would be most severe. In other words, the severity of impacts should inform both the matters that companies prioritize for action and those they deem material for the purposes of reporting. **We therefore urge that the Commission further strengthen this emphasis on the severity of impacts as determinant of their relative materiality for the purposes of disclosure.**

The Commission’s reporting guidelines on climate-related information introduce the idea of ‘double materiality’, distinguishing between financial materiality (as relevant to the NFRD’s requirement that a company disclose material information about its development, performance and position), and environmental and social materiality (as relevant to the impact of a company’s activities). In articulating this double materiality standard, the guidelines note (at p 7) that the “two risk perspectives already overlap in some cases and are increasingly likely to do so in the future”. In our view, this articulation of the distinct but increasingly convergent aspects of materiality is equally accurate and appropriate when applied to human rights impacts. **We recommend that the Commission explicitly propose the integration of this “double materiality” approach into the revised NFRD, including in relation to human rights issues.**

### 4. Targets and outcomes

The NFRD also requires companies to disclose “non-financial key performance indicators relevant to the particular business.” The guidelines state (at 4.5) that:

“Companies are expected to report KPIs that are useful, taking into account their specific circumstances. The KPIs should be consistent with metrics actually used by the company in its internal management and risk assessment processes. This makes the disclosures more relevant and useful, and improves transparency. Disclosing high quality, broadly recognised KPIs (for instance, metrics widely used in a sector or for specific thematic issues) could also improve comparability, in particular for companies within the same sector or value chain. ...

Considering their specific circumstances and the information needs of investors and other stakeholders, companies are expected to provide a fair and balanced view by using general, sectoral and company-specific KPIs.”

In our experience, a high proportion of the indicators in companies’ human rights disclosure relate to inputs, activities and near-term outputs, as set out in the summary of our research into nearly 500 companies’ reporting.<sup>4</sup> Companies often make assertions about what they are doing in terms of general policies and processes, but without evidence of whether it has been effective in terms of outcomes for people. To address this deficit in reporting, companies need to set out clear and measurable targets for mitigating material human rights risks to (or enhancing positive impacts for) people and appropriate KPIs for evaluating their progress against those targets.

The guidelines provide some examples of possible KPIs on human rights in the section on thematic aspects (4.6(c)). (Of course, some of the KPIs under social and employee matters, are also clearly human rights matters.) However, many of these are either about the existence of policies or processes, or are so broad as to not be easily measurable, such as “respect for freedom of association”. KPIs should focus on the company’s material human rights risks (understood as those human rights at risk of the most severe negative impact through the company’s operations and value chain) and the evidence of whether the company is effectively managing them or not, including evidence of the experience of affected stakeholders themselves.

In our view, there are some existing indicators – notably in the area of employees and other workers – that are highly relevant and well-developed, such as the % of the company’s workforce on temporary contracts, the % that are trade union members and/or covered by collective bargaining agreements, and median versus top pay in the company. Companies should be expected to use these.

At the same time, many human rights indicators are meaningless without extensive context and explanation and are not readily comparable across companies as a result (such as the number of cases of child labor or forced labor identified in the supply chain). The area of human rights has some of the same challenges as climate change in this regard. The Commission’s guidance on climate-related disclosure provides helpful direction in stating (at p 16): “Gaps in data and methodologies may in some cases make it difficult to present quantitative information about climate-related risks, especially regarding longer time horizons. In such cases, companies are encouraged to present qualitative information until these data and methodological issues are adequately addressed”. This guidance should apply equally to human rights.

In a small number of human rights related areas, such as health and safety and gender pay gaps, data and methodologies may be sufficiently mature to be specified for disclosure by all companies. **Beyond these areas and the types of workforce data highlighted above, we recommend that companies should be allowed to identify their own KPIs that focus on outcomes for people and can be compared year-on-year until greater consensus emerges on indicators that are insightful across companies and industries.** While this process happens, companies should be asked to place data based on KPIs in context so that they can be readily and appropriately interpreted.

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<sup>4</sup> Available at: [https://valuingrespect.org/wp-content/uploads/2019/09/ValuingRespect\\_TwoPager\\_Sept2019.pdf](https://valuingrespect.org/wp-content/uploads/2019/09/ValuingRespect_TwoPager_Sept2019.pdf).

## 5. Assurance of human rights disclosure

The NFRD provides (in Article 19a, emphasis added) that:

“5. Member States *shall* ensure that the statutory auditor or audit firm checks whether the non-financial statement...or the separate report... has been provided.

6. Member States *may* require that the information in the non-financial statement ... or the separate report... be verified by an independent assurance services provider.”

The non-binding guidelines do not provide further detail on this topic.

On the one hand, we know that human rights information is typically not assured, in part because assurance providers often feel they cannot assure it given its highly qualitative nature, which increases the costs and risks of the engagement, particularly for assurance providers that are regulated. Assurers may only check quantitative KPIs or other information that can be readily tested, but as explained above, these may not be meaningful or closely connected to most companies' material risks to people (in the sense defined above). Indeed, we hear stories from companies that have been asked by their assurance provider to remove valid and valuable human rights related information from their disclosure because they do not feel able to assure it. Equally, we see many assurance reports that are so heavily caveated and narrowed in scope that they cover little of the human rights related information provided.

On the other hand, we believe that assurance of human rights information has an important role to play in improving companies' own performance and building the confidence of stakeholders in what companies say they are doing to advance respect for people.

Following our development of the UNGP Reporting Framework together with the audit and advisory firm Mazars, we worked with Mazars on a follow up process of expert, multistakeholder consultation and testing that resulted in the UN Guiding Principles Assurance Guidance.<sup>5</sup> This guidance does not replace existing standards or frameworks that govern the work of expert audit and assurance practitioners, but complements them with subject matter guidance specific to the assurance of human rights information. It identifies competencies that are particularly important for the conduct of human rights assurance; highlights factors in the assurance process requiring particular attention when it comes to human rights information; and provides a set of indicators of the appropriateness and effectiveness of a company's human rights-related policies and processes from which practitioners can draw based on the nature and scope of an assurance engagement.

**Recognizing that we are still in the early stages of moving towards the practice of meaningful assurance of companies' human rights disclosure, we recommend that this element be given greater weight than is currently the case in the NFRD.** This could be achieved, for example, through a parallel revision to the EU's directive and regulation on statutory audit, informed by some of the insights that led to the UN Guiding Principles Assurance Guidance.

For the purposes of the NFRD revision, we would point to the following three issues:

- **Suitability of the scope of the assurance process:** an expert assurance provider needs to assess whether any limits on the scope of their engagement are reasonable or would render their conclusions misleading, for example if the company's reporting focuses on only one part of the business when it is clear that severe human rights impacts arising elsewhere are excluded; where a company has reported on one set of human rights issues (such

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<sup>5</sup> See <https://www.ungpreporting.org/assurance/>.

as health and safety) to the exclusion of other severe risks; or the assurance provider is prevented from communicating with certain key stakeholders as part of the assurance process.

- **Review of material human rights issues:** as described above, we believe companies should be disclosing information on human rights in line with the double materiality standard. In such cases, an assurance provider should assess whether the company's process for identifying these human rights issues was appropriate, including in the information it considered, the focus on the severity of impacts on those affected, who was consulted, and the quality of top-level oversight of the process;
- **Engagement with external stakeholders:** an assurance provider needs to understand the difference between key groups of stakeholders for human rights purposes – particularly between affected stakeholders and issue experts – and be able to integrate appropriate engagement with a cross-section of them into the provider's process to test assumptions and triangulate information.

**We recommend that companies should be expected to assure the following aspects of their disclosure:**

- a) **Identification of material human rights issues**, in line with the double materiality approach: assurance of the robustness of the process underlying the identification and prioritization of the reported risks;
- b) **Stakeholder engagement:** assurance that the company engaged with the stakeholders described in its disclosure, and in the manner outlined in that reporting;
- c) **Governance of human rights:** assurance that the management and board have played a role in accordance with what is described in the company's policy commitment and/or relevant annual report or other disclosure.

## **Annexes Attached to this Submission:**

A – Business Model Red Flags

B – Leadership & Governance BETA Indicators

# Business Model Red Flags

BETA

IS YOUR BUSINESS WIRED IN WAYS THAT PUT PEOPLE AT RISK?

DEVELOPED BY SHIFT AS PART OF THE VALUING RESPECT PROJECT





# ABOUT

This resource is a work in progress as part of **Shift's Valuing Respect project**. It provides a non-exhaustive menu of business model features that carry inherent human rights risks. It aims to help companies, investors and others foster sustainable business models that can be economically successful without exacerbating inequalities.

Analysis of human rights risks is often tied to characteristics of a particular sector or assessments of a particular company. Both approaches are important. But where risks are embedded in decisions about how a business will create value, including profits, they need to be identified and addressed at that level. **It is not possible to mitigate risks to people at the operational level if they are designed into the core of how the business is intended to operate.**

The primary intended users of the resource are:

- a. **Investors and civil society organizations** seeking to strengthen their analysis, strategies and engagement with companies in order to advance respect for human rights and thereby reduce inequalities;
- b. **Financial institutions** scrutinizing their portfolios for human rights risk and diagnosing whether significant human rights incidents are likely to be replicated by the company concerned or in other parts of the portfolio; and

c. **Business leaders** seeking to identify and address risks to people that may be embedded in the business model, in order to ensure the resilience of value propositions and strategic decisions.

The Red Flag indicators are grounded in three features of a business model:

- **the value proposition** (what the company offers and to whom);
- **the value chain** (how the company delivers value); and
- **the revenue model** (how the business model is profitable).

They are not intended to be an exhaustive list, but may help spark reflection and enable the identification of additional red flags.

For each red flag, we are developing supporting resources, including 3-4 questions for top managers or investors to ask when they identify a red flag in their company/ investment. Specifically, these resources will identify:

- Higher risk sectors/industries
- Key Questions to Ask
- Risks to People
- Risks to the Company
- Implications of the UN Guiding Principles
- Nexus with the SDGs
- Due Diligence Lines of Inquiry
- Mitigation Examples
- Alternative Model Examples
- Tools/Further Information



# BUSINESS MODEL RED FLAGS

## THE VALUE PROPOSITION

The business model is substantially dependent on...

- 1 | Lowest cost goods or services
- 2 | High-speed delivery
- 3 | Projects with short or fixed timelines
- 4 | Privatized access to public goods or services
- 5 | Processing personal data
- 6 | Online platforms
- 7 | Financial or advisory services to higher risk clients
- 8 | Products that harm when overused
- 9 | Products that harm when misused
- 10 | Products that harm when used as intended

## THE VALUE CHAIN

The business model is substantially dependent on...

- 11 | Speed in developing products or services
- 12 | Land use where ownership may be contested
- 13 | Depleting natural resources or public goods
- 14 | Commodities with unclear provenance
- 15 | Low priced agricultural commodities
- 16 | Sourcing low-paid labor from labor providers
- 17 | Gig workers or other precarious labor
- 18 | Business relationships with limited influence
- 19 | Collecting or holding sensitive personal data
- 20 | Shifting inventory risk to the supply chain
- 21 | Large scale or rapid automation

## THE REVENUE MODEL

The business model is substantially dependent on...

- 22 | Sales-maximizing incentives that put consumers at risk
- 23 | Markets where regulations fall below human right standards
- 24 | Aggressive strategies to minimize taxation

**Red flags** in this section relate, for example, to the **nature of the product or service**, or the way in which the company **differentiates its offering**.

**The business's commercial success substantially depends upon...**

**For example...**

1

...offering **lowest cost goods or services** such that it becomes economically challenging for the company and/or suppliers to **respect labor rights**.

- Selling apparel and other consumer goods premised on cheapest prices for customers, such that increases in production costs are absorbed through the wages of already low-paid workers
- Locating (and relocating) production to countries with lowest wages

2

...offering **high-speed delivery** such that it places pressure on warehouse workers and logistics workers in the **"last mile"**.

- Retailers offering free or low-priced express delivery to consumers in ways that place unreasonable time or wage pressure on logistics workers
- Logistics providers that rely on low wages and precarious labor

3

...commencement of projects with **short or fixed timelines** that do not allow sufficient time for consultation with groups affected by the projects.

Working to such timelines in the context of

- oil and gas projects
- agricultural land use
- construction projects

that impact local communities

4

...offering **privatized access to public goods**, such as water, health and security, where profit-maximization affects access or quality of service.

- Offering private water or sanitation services where profit-maximization affects access or quality of service
- Offering nursing home services and engaging in cost cutting activities at the expense of quality of service
- Providing private prisons or detention centres and reducing qualified staff or cutting maintenance or essential programs to achieve cost savings

5

...processing **personal data** to profile or predict individual behavior, as a service to third parties.

- Targeted advertising on social media platforms that restricts who can see housing or job adverts based on gender, family status or race
- Third-party data brokers running credit ratings and checks that affect access to products and services
- AI solutions designed to help the criminal justice system assess chances of recidivism but with discriminatory outcomes
- Facial recognition technologies where false positives lead to arbitrary intimidation or arrest

**Red flags** in this section relate, for example, to the **nature of the product or service**, or the way in which the company **differentiates its offering**.

The business's commercial success substantially depends upon...

For example...

6

...providing **online platforms** for individuals to interact where use of the platform can lead to **harm to human rights**.

- Online platforms through which individuals may post content or form groups with the purpose of inciting hatred or violence
- Real estate rental or job search platforms on which vendors may include discriminatory criteria in advertisements
- Online platforms that enable commercial users to refuse to sell to consumers of a certain ethnic group or sexual orientation etc.

7

...providing **financial or advisory services** that may enable higher risk clients to harm human rights.

- Providing finance to projects or borrowers where adverse impacts on communities are foreseeable
- Providing legal advice premised on operating in legal gray areas or exploiting the lack of laws that are relevant to the protection of human rights
- Selling management consultancy services to clients where advice may be used to undermine human rights
- Selling tax advice that supports the aggressive minimization of tax payments (See also red flag 24)

8

...offering products or services that when **overused**, can affect peoples' health, particularly when targeted at vulnerable populations.

- Marketing high salt/sugar foods to children or disproportionately targeting minority communities with such options
- High interest pay-day lenders clustering in minority communities or targeting minorities through online platforms
- Selling alcoholic beverages, including when engaging in sponsorship activities in geographies without laws on exposure of children to alcohol-related marketing (see also red flag 23)
- Offering social media platforms with features designed to maximize usage

9

...offering products or services that, when **misused** can have adverse impacts on human rights.

- Selling "dual use" products, services or technology (i.e. those normally used for civilian purposes, but which may also have military applications)
- Providing tracking or facial recognition technologies that may be misused to profile, intimidate or arbitrarily imprison human rights defenders or activists
- Providing pharmaceuticals, that may be misused for the death penalty
- Providing heavy machinery or equipment to governments for use in locations recognized under international law as occupied territories
- Selling ultrasound technology to health facilities that may misuse it for sex selective abortions
- Providing social media platforms, that may be misused for harassment or to incite hatred (see also red flag 6)

10

...manufacturing or selling products that, **when used as intended**, are likely to have severe adverse impacts on human rights.

- Selling tobacco products
- Selling products, e.g. or toys or building materials, containing dangerous levels of toxic substances, e.g. asbestos or lead
- Selling weapons or surveillance technology, particularly when associated with sale to higher risk customers

**Red flags** in this section relate to different **stages in the value chain**, including, for example, natural and human resources and their sourcing as well as risks relating to relationships with business partners.

**The business's commercial success substantially depends upon...**

**For example...**

11

...**speed in developing products** or services in response to client / customer wishes or to be first to market, such that excessive pressures are placed on workers or consumer safety is compromised.

- Requiring excessive speeds for the manufacture or processing of goods such as meat & poultry or other fast-moving consumer goods, impacting the safety or other working conditions of workers
- Undertaking rapid product development in the tech sector leading to workers working excessive hours
- Providing round-the-clock responsiveness to client requests in legal advice, management consultancy or other client services affecting the family life of workers
- Providing or changing orders to suppliers with insufficient lead time for capacity planning, impacting the health, safety and wages of supply chain workers
- Expediting R&D for new or updated products/services to market, leaving insufficient time to test for potential impacts on users/customers

12

...**land use** in countries in which ownership is often contested or records are unreliable or land users such indigenous groups are unrecognized.

- Relying on land use, including for extractive projects; the provision of commodities; or construction (e.g. of phone and transmission lines), in locations where:
- indigenous peoples have traditional ownership or use of land
  - ethnic/minority groups are denied/ dispossessed of formal land ownership rights
  - women may not have access to legal ownership
  - owners of land may have been otherwise dispossessed or moved without consultation or adequate compensation

13

...activities that **deplete** the quantity or quality of **natural resources** or **public goods** available to local populations, such that it undermines their access or health.

- Water extraction by food and beverage companies leading to water stress in a given catchment
- Harvesting of wild flora by agricultural or pharmaceutical companies depleting traditional food sources for indigenous communities
- Extractive projects leading to an influx of people that places stress on local services, such as in communities near mine sites
- Tech companies establishing large corporate headquarters in urban areas and reducing access to affordable housing
- Manufacturing activities that lead to pollution of the water, soil or air at levels that have an impact on people's health

14

...trading or using **commodities** for which there is little or no visibility into their **provenance**.

- Commodities traded on spot markets
- Using resources such as the following in circumstances of limited traceability:
  - Energy (e.g. oil and petroleum and gas)
  - Metals and minerals (e.g. iron ore, copper, aluminum, gold) and
  - Agricultural and other "soft" commodity products (e.g. coffee, cocoa, wheat, soybeans, cattle) (See also red flag 15)

15

...trading or sourcing **agricultural commodities** that are priced independently of production costs, such that farmers are unlikely to be able to sustain a living income.

- Food and beverage, pharmaceutical and cosmetics companies sourcing, and traders trading,
- price volatile agricultural commodities supplied by small-holder farmers (cocoa, coffee, palm oil)
  - price volatile labor-intensive commodities (bananas, cotton)
  - capital-intensive commodities for which price does not reflect the cost of production and that require large agricultural land area (soy, wheat, corn)

**Red flags** in this section relate to different **stages in the value chain**, including, for example, natural and human resources and their sourcing as well as risks relating to relationships with business partners.

**The business's commercial success substantially depends upon...**

**For example...**

16

...sourcing **low-paid labor** from labor providers, where there is little visibility into or control over the protection of worker rights.

Sourcing labor for construction, manufacturing, hospitality, call centres, agriculture and horticulture, social care and domestic work and other areas, where there is a risk that:

- workers face low wages, salary delays, excessive deductions and uncompensated overtime
- workers suffer discrimination and physical, verbal and sexual abuse
- workers are unable to join trade unions
- workers are housed in poor quality accommodation or subject to curfews
- especially in the case of migrant workers, workers are charged fees for recruitment services or their identity documents are retained

17

...labor relationships that are structured to **avoid costs** that come with formal employment arrangements.

Inappropriate or exploitative use of the following:

- Online and offline gig workers
- Contingent labor
- Unpaid internships
- Incorrect categorization of workers as "independent contractors"
- Reliance on labor provided by third parties (see red flag 16)

18

...structuring business relationships in ways that **limit** the company's ability to **influence** decisions or actions that affect the rights of stakeholders.

- Structuring JV partnerships such that the company situates control over decisions on land, employment and/or responses to community concerns with the business partner
- Structuring client-advisor relationships such that the scope of advice excludes consideration of impacts on people
- Structuring multi-bank syndicated loans, e.g. for project finance, such that the bank relies on the due diligence of the lead bank
- Utilizing franchise models in which labor, land acquisition and other rights-relevant issues are not covered by franchise contracts

19

...collecting or holding sensitive **personal information** about customers or other individuals, such that it could be used by others in ways that harm human rights.

- ICT companies storing sensitive personal information – for example on political affiliations or memberships - that may lead to harassment or arbitrary arrest if obtained by certain governments
- Companies holding genetic or health information that could lead to discrimination or lack of access to employment if publicly exposed
- Dating applications storing information on individuals' identity or preferences, which, if exposed, may be used by third parties to discriminate or threaten such individuals

20

...minimizing inventory risk, including through **just-in-time** delivery, such that the risk from changes in demand is shifted to the supply chain and vulnerable workers.

- Companies operating in various industries, including electronics, fast moving consumer goods and apparel:
- taking a position that the company will not warehouse goods
- withdrawing orders from suppliers with limited lead time when demand drops

21

...large scale or rapid **automation** of processes, such that there is insufficient time or capacity for workers to be upskilled or redeployed.

Automation in various sectors, including:

- Agriculture
- Logistics
- Maritime shipping; port logistics and transport
- Labor intensive manufacturing, such as electronics manufacturing
- Mining

**Red flags** in this section relate, for example, to **sales-maximization** and **cost-minimization** measures.

**The business's commercial success substantially depends upon...**

**For example...**

22

...incentive structures designed to **maximize sales** that create risk to the health and welfare of customers or patients.

- Excessive sales targets in banking leading to the sale of financial products that are not appropriate for, or requested by, customers
- Use of excessive sales targets or marketing strategies by the pharmaceutical sector, leading to over-prescription of potentially addictive medications
- Basing sales incentives on profits on essential medications, leading to higher prices and reducing access to medicines for vulnerable persons

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...operating or expanding into **markets** where laws or regulations fall **below international human rights standards**.

- Tobacco companies with growth strategies for markets without laws requiring warnings on packaging
- F&B companies with growth strategies for high salt/sugar products for markets without laws requiring nutritional information on packaging
- Alcoholic beverage companies engaging in sponsorship activities in geographies without laws on exposure of children to alcohol-related marketing
- Collecting or holding sensitive personal information in geographies with underdeveloped privacy laws (see also red flag 19)
- Lobbying against laws that protect workers or communities from corporate human rights impacts (e.g. lobbying against minimum wage laws)

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...aggressive strategies to minimize **taxation**, particularly with respect to operations in developing countries.

- Undue use of the following such that governments may be deprived of the resources needed to address poverty and to finance programs seeking to protect and fulfil human rights:
- transfer (mis-)pricing
  - negotiation of tax holidays
  - (non-)taxation of natural resources
  - offshore investment accounts



#### ABOUT VALUING RESPECT

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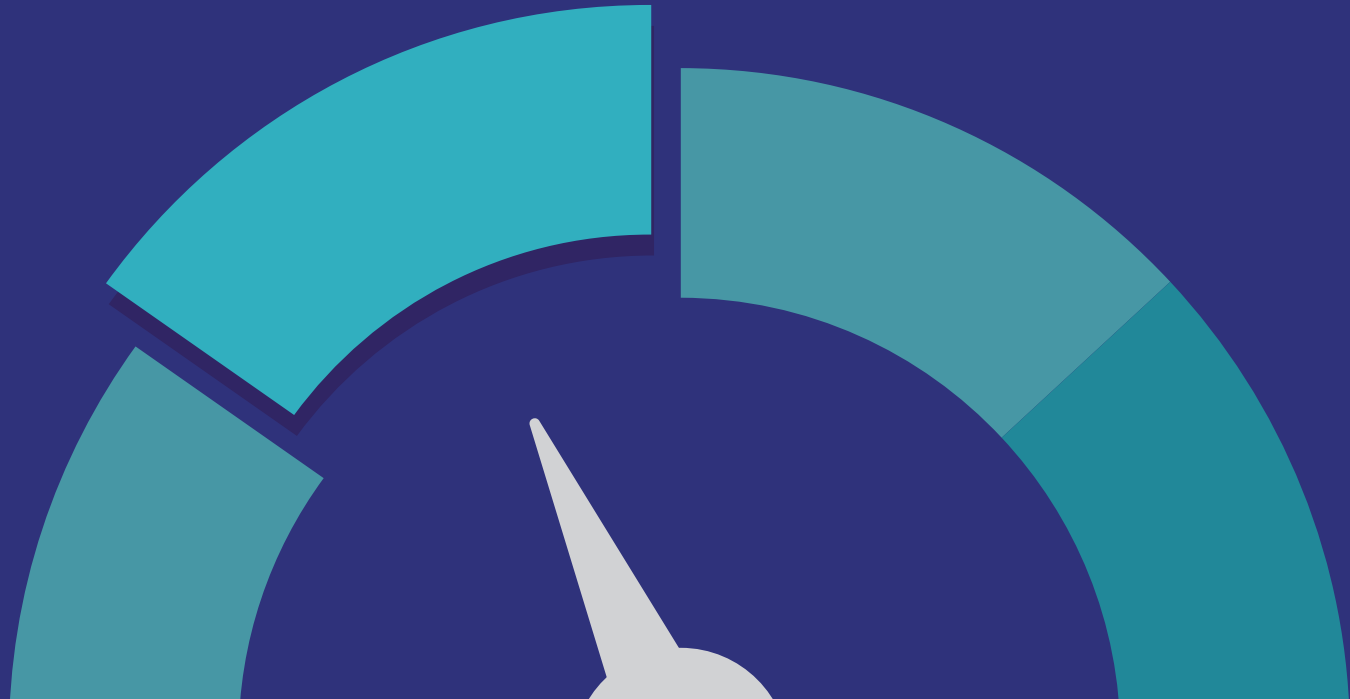
This is a **BETA** version of the **Business Model Red Flags**. We welcome your feedback, suggestions and questions as we continue to fine-tune this and other tools and resources of the Valuing Respect project. Please direct your feedback and inquiries to [info@shiftproject.org](mailto:info@shiftproject.org)





# Leadership & Governance **INDICATORS** of a Rights-Respecting Culture

BETA





## ABOUT

This resource is a work in progress as part of Shift's Valuing Respect project. It provides a menu of indicators of leadership and governance that help evaluate a company's progress towards building a rights-respecting culture.

The primary intended users of the resource are:

- a.** Business leaders seeking to assess the strengths and weaknesses of their company leadership, governance and culture with regard to respect for human rights;
- b.** Investors and civil society organizations seeking to strengthen their analysis, strategies and engagement with companies regarding progress towards respect for human rights.

Indicators of leadership and governance typically focus on formal systems - codes of conduct, organizational structures, roles, responsibilities and incentives. These help define how things *should* happen in an organization. But they miss the profound influence of senior leaders' behavior on how things *actually* happen: that is, on organizational culture.

The draft indicators suggested here are therefore grounded in four features of a corporate culture that are central to respect for human rights: authenticity of commitment; responsibility and accountability; respect and empathy; and organizational learning.

They look first at formal governance arrangements and processes that support those four features; then at key behaviors of senior leaders that exemplify and reinforce the features; and finally at the perspectives and behaviors that should be observable in the workforce where the right governance and leadership is in place.

The indicators do not have to be used together. Some may be more relevant in certain contexts and less in others. They are intended as a menu from which organizations can draw as appropriate. Yet they will be most robust when used in careful combinations, not least where indicators of governance are backed up with indicators of senior leadership behavior and evidenced in the experience of the broader workforce.

Throughout the indicators, we use the term "senior leaders" to include, but not be limited to, the most senior executives of the company (such as the CEO, COO, CFO, General Counsel etc.). The term also includes other individuals who hold important leadership positions, such as heads of departments or functions, country or regional office managers, or general managers of specific operational sites.

We welcome your feedback as we continue to work towards a polished version of this and other outputs of the Valuing Respect project.



# Authenticity of commitment

BETA

To embed these features  
of a rights-respecting culture...

## A Policy Commitment

...senior leaders should put in  
place certain formal governance  
arrangements and processes...

■ The company has in place a public policy commitment to respect human rights that is approved at the most senior level of the business, and stipulates the company's human rights expectations of personnel, business partners and other parties directly linked to its operations, products or services.

...senior leaders should themselves act in ways so  
as to show that they value respect for human rights

■ Senior Leaders regularly affirm - publicly, in interactions with staff and in their decision-making processes - the company's commitment to address risks to people associated with company's operations and value chain.

■ Senior leaders look for and call out any inherent tensions between respect for human rights and the company's business model or strategic business decisions.

...these perspectives and behaviors  
become observable among employees  
across the organization.

■ Employees and contractors are aware of the views of top management regarding the company's commitment to respect human rights, and find these views to be consistent with other explicit or implicit messages communicated by top management and their direct managers.

## B Addressing Tensions

■ There are known, clear and accessible processes through which people who work for or with the company can raise concerns about pressures they feel to act contrary to the company's responsibility to respect human rights, and which provide for confidentiality and non-retaliation.

■ Senior leaders proactively seek to understand pressures that employees and contractors may feel to act contrary to the company's responsibility to respect human rights.

■ Senior leaders praise behaviors and business decisions that advance the company's commitment to respect human rights, and call out those that run counter to it.

■ Employees and contract workers know what to do when they identify tensions between respect for human rights and other business pressures or performance requirements.

## C Lobbying

■ The company has in place policies that prohibit lobbying activities that undermine human rights protections for people who may be impacted by the company's operations or value chain partners.

■ The CEO / other senior leaders have taken a public position, or lobbied a relevant body, in favor of greater protection of one or more human rights that are relevant to how the business is run. (A "body" might include government agencies, inter-governmental organizations, and business associations).

■ Those individuals within the company with a mandate to conduct lobbying on behalf of the company, or to engage external lobbyists to do so, are aware of the company's public human rights commitment and the constraints it would place on lobbying activities.



To embed these features  
of a rights-respecting culture...

## D Cross-Functional Collaboration

...senior leaders should put in  
place certain formal governance  
arrangements and processes...

■ I The company has a formal cross-functional mechanism mandated to discuss how human rights risks are addressed. This has an executive sponsor and includes representatives of those functions, departments or business units best placed to address human rights risks through their actions.

and

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such  
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■ I Senior leaders proactively engage with a formal cross-functional mechanism, structure or process mandated to address human rights risks and explain how its work influence their discussions and decisions.

■ I Staff who take part in any formal cross-functional mechanism, structure or process that is mandated to address human rights risks consider that doing so brings value and influence in improving the company's implementation of respect for people's human rights.

## E Performance Incentives

■ I The company has in place performance incentives for senior managers that:

- ✓ reflect the company's salient human rights issues in relation to their own responsibilities;
- ✓ are supported by relevant KPIs for assessing how well the issues are managed;
- ✓ are given reasonable weight in relevant compensation schemes/reward systems.

■ I Senior Leaders making decisions about employees' or contract workers' compensation or other rewards give reasonable weight to their human rights-related performance.

■ I There is evidence that employees and contract workers are positively influenced by human rights-related performance incentives when making decisions that affect human rights risks/

## F Empowering Action

■ I The function in which the lead responsibility for human rights performance has been located has a formal mandate to embed respect for human rights across the company's operations and value chain.

■ I The individual(s) with lead responsibility for human rights issues are formally mandated to engage with managers in all parts of the business where human rights risks are most likely to arise.

■ I Senior leaders regularly express support for the work of the function with lead responsibility for human rights performance in interactions with leadership and staff.

■ I Senior leaders allocate financial resources to the functions or business units that need to address human rights risks, commensurate with the severity of those risks.

■ I Senior leaders regularly engage in discussion of the human rights implications of business decisions with the individual(s) responsible for embedding respect across the company's operations and value chain.

■ I The function in which the company has located lead responsibility for human rights performance is regularly consulted by employees seeking support to understand, prevent or mitigate human rights risks in their day-to-day work



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G

## Relationships with Internal Stakeholders

■ I The company has in place known and clear non-discrimination policies that address all aspects of the employment process (including hiring, promotion, harassment, redundancy).

■ I Senior leaders regularly affirm that all employees must be treated with respect and dignity, and are known to model this in their interactions with all company employees.

■ I The company has in place structures to engage employees through their freely elected representatives in discussions on industrial relations and workplace grievances.

■ I Senior leaders throughout the organization regularly seek out the direct perspectives of employees on whether they are negatively impacted by:

- i) Business decisions or pressures; and
- ii) the behavior of managers or peers.

■ I Employees feel that the company promotes a diverse and inclusive workplace where no one is disadvantaged because of their gender, race, ethnicity, sexual orientation, religion, or nationality

Source:  
<https://sloanreview.mit.edu/culture500>

■ I Employees demonstrate consideration and courtesy for co-workers, and treat each other with dignity

Source:  
<https://sloanreview.mit.edu/culture500>

H

## Relationships with External Stakeholders

■ I At least one member of the most senior governing body is formally mandated to engage regularly with external, policy-level stakeholders about a range of the company's salient human rights issues and to report back on the key issues raised.

■ I Senior leaders throughout the organization regularly listen to the voices of affected stakeholders in order to understand how their day-to-day realities are, or may be, negatively impacted through the company's a) operations and b) value chain.

■ I Employees can cite examples of how company or business partner activities can negatively impact people, and show understanding of what that means for the daily lives of the people affected.

■ I Employees view affected stakeholders as a valuable source of insight about how the company can understand and address risks to human rights, rather than as a threat.

■ I When the company is alleged to be involved in any major human rights-related incidents in its operations or value chain, senior leaders seek to engage constructively with individuals from, or those who represent, affected stakeholder groups.

■ I Employees with responsibility for addressing human rights risks regularly collaborate with policy-level or affected stakeholders to do so.



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## Learning from successes and failures

■ The company has processes through which it identifies and shares lessons from both successes and failures throughout relevant parts of the organization, to support the improved management of human rights risks and impacts.

■ The company conducts root cause analyses of major human rights-related incidents in its operations or value chain to identify and share lessons throughout the organization, including any necessary changes.

■ Senior Leaders engage with internal and external stakeholders to identify lessons to support improved management of human rights risks and impacts.

■ Senior leaders proactively look across instances of poor management of human rights risks for patterns of business practice that signify a systemic break-down in company commitment and processes.

■ The CEO / other top leaders communicate regularly - publicly and with staff - about the company's progress and challenges in addressing its salient human rights risks.

■ There is significant evidence of employees or contract workers raising concerns where they observe company decisions or actions that put people at risk or cause actual harms.



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FEEDBACK?

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Learn more at: [valuingrespect.org](http://valuingrespect.org)

