



INDICATOR DESIGN TOOL

A TOOL FOR FINANCIAL
INSTITUTIONS TO DESIGN
AND EVALUATE LEVERAGE
STRATEGIES WITH
PORTFOLIO COMPANIES

Shift

THE CHALLENGE

THE RESPONSIBILITY OF INVESTORS AND LENDERS TO RESPECT RIGHTS EXTENDS BEYOND THEIR OWN OPERATIONS TO INCORPORATE THEIR VALUE CHAIN, INCLUDING THE ACTIVITIES OF PORTFOLIO COMPANIES.

Investors and lenders have a responsibility to anticipate and address risks to human rights connected to the activities of their portfolio companies. This typically involves building and using “leverage” to seek to alter the practices and behaviors of investees and clients: for example, by setting expectations in legal agreements, providing capacity building, promoting international standards, working with peer institutions to increase influence, and even adjusting the costs of capital.

Failing to build and use leverage, and to demonstrate the effectiveness of doing so, regularly leads to negative reputational and financial consequences for financial institutions. The challenge is that integrating leverage into investment and lending processes is tricky. In general, providers of capital struggle to:

- ⦿ Go beyond engagement strategies that focus on high-level policies and processes, to employ approaches that can secure improved business practices and outcomes.
- ⦿ Engage with the root causes of human rights risks in specific industries and geographies, for which the necessary knowledge is rarely found inside banks and investor organizations.
- ⦿ Measure whether efforts to use leverage are leading to the desired impact in company practices and outcomes for workers, communities, and consumers and a reduction in related business risk.
- ⦿ Establish real internal accountability for achieving better “S” performance of specific companies and across a portfolio of companies.

The latter point is key – especially (though not exclusively) for development finance institutions, as the pursuit and use of leverage to improve outcomes for people is what **justifies the institution’s engagement with risk** in transactions, including through operation in higher risk contexts. Thus, in addition to identifying how **likely** it is that the change they are discussing with investees/clients will lead to better outcomes for people, investors/lenders also need to **track the role their leverage** played (or may have played) in changing portfolio company behavior. We know that leverage often takes time and requires a continuous improvement mindset. At the same time, leverage can never be a “blank check” for moving forward with high-risk transactions/investments. Investors and lenders need better tools to **institutionalize processes for holding themselves accountable** for positive change.

A TOOL FOR NEW THINKING AND NEW WAYS OF WORKING

The Indicator Design Tool provides financial institutions with a structured way to design and measure their efforts to use leverage with portfolio companies. At the core of the tool is an approach known as Theory of Change thinking: a well-established practice for designing, monitoring and evaluating interventions, adapted from the fields of international development and public policy.

USING THIS APPROACH, FINANCIAL INSTITUTIONS CAN BETTER:

- ⦿ Articulate leverage strategies that follow a logical process from their own activities through to enhanced know-how and systems at the portfolio company level and onwards to better business practices, social impacts, and business outcomes.
- ⦿ Stress-test and refine their leverage strategies by identifying risks or dependencies underpinning those strategies, including through engagement with expert and stakeholder inputs.
- ⦿ Design targets and indicators that can help them improve their own efforts to advance business practices and outcomes, as well as those of portfolio companies,
- ⦿ Report – internally and externally – about progress and challenges in addressing social risks in ways that are informed by data about outcomes not just changes in policies and processes.

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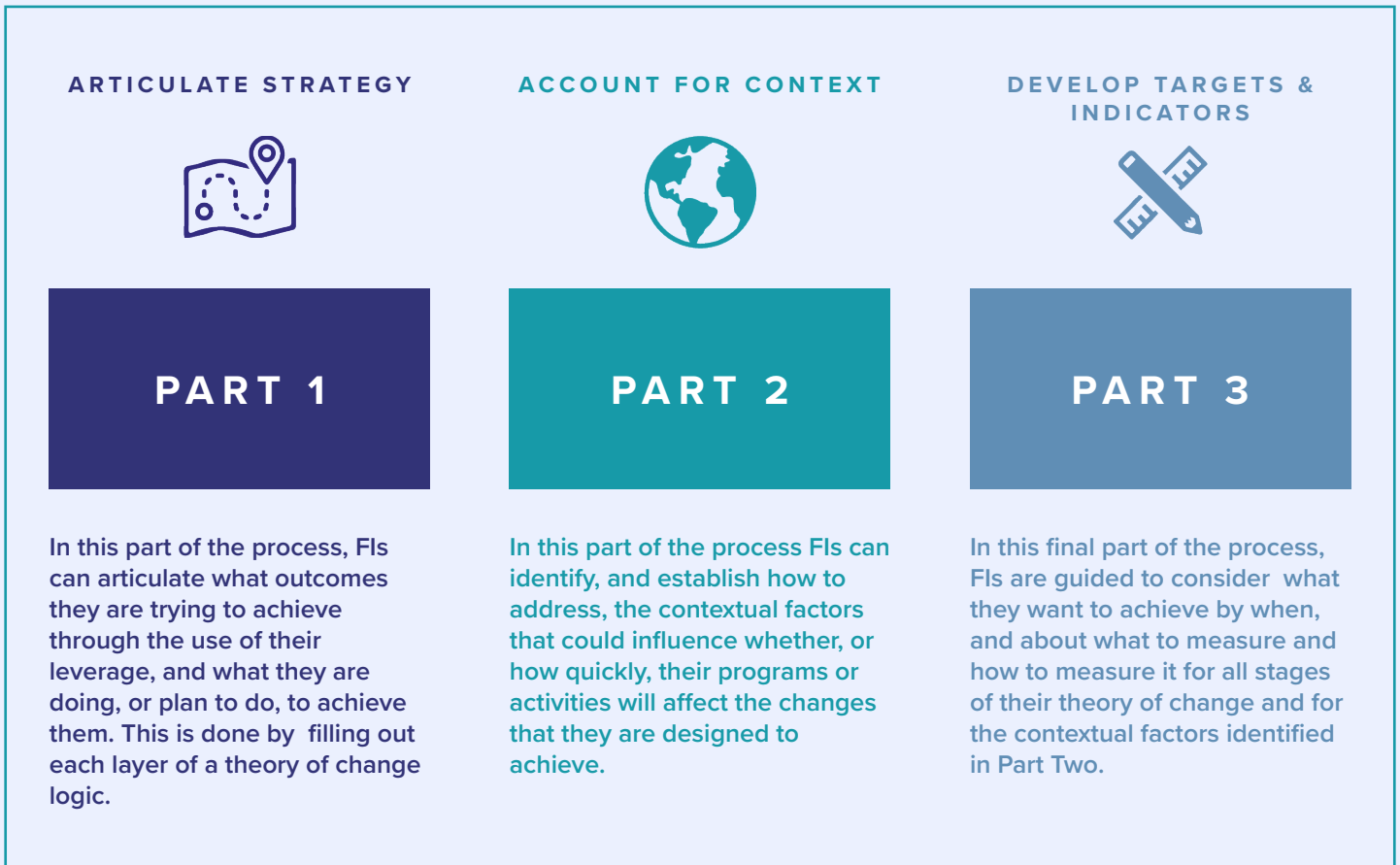


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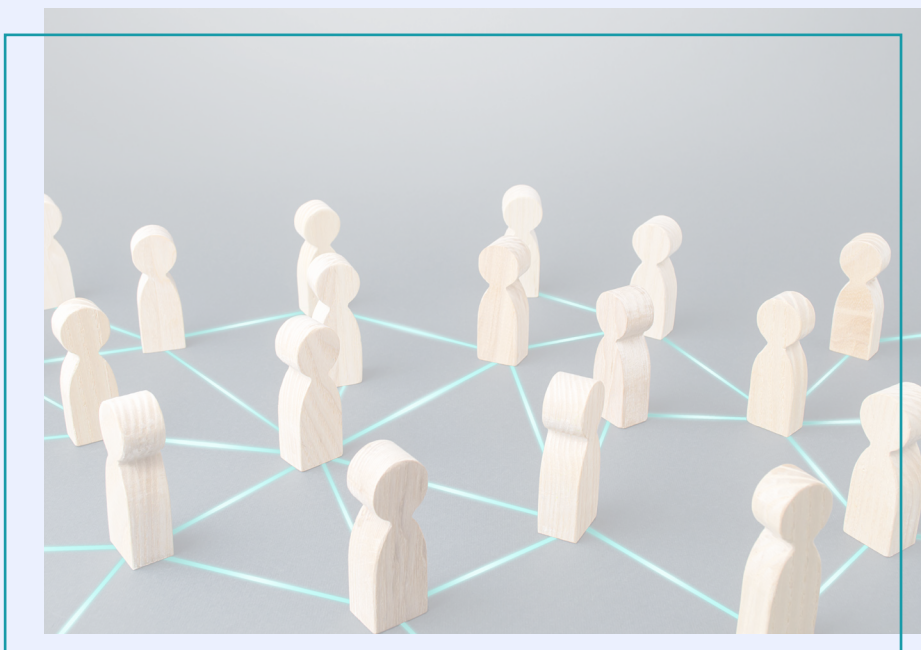
THE TOOL

The full [Indicator Design Tool](#) is structured into three parts, each with guidance to support users to apply the approach to their own context and objectives. Financial Institutions can follow all parts of the process or use only certain elements as needed.



Stakeholder engagement is a critical aspect of using this tool successfully. It can help financial institutions to spot and address blind spots in their own understanding.

Stakeholders can be internal (such as relationships managers, in-country teams and sustainability experts); credible subject-matter experts including from civil society as well as industry and multi-stakeholder initiatives; and legitimate representatives of workers, communities or consumers who are, or may be, impacted by a portfolio company's operations or value chain.



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USE CASES SUMMARY

As part of the process to define and develop the indicators in this resource, we engaged extensively with investors and lenders to understand how they are using, or plan to use, the resource. These are outlined below:

USE CASE	THE IDT CAN SUPPORT INVESTORS AND LENDERS IN...
<p>SHAPING LEVERAGE STRATEGIES WITH REGARD TO INDIVIDUAL COMPANIES, AN INDUSTRY OR AT COUNTRY LEVEL</p>	<p>Following the process steps that make up the tool can aid FIs in building robust strategies for leverage in various circumstances including:</p> <ul style="list-style-type: none"> • When devising initiatives targeted at specific human rights risks – such as forced labor - in a specific country. • To get at the root causes of major incidents when engaging with individual investees or clients • When seeking to engage a group of portfolio companies in the same industry, to define and advance practices that will lead to demonstrable mitigation of risks to people and business.
<p>EVALUATING AND INFORMING A PORTFOLIO COMPANY'S HUMAN RIGHTS RISK MITIGATION PLANS</p>	<p>The tool can help FIs seeking to critically engage companies on responses like, “Don’t worry we are publishing a policy and conducting training!” or to surface risks that reduce the likelihood that a client’s plans to address a salient issue are effective. This may take the form of:</p> <ul style="list-style-type: none"> • Evaluating whether mitigation strategies presented by portfolio companies are likely to meet stated objectives. • Supporting a portfolio company in shaping a robust and defensible strategy to address salient impacts.
<p>DRIVING INTERNAL BEHAVIORS THAT ARE NEEDED FOR LEVERAGE STRATEGIES TO SUCCEED</p>	<p>The tool can support financial institutions in articulating the behaviors that Relationship and Portfolio Managers need to stop, start, or sustain when applying leverage with portfolio companies. These behaviors might include referrals to the sustainability team and senior management when dilemmas arise, or routinely raising challenging issues during regular meetings with investees/clients.</p>
<p>STRENGTHENING INTERNAL ALIGNMENT AND ACCOUNTABILITY FOR THE IMPLEMENTATION AND IMPACT OF LEVERAGE STRATEGIES</p>	<p>The tool’s concepts and guidance can be used by financial institutions to:</p> <ul style="list-style-type: none"> • Build a clear and jointly held view of the aims and logic of leverage strategies across relevant parts of the organization, such as senior decision-makers, relationship managers, and sustainability teams. • Define targets and indicators for leverage strategies that can be used to enhance monitoring, evaluation, accountability and learning around those strategies.

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CASE STUDY: EXPORT CREDIT AGENCY

An export credit agency (ECA) was looking to achieve **a.** better defined leverage strategies for salient impacts in their portfolio; and **b.** a methodology for holding itself accountable for efforts to influence others to address these impacts. Recognizing resource constraints in engaging in complex, detailed analysis across a large portfolio, the ECA harnessed the theory of change thinking that underpins the IDT to implement its' existing leverage and remedy commitments.

The ECA now uses a framework for systematically operationalizing its commitments, supported by engagement at all levels of the organization and a dedicated change management process. A central feature of this framework is a **Leverage Strategy and Accountability Tool** to be used by Environmental and Social Risk Management (ESRM), deal teams and decision makers. The tool consists of:

A **Leverage Strategy Worksheet** to be completed by ESRM advisors in identifying and articulating effective leverage strategies or actions aimed at achieving better outcomes for people or the environment (i.e., *effectively* managing the risk). The worksheet guides ESRM advisors through the following five questions:

1. **The Risks:** What is/are the risk(s) to people or the environment we are seeking to manage?
2. **Desired Outcome:** What would effective management of the risk ultimately look like?
3. **Proposed Actions:** What are the actions we are proposing to take (or asking our clients or third parties to take) to achieve that outcome?
4. **Logic:** What is the connection between the outcome(s) we seek and the actions we are proposing?
5. **Assumptions:** What are the assumptions that would have to be true for our action to lead to the desired outcome?

A **Leverage Accountability Worksheet** intended to support cross-functional conversations among deal teams (i.e., ESRM advisors, relationship managers, underwriters, and others) to ensure effective implementation and monitoring of leverage strategies. The worksheet is organized into four discussion questions:

1. **Resources:** What resources will be required for us to implement this leverage strategy?
2. **Monitoring / Review:** When will we assess whether our approach is working?
3. **Indicators / Benchmarks:** How will we know whether our approach is succeeding?
4. **Escalation:** What are some of the possible further leverage actions we might take, if necessary?

CASE STUDY: MAPPING CLIENT RELATIONSHIP MANAGER BEHAVIORS

As part of the early field-testing of the Indicator Design Tool, several banks used it to articulate the specific, day-to-day practices that they were seeking to get client relationship managers (CRMs) to adopt as part of applying ESG policies and processes. Behaviors mapped included that CRMs:

- routinely ask prospective clients about actions they are taking to address human rights impacts;
- contact internal ESG teams to ask for support where they have a concern about the robustness of a client's due diligence; and
- regularly meet with other CRM colleagues to share progress and challenges in increasing the bank's leverage with clients.

Using the logic flow of the tool to define behaviors in turn creates a basis to measure the effectiveness of responsible lending business processes and issue-based or human rights capacity building. It opens the possibility of evaluating whether and in what circumstances the bank is making the necessary internal progress in meeting its own responsibility.

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ABOUT SHIFT

Shift is the leading center of expertise on the UN Guiding Principles on Business and Human Rights. For over a decade, we've worked with global companies, standard setters and financial institutions to put respect for people's dignity at the center of how business gets done.

Shift is a mission-driven organization, headquartered in New York City.

 shiftproject.org

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ABOUT VALUING RESPECT PROJECT

Valuing Respect Project was a three-year project, led by Shift, to research and co-create better ways of evaluating business respect for human rights. We developed tools and insights that can help both companies and their stakeholders focus their resources on actions that effectively improve outcomes for people. Valuing Respect was generously funded by the Ministry of Foreign Affairs of Finland, the Ministry of Foreign Affairs of Norway and Norges Bank Investment Management.

 valuingrespect.org