JUNE 2024

# Strengthening the S in ESG

GUARDRAIL

## 03

**Avoid indicators that offer insight into a company's intentions but no insight into whether these are followed through in practice.**

# INTRODUCTION

This is Part III of Shift's Strengthening the S in ESG Series focused on designing better social indicators and metrics. It is based on our analysis of almost 1300 indicators and metrics[1] used in ESG data providers' products or reporting requirements. Shift's findings are structured around three guardrails (what to avoid in indicator design) and three guidelines (what to aim for in indicator design) to support the use and design of effective social indicators and metrics. For an introduction to the series, **please visit our webpage.**

1 Of the almost 1300 indicators and metrics we researched: approximately 700 are social indicators used by five major ESG data providers, 225 are governance indicators used by these same providers and 350 are social indicators used in global or regional reporting frameworks. Shift was unable to verify whether the non-public indicators and metrics that we used for our analysis are the most up-to-date versions used by data providers at the time of writing (April 2024). We also recognize that the underlying methodologies used to reach a judgement on a company's performance against an indicator may offer more nuance that we could not access for our research.

# GUARDRAIL THREE

## AVOID INDICATORS THAT OFFER INSIGHT INTO A COMPANY'S INTENTIONS BUT NO INSIGHT INTO WHETHER THESE ARE FOLLOWED THROUGH IN PRACTICE.

### INTRODUCTION

A large number of the S in ESG indicators we assessed evaluate whether companies have policies, commitments or training activities in place related to business impacts on people. These indicators signal a company's intentions but say nothing about the extent to which the company is translating intentions into action. Therefore, a company's S score can become easily inflated, without the company actually making progress towards anticipating and addressing the company's most significant impacts on people across its operations and value chains. Such indicators may encourage over-simplistic box-ticking exercises that do not manage risks to people, the company or its investors.

### THE GUARDRAIL EXPLAINED

This Guardrail is informed by two concepts, one from the field of corporate compliance and one from behavioral science. First, the notion of "paper compliance," which refers to organizations that have documents, policies, and procedures in place to satisfy regulatory bodies or auditors but without internalizing the underlying principles of the regulations.[i] Second, the "intention-action gap" from behavioral science, which refers to the discrepancy between people's intentions to perform certain behaviors and their actions in practice.[ii]

Both concepts provide a lens through which to scrutinize S in ESG indicators that measure whether a company has policies or training programs in place that focus on addressing its impacts on people. While these are common, often necessary building blocks for companies working to improve their social performance, indicators with this focus should not be relied upon to signal the quality of a company's efforts. Without evidence of follow-through actions consistent with training or policy commitments, there is little to suggest that these commitments bring about the improved social performance they promise.

There are various drivers for a company to adopt sustainability-related policies and implement training programs.

Companies may do these things because of values-based motivations – for example, a company has established that implementing respect for people is the right thing to do, and good for business. The growth of generalized and issue-specific social due diligence regulation is another driver for companies to adopt social-related policy commitments. This is a positive development. However, it does mean that the mere existence of policy commitments offers less evaluative insight than it has over the past decade, when adopting policies about social issues (at least beyond regulated issues such as safety and diversity) was something only leading companies would do. Another motivation is simply gaming, where a company adopts a policy or invests in employee training with the sole goal of improving its ESG score and appeal to investors.

In sum, where companies achieve higher S in ESG scores based on their performance against indicators that narrowly evaluate the existence of policies or training activities, it can actually obscure investor insight into the seriousness and maturity of companies' social performance.[2]

## RESEARCH FINDINGS

### 01 More than 10% of the 700 ESG data providers' indicators assess the existence of policy commitments that give no insight into follow-through actions.

Our research identified a large volume of S indicators focused on policy commitments alone. These are formulated in various ways, such as whether a company "has a statement or policy on…", "states that it is committed to…", "has a code of conduct on…" or has a "statement of support on…". The indicators cover a range of topical issues, including fair compensation, board diversity, human rights, child labor, forced labor, health and safety, product safety, data privacy or responsible marketing and community engagement.

Some data providers are using indicators that look beyond the existence of a policy commitment to evaluate features of a company's policy that offer some insight into the quality of that commitment, such as whether it has an appropriate scope of application or aligns with international standards.

2 In this guardrail, we have not focused on attention to indicators about processes and procedures (such as standard operating procedures, risk management systems, and so on). These indicators are discussed in further detail in Guardrail One and Guideline Two.

## EXAMPLES OF THE TYPES OF INDICATORS THAT OFFER MORE INSIGHT INTO THE QUALITY OF A COMPANY'S POLICY COMMITMENT (THOUGH STILL DO NOT GIVE INSIGHT ON FOLLOW THROUGH)

**Indicators may assess whether a company...**

- has a health and safety policy or commitment statement which:
  a) identifies the issue as relevant and important; and
  b) applies to contractors or other external stakeholders.
- commits to recognize and respect human rights across its business activities including its own operations and its supply chain.
- commits to a threshold of maximum hours employees can work in a day or a week, and is aligned with the International Labor Organization's (ILO) related conventions.
- has a policy or statement supporting the right to collective bargaining that:
  a) refers only to compliance with local law on collective bargaining;
  b) covers the respect for or support of the right to collective bargaining.
- commits to recognize and respect the rights of indigenous peoples who may be impacted by its business activities, including respecting the right to free, prior and informed consent and seeking effective representation and participation from indigenous peoples.

In the case of these indicators, it is fair to assume that if follow-through actions are in place, that action will be of higher quality because the policy itself is more robust when evaluated according to the international standards. **The problem is that these indicators still fail to provide any insight into the likelihood of implementation and follow-through actions.**

**TIP**

**POLICY INDICATORS CAN SIGNAL POSITIVE SOCIAL PERFORMANCE WHEN THEY INCLUDE A REFERENCE TO FOLLOW-THROUGH ACTIONS.**

Policy indicators can signal positive social performance when they include a reference to follow-through actions. We found the following three examples of indicators already being used by ESG data providers.

1. The company has a policy or commitment statement on reducing health and safety impact through:
   - commitment to continuous improvement; and
   - time-specific, quantitative targets to reduce incidents.
2. The company has a responsible supply chain policy integrated into:
   - buyer training; and
   - purchasing policies or supplier contracts.
3. The company monitors the effectiveness of its human rights policy via defined processes, and sets targets or reports achievements for monitoring the effectiveness of its human rights policy.

**RESEARCH FINDINGS**

## 02 Training indicators typically used by ESG data providers offer no insight into the results of training.

Training programs can raise internal and external awareness, build capacity and knowledge, and so may serve as a basis for sustained practices that address a company's social impacts and risks. Therefore, indicators that focus on the existence of training(s) are an understandable feature of certain ESG data providers' methodologies. However, as currently formulated, the indicators in use typically fail to capture anything beyond evidence of investment in training or training activities in place, with no insight into the effects of the training in the form of new knowledge or behaviors being implemented.

These include problematic indicators that only evaluate whether a company...

- provides safety training to employees.
- provides its employees with human rights training.
- provides training on its supplier Code of Conduct.

- conducts training courses for employees on Corporate Social Responsibility (CSR).
- has employee training programs on human rights.

The underlying assumption across these types of indicators is that training programs are part of a company's effort to advance know-how and business practices needed to address impacts on people connected to its operations and value chain. However, there is widespread evidence that training activities lead to, at best, mixed results. For example, research into companies' diversity training suggests that there is 'very little evidence' that the training programs positively affect the behavior of the participating employees, or lead to organizational change. [iii] Some training programs can even have the opposite effect, by causing 'backlash and activating biases.'[iv] Therefore, even in the relatively more advanced field of corporate DEI programs, evidence of training programs alone cannot give reliable insight into a company's performance.

**TIP**

**INTEGRATE ATTENTION TO TRAINING AS PART OF INDICATORS THAT EVALUATE A COMPANY'S MANAGEMENT OF A SPECIFIC SOCIAL IMPACT**

Integrating attention to training as part of indicators that evaluate a company's management of a specific social impact, can offer helpful insight to investors. Though not common practice, some data providers are taking this approach. The example indicators below recognize the value of training in the fulfilment of a wider strategy, rather than looking at a training activity as an end in itself.

1. The company has initiatives to manage the health and safety risks of contractors who operate in the company's own facilities, including by:
   a) pre-screening contractors' safety management during tendering;
   b) providing training; and
   c) collecting statistics about contractor safety performance.
2. The company takes steps to build the capacity of suppliers, including via supplier training on social issues, supplier mentoring, secondments, and supporting suppliers through sharing best practice.
3. The company takes action to address responsible advertising, marketing or promotion for relevant issue(s) via detailed guidelines covering advertising, marketing or labelling, staff trained and company audits to ensure compliance.

## LOOKING AHEAD

Data providers should refrain from using indicators that only evaluate the existence of policies and training activities. However, as demonstrated in the boxes above, there may be ways for data providers to leverage company disclosures in these areas towards more holistic evaluations of a company's social performance: for example, by assessing evidence of follow-through actions or using this data as part of a more multi-faceted assessment a company's social performance on a specific issue.

## ENDNOTES

[i] See: Ezekiel Ward, ‘Helping Board Members Improve Paper Compliance Programs’.

[ii] See The Decision Lab, ‘Intention-Action Gap’.

[iii] Edward H Chang et al, ‘The mixed effects of online diversity training’, April 2019.

[iv] Michelle Hawley, ‘Most DEI Training Doesn’t Work: Here’s How to Tie Training to Impact’, February 2023.