JUNE 2024

Strengthening the S in ESG

GUIDELINE

01 Use indicators that are strong predictors of business decision-making and behavior.

Shift

INTRODUCTION

This is part of Shift's Series Strengthening the S in ESG, focused on designing better social indicators and metrics. It is based on our analysis of almost 1300 indicators and metrics used in ESG data providers' products or reporting requirements. Approximately 700 of these are social indicators used by five major ESG data providers[1], 225 are governance indicators used by these same providers and 350 are social indicators used in global or regional reporting frameworks. This resource is an introduction to our research into indicators that are strong predictors of business decision-making and behavior.

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 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.

BACKGROUND

Across the sustainability field, we are seeing greater attention to whether companies are set up and run in ways that support leaders and employees across diverse functions and levels of an organization to act in ways that address impacts on people, and related financial, operational and legal risks for the business. Desired actions can include: managers making non-discriminatory hiring decisions; buyers negotiating prices in ways that avoid incentivizing downward pressure on suppliers' labor practices; sales teams elevating high-risk transactions to executives for review and leaders at operational sites seeking out and addressing local community perspectives on the impacts they experience.

The indicators capable of offering the greatest insight into the organizational features that block or enable these types of behaviors are therefore of high decision-making value to investors, business leaders, regulators and other stakeholders. But this demands fresh thinking, a reduction of indicators focused on policies, documented processes and audits, and increased attention to **the dimensions of corporate governance and culture that are stronger predictors of day-to-day business practices and their effects on people's wellbeing.**

FINDINGS OVERVIEW

In this Guideline, we look at indicators that are strong predictors of business decision-making and behavior in relation to three dimensions of business practice that standard setters and investors are increasingly paying attention to:

A. Governance i.e., the extent of board and executive level oversight of people-related risks and risk management.

We found:

1. Only a small number of S in ESG indicators in use evaluate board-level scrutiny and oversight of sustainability commitments or programs. None offer insight as to the level of attention on social impacts and risks.
2. There is evidence that it is feasible, though not yet common, to evaluate whether there is board oversight of risks to people typically impacted by the company's industry - some existing ESG indicators do address board attention to specific sustainability issues.

3. Data providers are not evaluating the existence of efforts to inform the board of the company's management of social risks nor board members 'S' competence.
4. There is an opportunity to use indicators that evaluate the regularity of substantive board discussion about how the company addresses risks to people and business across its operations and value chain.

B. **Stakeholder Engagement** i.e., the breadth and quality of companies' engagement with affected stakeholders.

We found:

1. Indicators could be strengthened by evaluating whether companies are engaging with all relevant affected stakeholder groups across their operations and value chains, and the extent to which this engagement is aligned with international standards.
2. Some data providers are beginning to focus on the quality of a company's stakeholder engagement, but most focus on companies' commitments to engage or the existence of engagement mechanisms. We found no indicators in use for evaluating stakeholder feedback about company engagement.

C. **Social Targets** i.e., the degree to which a company sets credible social targets.

We found:

1. Data providers are evaluating companies' targets but seemingly without attention to whether targets exist for addressing impacts on stakeholders who are vulnerable to harm from typical industry practices.
2. Existing social indicators are not typically assessing the quality of targets that a company sets. Far more can be achieved in this area, especially given positive developments in reporting frameworks.

Overall, we found that the most-used social indicators offer very little insight into the actual inner workings of organizations. At best they fall foul of Guardrail III in this series, which explains the need to avoid indicators that offer insight only into whether something is being done, but not into whether that thing is being done well. The good news is that reporting standards are trending towards requiring companies to disclose this type of information, thereby increasing the viability of such analysis taking place at scale. Relevant promising developments in the reporting standards landscape are presented within each of our findings.