JULY 2024

Strengthening the S in ESG

GUIDELINE

03 Use indicators that offer insight into a company's contribution to positive outcomes for people.

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.

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.

GUIDELINE THREE

USE INDICATORS THAT OFFER INSIGHT INTO A COMPANY'S CONTRIBUTION TO POSITIVE OUTCOMES FOR PEOPLE.

OVERVIEW

The vision for companies' operations and value chains to generate positive outcomes for people and planet, and to contribute to resilient value chains, economies and societies, is core to the field of corporate sustainability. This resource highlights three ways that ESG data providers can improve the indicators they use to offer more reliable insight into companies' progress towards this vision of positive outcomes for people.

1. First, by being clear about whether metrics used are offering insight into outcomes for people, for business, or both;
2. Second, by using metrics that give insight into the extent to which companies are systematically advancing the practices and behaviours needed to deliver positive outcomes for people at scale; and
3. Third, by making greater use of qualitative measures that can off-set the inherent limits of quantitative information to offer insight into people's lived experience.

BACKGROUND

Research conducted by Shift in 2019 found that the outcome-related indicators used by ESG data providers, or disclosed by companies, related solely to outcomes for a company's workforce – almost exclusively for direct employees – and overwhelmingly focused on already-regulated topics, such as health and safety and diversity and privacy. Our latest research shows little to no change since then. As shown in the box overleaf, we found no data provider indicators that are direct measures of outcomes for value chain workers, affected communities or people impacted by the use of a company's products or services.

Broadly speaking, the reasons for the lack of comprehensive outcome metrics have not been well scrutinized. Some of the reasons put forward are not borne out by evidence, such as arguments that outcomes for stakeholders beyond employees are not material to understanding a company's social performance or that strong performance on traditional business metrics (e.g., turnover/retention or customer satisfaction) equates to good management of risks to people.

More legitimate reasons include constraints on companies in accessing information about outcomes for people beyond employees (eg. where it is prohibited to gather racial/ethnic data); and the limited number of agreed methodologies for measuring progress in addressing impacts beyond the workforce. Perhaps the most challenging limitation is that outcomes for workers, communities or consumers and end-users across value chains are typically large in number, geographically dispersed and can change rapidly. This means that trying to measure them at scale and across time can have significant resource implications.

Our findings and analysis focus on three promising avenues to inform the work ahead.

OVERVIEW OF ESG DATA OUTCOME METRICS

100% of the 60 ESG data provider outcome indicators we identified focus on companies' own workforce.

- Of these, only 10% are designed to analyse outcomes for the wider workforce beyond employees.
- 37% of indicators focus on health and safety; 23% on diversity; 15% on pay-gaps; 8% on collective bargaining; and 8% on retention/turnover. The remaining indicators focus equally on wages, strikes and work stoppages, well-being and professional development.

Across the 60 indicators being used there is a great deal of repetition. For example:

- Of the approximately 25 measures focused on health and safety outcomes, there are 4 broadly similar indicators: focused on fatalities; lost time injuries; accidents; and occupational illness.
- Of the approximately 15 measures focused on diversity outcomes, there are two dominant indicator formulations: the percentage of staff that specific populations represent at different levels of seniority; and the percentage of non-employee women.

RESEARCH FINDINGS

01 Existing outcome indicators used by data providers overwhelmingly only offer insight into business outcomes. S in ESG indicators should be scrutinized for whether they offer insight into outcomes for people, for business or both.

Global reporting standards distinguish between information that is material because it (a) offers insight into impacts on people and planet (impact materiality) and/or (b) it reflects risks to business (financial materiality), while increasingly recognizing the overlapping and dynamic relationship between the two. There is an opportunity to use this construct to be clearer about what individual outcome indicators are actually saying, and what investors and other stakeholders should and should not take from them.

Our research found only a small sub-set of outcome indicators in use that provide thorough insight into outcomes for people, with many more seeming to do so until scrutinized. Employee and contractor fatalities and accidents are clearly examples of metrics that offer insight both to investors about a business's impacts on people alongside a sign of potential legal or reputational risk to the company.

Beyond this, the picture is more complicated[2]:

- The "lost time injuries" safety metric offers insight into hours that workers are unable to contribute to a company's value-creation, so undermining the business's productivity. Quite apart from evidence that this metric can be gamed, the metric says nothing about the pay or benefits that workers receive (or lose out on) due to missed work, nor about any longer-term effects on the quality of work and life for injured workers .
- Diversity metrics spotlighting the percentage of women within management, executive roles and at board level do offer insight. But it is also true that these metrics say nothing about the experience of women working in these positions, for example whether they have been subject to harassment or other forms of discrimination throughout their career.

2 Shift, with support from relevant subject-matter experts, plans to conduct further research into workplace outcome evaluation in specific areas. This additional research will identify where underlying measurement methods do address outcomes for people, and where this is absent, and explore the benefits and pitfalls of commonly used metrics

While we did not find indicators focused on outcomes for people beyond companies' own workforces, these same challenges of clarifying whether indicators offer insight into impacts on people, impacts on business or both will arise for metrics that address impacts on other stakeholder groups beyond a company's own workforce.

RESEARCH FINDINGS

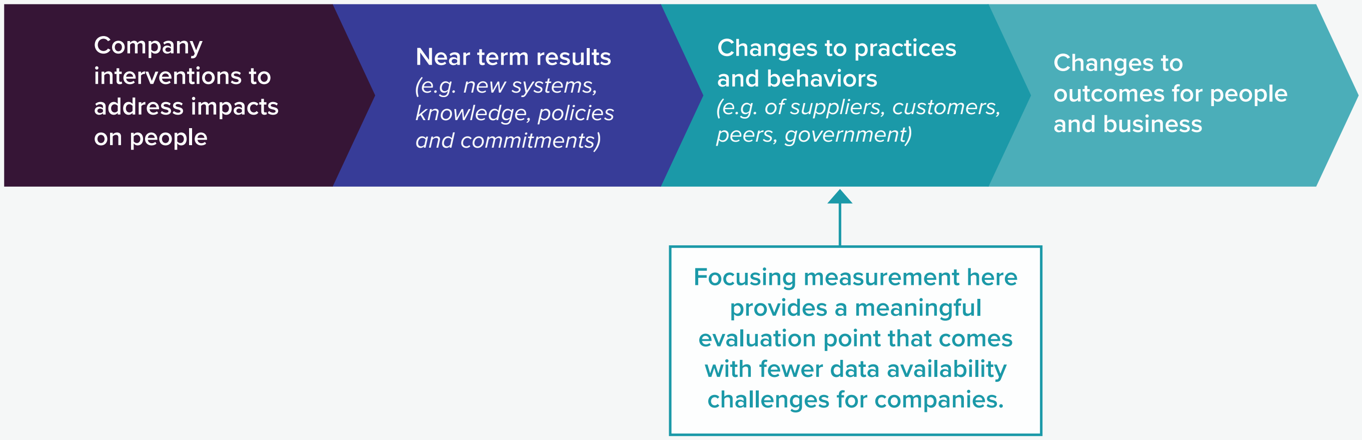
02 Indicators often fail to probe the degree to which companies are systematically advancing the practices and behaviors needed to deliver, scale and sustain positive outcomes for people.

For the majority of companies, addressing the most significant impacts on people connected to their operations and value chains demands attention to the practices that are their root cause, such as commercial decisions that externalize risks onto the most vulnerable in society; absent or weakly-enforced legal protections for workers and conusmers; or the persistent marginalization of the voices of at-risk communities in macro-economic policy and business decision-making.

Data providers have an opportunity to concentrate on indicators that assess a company's role in changing the practices that are the drivers of good or bad outcomes for people. While this is one step removed from direct measures of outcomes, well-designed indicators in this area would represent a welcome advancement from prevalent indicators focused on activities or outputs, such as improvements in policies, management systems or awareness building. These reflect what companies intend to do or what their employees are supposed to do, but are not necessarily reflective of what happens in practice.

Moreover, while it can be hugely resource intensive (and sometimes impossible) to measure actual outcomes in workers' and communities' lives at scale and over time, it is much more viable to access data on the prevalence of practices and behaviours known to be drivers of such outcomes. An additional benefit of focusing on the implementation of desired practices and behaviors is that it can offer a near-term signal of genuine progress in situations where achieving sustained and widespread outcomes for people can take many years.

IMPACT PATHWAY



BY WAY OF ILLUSTRATION, INDICATORS EVALUATING PRACTICES AND BEHAVIORS COULD LOOK AT:

- **Whether a company collaborates with business peers and other stakeholders, with demonstrable progress in addressing systemic issues that typically underpin the company's priority human rights risks.** Several data providers are already using indicators about companies' engagement with industry initiatives, such as whether there is evidence of "participation in a recognised human rights related initiative or collaboration" or being a "signatory or member of a recognised supply chain related initiative." As noted in Guardrail 2 of this series, the problem is that these indicators typically only capture information about whether a company has signed up to an initiative, not how the company uses its participation to align with the initiative's principles and goals and improve its practices. On the plus side, some providers have started to go further by analyzing the nature of a company's involvement in such efforts, for example by seeking evidence of "senior direct involvement" in the initiative. But even better would be indicators that spotlight demonstrable change in scaling relevant practices across signatories, and seek to evaluate the initiatives themselves, by looking for clear action plans, agreed outcome-oriented targets and accountability measures.

- **Whether a company is systematically adopting practices that have been proven to translate to better human rights outcomes for value chain workers, impacted communities or end-user/conumers.** As we discuss in Guideline 2 of this series, indicators could be designed to evaluate whether a company modifies its purchasing practices to avoid pressures that readily translate into impacts on wages and working hours at supplier sites; or can demonstrate progress in improving the quality of its relationships with indigenous communities and other local community members across relevant operational sites.

The Role of Outcome Metrics: Great for due diligence, bad for ESG ratings.

There are many good reasons for companies to evaluate whether their actions to address risks to people in specifc locations are delivering positive results for relevant affected stakeholders. So, where data is available, or workable ways of gathering data and good measurement methodologies can be found, these should be pursued. Where scale is a challenge, sampling can be used to test outcomes periodically in ways that will provide the greatest learnings: for example, by ensuring that measurement of outcomes at least includes attention to the most at-risk workers and community members, or by evaluating impacts in a mix of geographic locations that have distinct socio-economic contextual factors that could influence outcomes in different ways. Data about impacts in specific places can also be used to strengthen the quality of a company's communication with external stakeholders including affected groups or civil society and investors. When used in these ways, data on the progress and setbacks experienced by workers, communities and others can be appropriately contextualised and understood.

However, outcome metrics can be inherently challenging for data providers' methodologies. Providers are looking for comparable data across companies and even industries, whereas outcome metrics for single issues (e.g., access to clean water for communities, or workers removed from forced labor conditions) will usually need to reflect local contexts. For example, where migrant workers have paid fees for their jobs that lock them into debt, then reimbursement of fees may be a good outcome measure for progress in addressing forced labor; where their identity documents have been taken, then the number of workers whose documents have been restored may be the right measure.

In addition, efforts to produce more aggregate, cross-sector metrics, such as the number or proportion of suppliers where there is a significant risk of forced labor imply that they can reflect changes in the number of people in forced labor, but are more likely to incentivize under-reporting of an issue that is already hard to detect, and fail to convey whether the company's actions are incentivizing the problem or enabling solutions.

These challenges merit further attention. But this must start with further exploration of credible methods to evaluate the impact of companies' due diligence efforts (not least by companies themselves), and a clearer understanding of what outcome metrics - beyond those related to a company's workforce - might be able to provide authentic insight across a whole industry or even multiple industries.

RESEARCH FINDINGS

03 There is some attention to the value of sentiment data, but its potential to enhance S evaluation is untapped.

Multinational companies commonly conduct employee, customer and consumer surveys. Executives, boards and investors tend to recognise the value of these forms of sentiment data as a source of business insight to inform strategy, decision-making and an understanding of the intangible aspects of enterprise value. Data providers use some indicators that reflect that they place some importance on companies understanding more about the perspective of employees and consumers. For example, we found indicators looking at whether companies conduct surveys to measure employees' satisfaction relating to their job role and work environment; the frequency with which companies survey employees; and whether customer satisfaction is measured. But even these formulations of indicators do not go far enough, because they stop at seeking evidence of a process to gather feedback from wide groupings of people, not analyzing trends in sentiment data about the experience of the most at-risk workers, communities or consumers.

There is an opportunity to tap into similar methods to understand the experience of workers in the value chain, affected communities and at-risk consumers. Some companies are already innovating in this space. For example: Nike has worked with its suppliers to implement a Worker Wellbeing Survey in 64 factories in 13 countries, reaching 385,000 workers; and the South African mining company Gold Fields uses indicators related to trust, support and compatibility of interests to measure the quality of its relationships with local communities.

It will take time to see how far sentiment analysis can improve the S indicators used by data providers to offer insight to investors. But it is worthwhile to begin imagining what helpful formulations of such indicators might be. Standard setters and investors could set the wheel in motion, for example by using outcome-oriented indicators that blend quantitative and qualitative information together such as: the number and percentage of women at different levels of an organisation who feel they are given opportunities for career progression equal to their male colleagues; or the percentage of relocated community members who feel that the process and outcomes have been fair. Increasing these types of disclosure would then allow data providers to assess whether a company has methods to hear about the experience of relevant affected stakeholders that then inform its understanding of risks, the effectiveness of its risk mitigations or both.

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ABOUT SHIFT

Shift is the leading center of expertise on the UN Guiding Principles on Business and Human Rights. 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. Shift is a non-profit, mission-driven organization, headquartered in New York City.

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