JUNE 2024

Strengthening the S in ESG

GUIDELINE

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

C Focus on a company's social targets.

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, 225 are governance indicators used by these same providers and 350 are social indicators used in global or regional reporting frameworks. This resource is one part of our research into indicators that are strong predictors of business decision-making and behavior (**see here for an overview of this guideline**).

This instalment presents our findings on indicators about **targets** related to social issues. Part A looks at indicators related to **Governance**, and Part B at those related to **Stakeholder Engagement**.

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). Shift recognizes that the underlying methodologies used to reach a judgement on a company's performance against an indicator may offer more nuance than we were could not access for our research.

GUIDELINE ONE

USE INDICATORS THAT ARE STRONG PREDICTORS OF BUSINESS DECISION-MAKING AND BEHAVIOR.

PART C: FOCUS ON INDICATORS RELATED TO SOCIAL TARGETS

Finding #1: Data providers are evaluating companies' targets but seemingly without attention to whether targets exist to address impacts on stakeholders who are vulnerable to harm from activities and practices typical to the company's industry.

Finding #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.

BACKGROUND

Why evaluate targets? Where a company has set targets in relation to the most severe human rights impacts connected to its operations and value chain, it is more likely that these will be adequately reflected in operational budgets and plans. Moreover, the existence of publicly reported targets can signal that a company's leadership views this aspect of the company's performance as important, intends for progress to be measured and that the results should inform future decisions and actions and support continuous improvement.

In sum, the existence of **outcome-oriented, time-bound and measurable** targets is a strong leading indicator of what actually happens within a company and in its interactions with value chain partners and affected stakeholders. This is why targets are emphasized in contemporary reporting standards and include explanations about what makes for credible sustainability targets [see overleaf]. This convergence of reporting requirements opens up opportunities for ESG data providers to focus more of their analysis on the types of targets that companies are setting.

THE RISING BAR FOR DISCLOSURE.

MAKING BETTER S INDICATORS FEASIBLE.

The **European Sustainability Reporting Standards** include minimum disclosure requirements on metrics and targets that reflect the expectation that companies assess progress on how they address material human rights risks and impacts with “measurable, outcome-oriented and time-bound targets”. ESRS 2 General Disclosures require that companies “shall disclose any measurable, outcome-oriented targets it has set to assess progress” and for each measurable outcome-oriented target, disclose additional information, including: “a description of the relationship of the target to the policy objectives”; “the scope of the target, including the undertaking’s activities and/or its value chain where applicable and geographical boundaries”; “whether and how stakeholders have been involved in target setting for each material sustainability matter”; and “whether the progress is in line with what had been initially planned,” and “an analysis of trends or significant changes in the performance of the undertaking towards achieving the target.”

The **Global Reporting Initiative’s** Universal Disclosures include a focus on targets and metrics under the theme of “Management of Material Topics” (GRI 3-3). This includes that companies shall “report goals, targets, and indicators used to evaluate progress” and “the effectiveness of the actions [taken to address material impacts], including progress toward the goals and targets.” The relevant guidance states that when reporting on goals and targets, the organization should report, among other details: “how the goals and targets are set; whether the goals and targets are informed by expectations in authoritative intergovernmental instruments and, where relevant, by scientific consensus; the organization’s activities or business relationships to which the goals and targets apply; and the timeline for achieving the goals and targets.”

The **IFRS Sustainability Disclosure Standard on General Requirements** (IFRS-S1) includes disclosure requirements about metrics and targets. The standard states that “An entity shall disclose information about the targets it has set to monitor progress towards achieving its strategic goals, and any targets it is required to meet by law or regulation. For each target, the entity shall disclose: the metric used to set the target and to monitor progress towards reaching the target; the specific quantitative or qualitative target the entity has set or is required to meet; the period over which the target applies; the base period from which progress is measured; any milestones and interim targets; performance against each target and an analysis of trends or changes in the entity’s performance; and any revisions to the target and an explanation for those revisions” (paragraph 51).

RESEARCH FINDINGS

01 Data providers are evaluating companies' target setting but seemingly without attention to whether targets exist for addressing impacts on stakeholders who are vulnerable to harm from typical industry practices.

Of the social indicators that mention targets set by companies, our research identified that almost 50% of these focus on health and safety, or diversity and inclusion. Focusing evaluation on these employee issues has the benefit that they are, for the most part, issues that all companies will need to address in some regard.

50% of indicators that mention targets set by companies focus on health and safety, or diversity and inclusion.

However, there are two problems with this. First, indicators focused on health and safety appear to ignore whether targets apply to non-employees within the workforce. Yet it is often non-employees who are most likely to experience job insecurity and lack access to union representation that might help them elevate concerns about health and safety, and who are also most likely to lack health-related benefits. We found one exception, in which a data provider scores a company more highly for targets that include contractors as well as employees.

Second, impacts related to health and safety or diversity and inclusion may not be the most severe or material social risks that the company is connected to across its operations and value chain. For example, a bank should arguably be paying equal, if not greater, attention to risks related to its customers, and a renewables company to risks of labor conditions in its supply chain and/or community impacts.

Equally problematic, though less prevalent, are indicators framed in overly broad terms. Examples here include indicators that evaluate if a company sets targets for "sustainability performance" or whether a company reports progress against "human rights" targets. Such indicators, at face value, seem incapable of offering insight into whether a company has set targets for its most significant impacts on people.

Workable solutions may not be far off. First, it is fairly straightforward to write indicators that could offer a clearer sense of whether companies set targets for a wider range of sustainability issues beyond health and safety, and diversity.

Better indicators could, for example, focus on the extent to which a company:

1. Sets targets to address risks/impacts related to its own workforce beyond employees, or explains why targets are limited to employees only; or
2. Sets targets to address risks/impacts related to people outside of its workforce (for example, value chain workers, communities, or those impacted by the use of its products or services); or
3. Sets targets for risks/impacts related to stakeholder groups that are typically impacted by companies in its industry.

Second, our research found that some data providers are already using information about targets to evaluate companies' overall management of a variety of sustainability issues, such as the health of products, community development, and responsible supply chains. This suggests that, in principle, looking for evidence of targets outside of employee diversity, and health and safety is indeed feasible.

RESEARCH FINDINGS

02

Existing social indicators are not typically assessing the quality of the targets a company sets. Far more can be achieved in this area, especially given positive developments in reporting frameworks.

Some data providers analyze the characteristics of targets that companies set. For example, we found indicators that seek to offer insight into whether targets are time-bound, quantitative or qualitative, and supported by evidence of how progress is monitored. This suggests that it is feasible for analysts to evaluate companies' targets for their quality, guided by the criteria used in reporting standards.

Indicators could assess the quality of targets by looking at whether targets are:

- Outcome-oriented, meaning:

  a) targets are a direct measure of outcomes for people (for example: the proportion of the workforce paid a living wage, or the extent to which indigenous communities have been able to exercise their right to Free, Prior and Informed Consent);

  b) targets are adjacent to outcomes and key to achieving desired outcomes, such as the proportion of communities reporting respectful engagement processes;

  c) targets are a measure of systemic changes aimed at improving outcomes for people (for example, achieving industry- wide commitment to collective bargaining, or embedding land rights in local laws in high-risks contexts).

- Clearly scoped, meaning they are accompanied by details of whether the target applies to a consolidated corporate group, a single entity or business unit, its upstream or downstream value chain, or specific geographic regions.
- Informed by external parameters, for example, UN Sustainable Development Goals, ILO labor rights standards, or similar.
- Informed by engagement with affected stakeholders, their legitimate representatives and/or subject-matter experts.