



IHS Markit Perspectives XI (27 October 2020)

The importance of social initiatives within ESG

IHS Markit's Perception Analytics team engages in in-depth discussions with investors and analysts daily. Given recent market volatility and significant economic uncertainty, IHS Markit will be speaking to investors and analysts on a regular basis over the next few weeks to assess how the current situation with COVID-19 is impacting their evaluations of and engagement with corporate issuers.

Traditionally, most issuers and investors have placed more emphasis on the Governance and Environmental factors when analyzing ESG, however, in light of the pandemic coinciding with increased scrutiny on social injustice, companies are becoming more vocal about their positions on social initiatives. Given this recent shift, we explore the topic of how the Street assesses a company's stance on pressing social issues as well as how companies should be communicating their efforts to stakeholders. **Thus, the eleventh topic we gathered feedback on is how social impact initiatives within ESG influence a company's investment case.**

Several investors and analysts assert that a company's social initiative efforts have become more material to their investment case. In particular, they highlight the importance of diversity across the corporate workforce.

- “We absolutely have been looking at human capital management as being a fairly impactful area. From a stewardship perspective, **we are voting on companies based on their Board diversity with the aim that Board diversity will help improve overall workforce diversity. When doing that analysis, we also take into consideration the level of management diversity there is and what programs a company has in place.** We look at that to see if a company is really building talent from within and doing it to ensure that there is diversity within the talent ranks itself. So, we take that into consideration when we do the analysis of Board diversity and any shareholder resolution related to these issues as well. I expect that there will be increased pressure on companies to provide more detailed information in their reporting in the way that they handled those issues during COVID-19. There is certainly a bit of appetite from a diversity and inclusion perspective as well. So, my expectation is that there will be more pressure for that.”
Analyst, US investment manager (>\$325B EAUM)
- “We are having conversations with companies about how they are communicating racial equity injustice and if they are communicating with their employee base about this issue. **We are asking what policies or procedures companies are planning to put in place or are in the process**

of implementing to address racial injustice. We also want to know about any external outreach or contributions companies are making to organizations that further that cause.”

Analyst, US investment manager (>\$1,800B)

- “It is important to understand a company’s social initiatives. At the Board level, it is very important to see diversity. That works its way down the ladder. Addressing hiring practices is generally an important way to reduce cognitive bias. **It would be very interesting to see the diversity makeup of companies in the US. It would be good to see the self-identified ethnic breakdown of the Board because they set the tone for a lot of initiatives.** This is important because the minorities in the US are sharply underrepresented at that level across big US companies. That would generally bring advantages to a company. A little more ethnic diversity is useful for companies.” *Analyst, US investment manager (>\$20B EAUM)*
- “Social initiatives and efforts relating to diversity and inclusion are pretty important. **If a company is blatantly not taking efforts on issues relating to this or even creating negative waves, then I am sure this would have an impact on the share price at some point.** Most companies will now provide a couple of slides within any presentation on ESG. I look at a number of companies within Indonesia and there is more focus on these kinds of topics almost across the board. It is very important for businesses to maintain a focus on ESG. From an investor’s perspective, such topics are becoming very important. All major fund management houses will now have dedicated ESG personnel and there are also a number of dedicated ESG funds. These issues have become important enough to have positive or negative impacts on share prices and position sizes.” *Analyst, APAC sell-side firm*

Furthermore, many respondents note that it is critical for companies to have consistent communication that highlight their commitment to fair social practices.

- “When it comes to a company’s diversity in the workforce and gender neutrality, that is definitely something we look at and consider. We look for diverse workforces and diverse Boards. We also look at a company’s contribution to society including the obesity and diabetes epidemics. Those are other considerations for the societal impact of the business. A company’s social impact initiatives absolutely have an impact on how we view the valuation of a company. Having a slide deck on hand that a company can send to investors who are asking about social initiatives would be helpful. **Companies must have a consistent message and make sure it is entrenched into the work the company is doing in terms of growth projections, margin projections, and the mission statement.** It needs to be engrained in all of that, so the company can point to examples.” *Portfolio Manager, UK investment manager (>\$35B EAUM)*
- “**Social impact initiatives have an impact on how we view an investment because companies have to “walk the walk”.** A lot of people are signing up to pledges, but it needs to be visible that a company’s efforts are making an impact. We want more female representation on the Boards of companies, but what happens too regularly is that certain individuals that happen to be female are sitting on a lot of different Boards. We would prefer somebody sitting on fewer Boards so that they are not stretched too thin, but we cannot say that

because we also want female representation. That is where the challenge lies because we also want it to be skill based. Some companies are not saying what their social efforts are. I am not sure if that is good or bad. The opportunity has to be equally based on merit with a bit of a helping hand to help marginalized individuals whether it is based on sex or color.” *Analyst, UK investment manager (\$45B EAUM)*

- “A company’s social impact initiatives would ultimately have an impact on the branding and how a consumer perceives a brand. If we do not agree with a brand strategy or see it as negative from a consumer perception perspective, then that impacts revenues and would definitely impact how we see the outlook for a company. Brands that have a meaning or purpose attached to them are doing better. There is really a clear impact on that. Whether or not a company should communicate on these initiatives depends on the situation. **Communication needs to come from a company that already had a strategy around social initiatives. If there are brands that have had a certain issue or have built credibility, then it makes total sense to communicate that.** If it is just noise, then it does not work. It really has to be genuine and depends on how much work has been put in.” *Analyst, US investment manager (\$80B EAUM)*
- “A company’s social impact initiatives will play an increasingly bigger role from this point forward. We are assessing the impact on any given company regarding growth or prosperity, and diversity is clearly an important metric. The impact will vary by industry and by company, but now is the time for companies to address it. We are certainly putting a greater lens on it as well. The social initiatives are very material especially for a consumer company when you start bringing brand and reputation into the discussion which can certainly have an impact on our investment decision. Words and actions are certainly two different things. **The companies that are willing to hold themselves accountable and put out diversity metrics, targets, and communicate a plan to all stakeholders about how they will achieve these metrics are the companies that will continue to differentiate themselves from the noise.** It is especially important for consumer companies because consumers vote with their wallet, so reputation and brand are everything. That is why the consumer industry will be the industry that is most scrutinized from this angle.” *Analyst, US investment manager (>\$425B EAUM)*
- “We do consider a company’s social impact initiatives as part of a holistic assessment. We emphasize understanding the exposure to sustainability risks, how companies manage them, and want to see relevant performance metrics published in public company reporting. That is our main focus, and from there, these social efforts are also considered. We do our own sustainability assessments and look at how companies disclose compared to our expectations. **We recommend companies look to at international standards on sustainable reporting. We recommend they look at SASB with its industry specific indicators and GRI for a broader range of stakeholders.**” *Analyst, European sovereign wealth fund (>\$750B EAUM)*

A few participants remain skeptical of public issuers’ progress and impact as it relates to true social justice reform.

- “It scares me that one of my companies could find itself on the wrong side of societal debate. I am a big believer that there is structural racism in the world. I do not believe there are individuals

inside the companies seeking to oppress certain parts of the population. The way companies put social issues at the front and center of their conference calls surprises me. **I am a bit cynical that this is their main concern despite how it might be presented. It seems to me that they are talking about social issues because it is in the news rather than because it is something that the people at the firm have been waking up and thinking about immediately for the last 10 years.** I do not know if this an issue that will be fixed by specific company actions per se. Companies have to hire the best talent. The business has to take priority compared to serving a grand social mission. Businesses have to make some kind of public statement about these current events because they do not want to find themselves on the wrong side of a boycott. Companies risk looking disingenuous when they put out these sentimental messages about their beliefs. The reality is they are trying to outcompete their rivals and maximize profits. I am just a little bit cynical about some of the messaging.” *Analyst, US investment manager (\$145B EAUM)*

- “At the end of the day, a company’s social initiatives are an overlay in its investment case. Investors want to know that companies are making an effort. They may not be perfect in all of these metrics, but they do have an action plan to improve their impact rather than just paying lip service. With all of that being said, these social initiatives are not very material to a company’s valuation. They will be increasingly important but less so right now. **There are not any companies that come to mind when considering best-in-class practices, which leads me to believe that no companies have differentiated themselves with their actions.**” *Analyst, US sell-side firm*
- “**It is too early to say how social issues would feature into investment decisions.** As a group when we are discussing investment themes and ideas, those are some of the issues that started to become more prevalent in the last 10-12 months. We will have to see if company actions change anything. An example of a topic being discussed is race relations, but that is just one element in a broader discussion around populism. Those are issues that are increasingly interesting to keep on top off going forward.” *Analyst, UK investment manager (>\$1,200B EAUM)*