

## THOUGHT LEADERSHIP

# Simplifying the Social 'S' Component of ESG

*By Third Economy Staff, July 2022*

The social 'S' component of ESG is often difficult to incorporate into an ESG program because it encompasses so much. From human rights and workforce diversity to data security and supply chain, the 'S' in ESG acts almost like a catch-all category for whatever doesn't fit into the 'E' and 'G.'

Compounding these challenges, the social component of ESG is not always easy to measure. When it comes to environmental factors, for example, we can easily measure things like carbon output and water consumption. But "human rights"—how do you measure that?

To help simplify for clients, we often break down the 'S' into three related categories: Social capital, human capital, and product innovation. These categories let us think more concretely about what the social component of ESG is and involves.

Below we illustrate these categories using practical, real-world examples. We show how the social component of ESG can present both risks and opportunities that may impact a corporation's ability to generate long-term financial returns.

## SOCIAL CAPITAL

Social capital primarily refers to relationships with stakeholders, especially business partners and customers. How you manage those relationships will make a difference.

For example, supply chain partners can present risks to your reputation and brand goodwill.

For years companies have fallen under scrutiny for working with questionable suppliers. Nike and Apple, for instance, have been accused of sourcing goods from 'sweatshops' that potentially violate basic norms

around human rights and dignity. In the extreme, negative supply chain practices can potentially alienate loyal customers.

More immediate impact might stem from changing behaviors among procurement teams. As businesses seek to advance ESG initiatives, procurement officers are being far more deliberate about vendor selection.

Many procurement teams, for example, now rely on Ecovadis, an independent firm that evaluates and rates supply chain sustainability. If your business and supply chain partners don't meet standards, you may struggle to gain new B2B relationships.

For similar reasons, data security and customer privacy also fall under social capital. As business networks become more complex, data security matters more than ever. The potential reputational risks are overwhelming. Your business—and those you partner with—don't want to garner headlines because of a data breach.

If you lose customer trust, you risk losing customers too.

## HUMAN CAPITAL

Human capital primarily refers to relationships with employees and labor practices. In the past year, this area has come into much sharper focus, as businesses try to navigate workplace safety amid a global pandemic; the 'Great Resignation' amid an historically tight labor market; and the future of work, as employees demand greater flexibility and permanent remote status.

Investors are watching closely to see how companies navigate these issues, as it impacts the strength of your workforce and ability to attract and retain talent, both of which significantly impact long-term financial prospects.



It is against this backdrop that workforce diversity, equity, and inclusion (DEI) initiatives find favor among investors. Companies that prioritize diversity in hiring practices, especially within leadership, stand to attract talent, foster more productive cultures, and help businesses stay responsive to an increasingly diverse customer base.

In addition, diversity matters when it comes to attracting capital. Some asset managers are creating products like State Street's Gender Diversity Index Fund, which only include corporations that meet specified gender diversity ratios. As these products gain popularity, corporations that lack diversity could find they aren't included in important fund options.

The relationship between labor and corporations is also coming under greater scrutiny. Amazon, for example, has generated negative headlines for several years after reports revealed substandard working conditions in their warehouses.

These headlines could push consumers to consider alternatives. And that risk matters when analyzing Amazon's current dispute with labor.

Amazon could choose a more union-friendly approach, which might help generate brand goodwill, while also helping to create safer working conditions, reduce turnover, and foster a more productive workplace. In this respect, the ROI calculus—and investor assessment—should go beyond the narrow question of wage increases and consider the overall impact on long-term profitability.

## PRODUCT INNOVATION

Finally, product innovation refers to the practice of creating new products that capitalize on evolving markets and consumer trends.

In the last few years, for example, Apple has articulated a privacy-centric brand to differentiate its product lineup and build customer loyalty. Given that data privacy is top of mind for many consumers, it makes sense to build products that showcase strength in that area.

Similarly, talent acquisition and management companies have developed new products to take advantage of the trend toward diversity hiring. ADP, for example, enables clients to harness data insights to take a data-driven approach to diversity talent management.

A socially conscious approach to product innovation is not new. Fair Trade coffee and other grocery products have been a staple for decades, carving an industry niche to appeal to consumer trends. Conscious consumers want to be confident that the goods they buy result from sustainable supply chain infrastructure and not exploitative practices.

## OWN YOUR NARRATIVE

Investors will analyze your company based on how well it's positioned to navigate social risk and capitalize on unfolding opportunity. How will you convey your readiness?

Although independent third parties are finding ways to measure social factors, many elements still use softer indicators. For this reason, the social component of ESG requires clear, sophisticated storytelling.

How you convey your ESG narrative can go a long way toward shaping investor perceptions of your business.

Let Broadridge and Third Economy help. We deliver an end-to-end process that helps you identify milestones, benchmark your accomplishments, and own your ESG narrative. Whether you are just getting started or well into your ESG efforts, we've got the roadmap you need to advance your ESG capabilities.



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