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How to combine yield with sustainability factors

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The topic of ESG (Environmental, Social, Governance) has permeated our thinking, as is supported, for example, by the tenfold increase of Google queries about this topic in the past five years (source: [Google Trends](#)). As leading investment company in the field of sustainable investments, it has been one of our tasks for more than two decades to assess companies not only on the basis of financial key ratios, but also with respect to the degree of responsibility they assume for the impact of their operations on the society and the environment.

In contrast to the areas of S and G, the E department (environment) has seen numerous measurable indicators emerge in recent years. For example, it now seems plausible to infer a company's effect on the environment on the basis of its CO₂ emissions or its water consumption. Examples of indicators of good corporate governance are a standard of practice for the Management and Supervisory Board, compensation policies, information about memberships in national and international lobbies etc. However, their implementation and effectiveness often defy even the most intricate research efforts of quantifying such initiatives. Coming up with comparable evaluations is a challenge. The same is true for S (i.e. the area of social engagement), which we focus on in this article. Examples are humanitarian rights, supply chain management, and product responsibility. A lack of transparency or inconsistent data acquisition by the company erode the validity of these indicators. Are they, then, measurable enough to facilitate a meaningful evaluation? We have listened to what companies had to say in connection with the topic of social factors in the sustainability assessment and received interesting responses to controversial questions.



How to measure social factors?

In this field, identifying indicators that allow for a standardised scoring of companies is particularly challenging. It is equally important how a lack of data (i.e. unavailable or simply non-existent) is handled. Our partners in [ESG research](#) are convinced they can illustrate the various risks, the way they are managed, and the respective reporting with their methodologies. Our discussion revealed that a vast array of different approaches was being used in this context.

One of our partners pursues a clearly academic approach. In the process, a large number of qualitative and quantitative indicators are established and assessed with regard to their relevance for the business model in question and to their implementation and monitoring by the company. This is based on the latest scientific findings according to which indicators are updated dynamically. Every indicator is evaluated and weighted differently according to the relevance it was awarded. This is particularly important when no data are available for a specific parameter. In case of unavailability of information, an indicator can be set to zero. Depending on the quality of information, positive or negative values are assigned to the indicator and corrected by raising controversies in this field, if any. Handling cultural differences is slightly trickier. Here, a globally standardised methodology is employed, as a result of which cultural differences have little impact on the score. This can lead to a situation where, in regions where enormous pressure to perform is socially accepted, companies are given best-in-class status for personnel management despite the pressure the employees are under from management. If this situation causes extreme physical or mental fatigue with unwanted effects, it is taken into account in the score of the company, potentially as violation or controversy. The degree to which S contributes to the overall ESG score differs from company to company.

Another partner relies on a wholistic approach in its scoring process. For every sector, the key topics are established and weighted in such a way as to ensure that they account for at least 50% of the overall weighting. This approach resorts to sustainability factors that according to the Sustainability Accounting Standards Board (SASB, source: [Value Reporting Foundation](#)) have financial, material effects on the typical company of the respective sector and to globally used guidelines. Among them are, for example, UN Global Compact (source: [UN Global Compact](#)), the OECD Guidelines for Multinational Enterprises (source: [OECD Guidelines for Multinational Enterprises](#)), and the Sustainable Development Goals (SDGs, source: [UN Department of Economic and Social Affairs Sustainable Development](#)). The magnitude of the sector-specific risks defines the specifications and weightings of the various scoring areas (E, S, and G). Pharmaceutical companies and educational establishments are among the sectors with the highest weighting of up to 80%. In addition, there are indicators that are taken into account across all sectors, such as personnel and supply chain management. Unavailable data have a negative effect on the ESG score. In this approach, too, violations and controversies cause a reduction in points in the total score. The assessment of the sustainability performance is provided to the companies and allows for a response from their end.

EU Social Taxonomy – chance of global impact?

At the moment, the possible impact of the first draft of the EU Social Taxonomy (source: [Europäische Kommission](#)) is still unclear. Much like the EU Environmental Taxology, the draft version is in favour of criteria that contribute significantly without causing any significant harm. The goals connected to the Social Taxonomy could call on companies for more transparency in the areas of healthcare, human rights, equality, and non-discrimination. It is important for products and services to contribute to adequate living conditions, as they are not only supposed to define a guaranteed social minimum, but also add positively to the improvement of the socio-economic environment and/or the fulfilment of social needs. While at the time the interviews were conducted our data providers did not want to make any binding statements about the Social Taxonomy, they did emphasise that their own metrics were in line with it. One should not expect them to have an immediate effect on a global scale or to make the measurement of social impact easier or even possible. But expectations are for countries outside of Europe to follow suit with their own taxonomies. It is definitely a step in the right direction, but the measurement of the social impact will remain challenging.

The ESGenius Score

Erste Asset Management uses information from various providers as basis for its high-quality sustainability research. In addition, it also resorts to information from international institutes and NGOs in order to complete the picture. By taking into account different methodologies, factors, and weightings in our proprietary sustainability score – the ESGenius Score – we can establish a better picture of the sustainability efforts and performance of companies and states.

Read the full ESGenius newsletter on social responsibility and sustainable investing: <https://blog.en.erste-am.com/dossier/social-responsibility/>

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