New Approaches to Assessing the Social Impact of Business in Fragile and Conflict-affected Settings

Executive Summary of a Discussion Paper for LSE IDEAS

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Introduction

Businesses face growing public expectations to contribute positively to Environmental, Social and Governance (ESG) outcomes. Frameworks such as the Sustainable Development Goals (SDGs) help mobilise business contributions, and it is becoming increasingly mainstream to report on ESG performance through internationally accepted standards. However, there is a lack of knowledge on how to measure the actual impacts of ESG contributions of businesses. The same gap applies to their SDG contributions. Using the co-construction of knowledge model, this paper aims to develop proposals that address current practice barriers and identify opportunities for new impact assessment guidance on responsible business conduct which will better align policy and practice to desired social outcomes especially in relation to the SDGs. We use two different concepts – Human Security (HS) and Positive Peace (PP) – that are believed to be valuable, offering a methodology for companies operating or investing in FCS to assess their impact in connection to human rights, security and sustainable development. The paper examines the added value of these approaches by comparing them to current ways of measuring ESG impact while assessing their compatibility with each other. It is believed that such an exercise will also address the question as to why many companies and investors often avoid conducting business in FCS, hence potentially identify reasons for market failure.

The development of this paper has been informed by a series of interviews with representatives from businesses, including the financial sector, and a two-day roundtable discussion in The Hague in February 2020 with private sector and government representatives, academics and civil society actors. The proposed guidance is intended to serve companies that wish to clearly define their social responsibility, in order to not only avoid doing harm but also 'doing good'. It also offers a way to simplify reporting on social responsibility standards and guidelines and ultimately create more value for their business. Indirectly, it is meant to assist ESG rating agencies and financial institutions and investors when reviewing the risk management by the companies in settings where higher risks are involved.

The paper suggests that in more high risk areas, a corporate sustainability strategy and a materiality analysis will require an outside-in and bottom-up approach that can bring to light the relevant ESG issues applicable to the local communities where the company is operating so these can be fed back from the country level office to inform a global standard that is measured at headquarters level.

Understanding and Dealing with Conflict and Fragility

Over the years, the 'business case for respecting human rights' has become stronger, driven by the UN Guiding Principles on Business and Human Rights (2011)[1] and illustrated by the growing litigation risk against corporations. Increasingly, companies need to demonstrate to their stakeholders (i.e. shareholders, financial institutions, customers and employees) that their presence has no negative impact on the development of the local communities where or with whom they work.

It is also noted that the discourse on companies' roles in FCS has changed over the last decade or so. This includes an increased consensus that companies must avoid negative social – in particular human rights – and environmental impacts in FCS as a matter of both risk management and responsible corporate citizenship. Nevertheless, many companies today still assume that their experiences when operating in a context of fragility and conflict are entirely due to external factors such as the absence of an effective government or high rates of unemployment among youth. The misunderstanding by companies about their own role in relation to conflict often leads them to see conflict as a phenomenon over which they have no control, and therefore they find no reason to get involved in its resolution. **The challenge for private sector actors in contexts of conflict and fragility is that they are or become inherently part of the local political economy in FCS.**

The value-added of **Human Security** in connection to risk management is in **highlighting the comprehensive nature of threats to everyday life, and how different forms of risk and vulnerability, including business risk, are interconnected and how their reduction promotes peace**. This represents a powerful shift in mindset towards conceiving peace in an active and "positive" way — from looking at the issues through a conflict lens and at factors that drive violent conflict, towards influencing those conditions or factors that enable and sustain peace, also called **Positive Peace**. When peace is portrayed as a continuum that requires progress in all aspects of sustainable development, the role of the private sector in respecting or promoting peace suddenly becomes clearer.

Current State and Future Outlook for ESG Impact Measuring and the SDGs

Moving away from the more traditional (and increasingly outdated) focus on Corporate Social Responsibility (CSR), today's responsible businesses operations use ESG criteria not as an 'add on' to the core business activities but as an integrated part of the business strategy. Unlike CSR, ESG demands metrics. Evidence of ESG activity is now seen as vital to understanding corporate purpose, strategy and management quality of companies and is key to investment decisions. Big asset management firms and government pension funds want business leaders to focus on ESG impact. Having a positive impact on ESG factors is not just a bonus anymore, but something shareholders demand, because they believe it is going to drive growth, market share and profitability. Many ESG studies seem to conclude that the efforts by companies to 'do more good' not only lowers risks but get financially rewarded as well.[2] **While specific ESG-financial performance studies for FCS have yet to be conducted, the common thread in most studies so far indicates that a focus on ESG could be financially beneficial**, which implies that this will also be the case in FCS. It is therefore

[1] United Nations, "Guiding Principles on Business and Human Rights: Implementing the United Nations, 'Protect, Respect and Remedy' Framework", 2011, http://www.ohchr.org/Documents/Publications/GuidingPrinciplesBusinessHR_EN.pdf <Accessed on 29 May 2020>.

[2] A joint study by DWS Investment and the University of Hamburg found a positive relationship between ESG and Corporate Financial Performance (CFP) on the basis of existing meta-analyses See: Global Research Institute DWS, Digging Deeper into the ESG-Corporate Financial-Performance Relationship, 2018; https://download.dws.com/download?elib-assetguid=714aed4c2e83471787d1ca0f1b559006; A report by UN PRI and the International Corporate Governance Network summarizes 5 studies that support the claim that there is a clear linkage between ESG factors, company performance and investor preferences. See: UN PRI and ICGN, Investor agenda for corporate ESG reporting, 2018; https://www.unpri.org/download?ac=6181 <Both accessed on 29 May 2020>.

recommended that an ESG financial performance study for FCS will need to be conducted to determine the extent of this relationship.

ESG rating agencies such as MSCI and Sustainalytics that monitor and evaluate material ESG impacts use different definitions of ESG performance and as a result may give different ratings to the same company. For investors, the social element of ESG issues can be the most difficult to assess. There is a need for more on the ground data on the socio-economic dynamics in relation to conflict and security in FCS and the presence of any vulnerable groups to consider material impacts and define thresholds. Also, under pressure from investors to create more company value, demands for tracking and reporting on the company's contributions to the SDGs are growing. This implies that companies need to go beyond 'do no harm' approaches and may need to bring human rights, security and sustainable development under one umbrella. SDG 16, covering ESG issues such as Human Rights and Corruption, has been recognized as an enabling goal playing a fundamental role in the achievement of many of the other SDGs.

Development of corporate social responsibility in FCS

Over the past 20 years, international norms, standards, and agreements have started to call for more direct engagement from the private sector in preventing conflict, and potentially contributing to peace. However, it is neither clear to what extent any of the existing standards are implemented effectively at different levels of the company and on different companies, nor what kind of effects they have in the context or on the company itself, positive or negative. Despite the wealth of standards and guidelines, there is currently no single guideline or standard dealing with all aspects of corporate responsibility in FCS while existing guidelines are not tailored to a specific context.

With public international standards on corporate responsibility continuously evolving and more avenues of redress for victims of corporate human rights abuses gradually emerging, mandatory disclosure of human rights and other social impacts will become more widespread. In the future companies are likely to face greater legal accountability for their social performance which places higher demands on tracking and reporting. With many companies already struggling with today's standards, **the challenge will be to (1) reduce complexity and tie sustainable development, security and human rights together on the basis of existing data as a way to become more cost-efficient and (2) determine materiality of multidimensional issues** and identify the measures that can demonstrate the extent of their materiality to the business.

ESG Impact Measurement in FCS

While many companies already have social and environmental impact plans and sustainability policies at their disposal, they struggle to address complex and dynamic situations on the ground in FCS. So far, sustainability policies – including compliance with existing international standards – have often failed to mitigate the adverse impacts of corporate activities on communities or provide an adequate mechanism for effective accountability or for generating support among local people.[3]

Determining the social impact of current standards offers a starting point for defining a company's responsibility and its boundaries. Corporate responsibility is currently defined by existing guidelines and standards broken down by their materiality to the business. Any ask from companies to go beyond the guidelines to cope with the challenges in FCS stretches the prevailing perspective of corporate responsibility. Nevertheless, some multinational companies that acknowledge current standards to be insufficient in dealing with high-risk contexts, have taken on additional responsibility towards the community. Partly driven by past company experiences including (fear of) shutdowns and demands from investors, a number of individual companies are working to develop specific

[3] Many examples of case studies on the negative impacts of multinational companies can be found on the websites of the Business & Human Rights Resource Centre, SOMO and Global Witness, among others.

company policies and operational guidance for high-risk contexts which involves, among other, more community engagement and third-party audits.

The Human Security Approach for Business

A Human Security (HS) approach for businesses operating in FCS brings together the 'human elements' of security, rights and development. It is an inter-disciplinary concept that displays the following characteristics: people-centred, multi-sectoral, comprehensive, context-specific and prevention-oriented. Human Security, therefore, connects fragility, human rights and sustainable development together and offers a basis for identifying thresholds of people's resilience. In short, Human Security (HS) takes a holistic approach that helps clarify how diverse issues—ranging from deprivation in all its forms to violence and environmental degradation—interact and require comprehensive, context-specific solutions. As such, it does not add another layer to the existing frameworks but rather strengthens the work already in place by tying it together.

The entry point for companies taking HS risk-informed and risk-responsive actions can be easily translated into an SDG contribution (see Figure below). Rather than selecting SDGs based on their general alignment with the core business as is the case today, **Human Security emphasizes 'local' risks as a starting point** so any SDG contributions can be directly connected to the actual improvement in people's wellbeing and security. From a measurement angle, HS has the ability bring together interrelated material ESG issues under one umbrella allowing composite indicators to be created that cover sustainable development, security and human rights dimensions. Such a people-centred approach will offer more clarity for a company's SDG identification and has a high potential to increase social impact framed as a contribution to HS. To achieve this, **it is essential that ESG criteria are stretched and tied to the risks faced by local stakeholders and become material to the business**.

Dimension of Human Security	**Risks to security**	**ESG classification**	**SDG classification**
Economic	Poverty, unemployment, corruption, lack of access to land, water, electricity, credit or good education	Governance and Social	SDG 1, 4, 7, 8, 9, 11, 16 and 17
Food	Hunger, famine	Social	SDG 2
Health	Infectious diseases, unsafe food, malnutrition, lack of access to health care	Social	SDG 3, 6
Environmental	Environmental degradation, resource depletion, lack of access to drinking water, natural disasters including drought or floods, pollution	Environmental	SDG 6, 12, 13, 14, and 15
Personal	Physical violence, crime, terrorism, domestic violence, child labour, injustices	Social	SDG 5, 8 and 16
Community/group	Inter-ethnic, religious and other identity-based tensions, group grievances based on socio-economic & cultural inequalities, lack of social cohesion	Social	SDG 5, 10, 11, 16
Political	Political polarization, repression, human rights abuses, corruption, lack of transparency, injustices	Governance and Social	SDG 10 and 16

Figure 1: Human Security Risks mapped to ESG and SDGs. (Figure by authors)

Towards an operationalization of the Human Security Business Partnership Framework

The aim of the Human Security Business Partnership (HSBP), developed by LSE IDEAS, is to re-set the relationship between companies and communities, and direct their combined efforts to improve HS from the ground up. The HSBP Framework for Action and Innovation proposes a new model of multi-stakeholder collaboration and associative governance between the private sector, local communities, government and other stakeholders that enables the development of more effective responses to complex situations of conflict and fragility.

The partnership provides an essential governance mechanism through which a mutual effort between company and community can determine ESG factors and assess corporate impacts. Each principle provides a 'hook' for the impact assessment process (as well as being intended to shape how companies intervene generally in the local environment). In other words – local, inclusivity, future building, trust-building and sharing principles can each be used as 'meta-indicators' to assess corporate social impact within a context of collaborative working.

Conclusion

Human Security and Positive Peace work together in ways that have positive implications for measuring social impact by businesses operating in FCS, because they recognise the interconnectivity between human rights, security and sustainable development. Their combined use captures the comprehensive and dense nature of 'impact', enabling users to bridge to ESG risks that are closer to the business perspective and **integrating social dimensions alongside environmental and governance aspects**. Another strength is the relational element (focusing on risks to local people), envisaging **impact measurement as an interactive process, conducted jointly between companies and communities, while setting it within a broader context of durable peace and sustainability**, provided by the Positive Peace concept and measurement process.

As a follow-up to this paper, it is proposed to develop an integrated framework for ESG-HS risk informed measurement that shows in more detail **which ESG issue matters most in relation to the various risks local people face and to what extent these issues are material for the company**. HS indicators can inform how ESG actions by companies within the context of the SDGs, can be **risk responsive**, thereby creating impacts on multiple fronts across a wider set of SDGs including on SDG 16 that currently plays an underappreciated role in the eyes of companies and investors. **Such a framework can potentially provide a powerful way of measuring social impact in FCS by combining the strengths of HS and PP.**

The authors conclude that the combined HS and PP approach is capable of determining the materiality of multidimensional ESG issues and they can offer integrated measures that demonstrate the extent of their materiality to the business. This requires an on-going process that can lead to proactive, coherent business processes and making progress on implementation of current guidelines while aiming to set a new ESG-HS standard.