Knowledge@HEC

Number 9 | *The Research Review for Business Leaders* | December 2022 - January 2023

ADDRESSING THE “S” DEMANDS OF ESG

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Summary

Addressing the "S" Demands of ESG

Eloïc Peyrache
General Director and Dean of HEC Paris

Because of Europe's strong social welfare tradition, the social dimension of business has an additional legitimacy and urgency here. Top-quality research and teaching have an essential role to play in understanding growing inequalities which hinder the urgently needed ecological transition, in interrogating the environmental, social and governance (ESG) factors, their interplay and their promise and limitations, in leveraging theory and the most ambitious empirical methods. As a leading business school and research center in France and Europe, HEC Paris' faculty has a responsibility in providing science-based evidence and practical tools to reinvent the business of tomorrow.

HEC scholars work with public and private regulators such as the European Financial Reporting Advisory Group (EFRAG) and the International Sustainability Standards Board (ISSB) chaired by Emmanuel Faber, who recently told HEC students: "Don't quit!". They are joining forces with colleagues from leading European academic institutions in the Business Schools for Climate Leadership collaboration to widely diffuse knowledge and increase awareness. They work with CEOs of the Business for Inclusive Growth coalition (B4IG) and members of the *Institut Français des Administrateurs* (the French Administrators Institute) to develop, test, and evaluate novel strategies, policies and practices designed to tackle inequalities in the field.

In this Knowledge@HEC issue, we share academic knowledge and highlight professional experiences through interviews. Strategy and Business Policy professors Marieke Huysentruyt and Bénédicte Faivre-Tavignot present their research and teaching; Finance researchers François Derrien and Maxime Bonelli reveal their key findings on the effect of ESG reports on employee's investments. Camille Putois, Director of B4IG, and Gilles Vermot Desroches, Chief corporate of Citizenship and Institutional Relations at Schneider Electric, share their view and experiences of implementing ESG and measuring the impact of their initiatives.

Marieke Huysentruyt
Associate Professor of Strategy and Business Policy and Academic Director of the S&O Inclusive Economy Center at HEC Paris

Companies' sustainability or environmental, social and governance performance (ESG) has increasingly become a strategic consideration, a source of unique reputational, financial, and relational competitive advantage. The COVID-19 pandemic, the Yellow Vests protests and other social movements, the deepening and widening inequalities and economic crisis have put the "S" side of business in stark relief. Today, companies are more than ever hard-pressed to be upfront and ambitious about their social impacts. ESG frameworks help companies take stock of their sustainability performance. And they are incredibly influential as they guide investment decisions.

Yet, we are just beginning to make sense of a complex set of ESG frameworks. Working with Standard & Poor's Global Ratings' researcher Bruce Thomson, we find that when it comes to the coverage of the "S" factor, the major ESG frameworks don't all agree or align. For example, while companies are always asked to consider their employment conditions, not all ESG frameworks require companies to consider their social impact along the entire value chain. Yet, companies are part of a system, and thus need to address human rights of supply chain workers and their impacts in the communities where they operate.

In that system, the ecological transition needs to be socially fair to be efficient. As Gilles Vermot Desroches of Schneider Electric notes (p.11): "We won't make progress on climate matters if we do not harmonize our value chain and, therefore, human rights issues. There must be respect to those who work for our suppliers, and for our suppliers' suppliers, etc."

Furthermore, some social challenges, such as the forced migration and refugee crisis, are not covered at all by the ESG frameworks. Being aware of these differences and limitations, knowing which combination of ESG frameworks yields a more holistic view of a company's social performance is a foundational step, a basis for improving our understanding.

Europe is busy preparing a new set of sustainability standards that will become law, in all likelihood around January 2024. These standards will be a game changer as they oblige companies of a certain size to publicly report on a whole host of ESG criteria in a systematic and comparable way. The transparency and broad coverage of all ESG factors (double materiality) surely will help improve the accountability and credibility of business, and push companies to walk the talk.

"The performance of companies in relation to ESG standards helps socially conscious investors screen their investments. Such considerations are becoming increasingly important to investors," note Finance researchers François Derrien and Maxime Bonelli (p.12).

How Will New European ESG Reporting Standards Affect Companies?

The European Commission mandated a group of experts to work on new European corporate social responsibility reporting requirements. Marieke Huysentruyt, Associate Professor of Strategy and Business Policy and Academic Director of the Inclusive Economy Center at the Society & Organizations Institute of HEC Paris, was part of a group that drafted legislation on the question of equal opportunity. She describes how her working group shaped their proposals for a wide, long-lasting impact.

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Early in 2021, the European Commission mandated the European Financial Reporting Advisory Group (EFRAG) to work on new European non-financial sustainability reporting standards to amend an existing, 2014 directive.

The new legislation, the Corporate Sustainability Reporting Directive (CSRD), will standardize non-financial reporting criteria on environmental, social and governance (ESG) factors across the European Union. Now in draft form, it is intended to update and improve on the current directive, enlarging its scope, for example, to include companies of 250 employees and more that operate in the EU. The new directive will therefore apply to some 50,000 companies (up from 11,000 previously), and will have a concomitant effect on company stakeholders, including companies' supply chains — requiring large companies and their associated firms to report on how their activities affect both people and the environment.

The new directive has an ambitious timeline, with the aim that general guidelines be adopted in October 2023 and be applied beginning in January 2024. Sector-specific guidelines will follow one year later.

WORKING ON SOCIAL STANDARDS: CHOOSING CRITERIA

Those working on the directive were divided into nine "clusters," working on one of three broad topics: environment, social and governance. As a Secretariat member appointed by EFRAG and the European Commission, I worked on the second topic, as it applies to a company's own workforce.

We established a set of criteria to delineate the information we would require companies to disclose: namely, information quality (how relevant, verifiable, understandable the information could be); double materiality (we want to require data not only about how societal challenges affect companies' finances but also how companies affect societal issues); reporting boundaries (the same boundaries that companies use to create financial statements, complemented by upstream and downstream value chains); and time horizon (the same used to create financial statements, complemented by retrospective and forward-looking information).

We began our work with an analysis of existing standards and human rights documents, such as the United Nations' International Bill of Human Rights and documents from the UN's International Labor

Organization. This led to the identification of subtopics in the social sphere: working conditions, equal opportunity and other work-related rights.

I worked on the topic of business and equal opportunity, which included consideration of inequality, discrimination, diversity and inclusion, gender, age, disability and other vulnerable groups.

In drafting the disclosure requirements, we looked at relevant international databases, regulations, standards and frameworks, and sought to justify why we chose to adopt — or adapt — existing norms. Our goal was to push toward the internationalization of any valid existing standard.

SOCIAL REPORTING STANDARDS: AIMING FOR QUANTIFIABLE INFORMATION

In our requirements for social reporting regarding a company's own workforce, we ask that companies report on how they affect their own workforce, both positively and negatively, regarding working conditions, equal opportunity and other work-related rights.

We ask for information about the principal actual or potential adverse impacts on a company's own workforce connected to its operations; any actions taken to prevent, mitigate or remediate adverse impacts; as well as the result of such actions. The CSRD requires disclosures of the principal risks to the company, including the company's value chain, and how it is managing those risks. The standards also ask companies to disclose quantitative information, such as the male-female pay gap, CEO pay ratio, employment of persons with disabilities, differences in benefits according to contract types and violations of equal opportunities rights.

POTENTIAL IMPACT OF THE CSRD: A KNOCK-ON EFFECT ON SMEs

Based on powerful human rights treatises, the CSRD governing social questions is asking companies to embody a vision that could have an effect not only on how companies manage social justice issues, but on numerous other practices, such as recruiting, staffing and information gathering. We expect it to have a long-lasting impact.

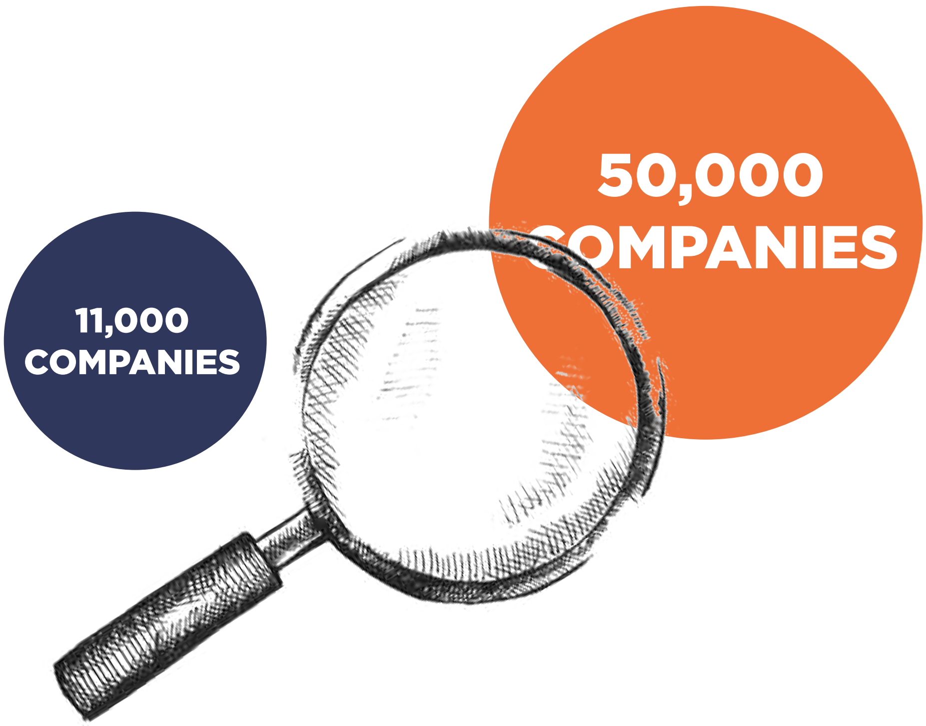
It will have a knock-on effect on SMEs that are doing business with large companies, requiring them to consider ESG issues and collect necessary data.

In addition, the transparency required by the CSRD could for example serve to reduce wage inequalities by making such disparities obvious to all employees.

Furthermore, the voluminous data generated by the reporting requirements will undoubtedly aid researchers to address the question of what companies can do and are doing to contribute to important societal challenges.

PRACTICAL APPLICATIONS

When the European legislation will pass, it will affect 50,000 companies and the companies in their value chain. In its expanded requirement of the information that companies must provide, it has the potential to have not only a cultural impact, but also to affect recruiting, staffing, information gathering, and how companies manage their actions on environmental, social and governance factors.



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What Role the Board Can (and Should) Play

Faced with rising demands from society, it is crucial that companies address their social/societal impact and the board has a key role to play. A report recently published by the ESG Club of the French Institute of Administrators brushes a fresh picture of current social expectations regarding businesses. In this report, the members of the Social/Societal working group put forward recommendations for administrators to understand these expectations and anticipate the effect of social impact on the competitiveness of companies. Bénédicte Faivre-Tavignot, Associate Professor (Education Track Faculty) of Strategy and Business Policy and co-founder of the Society & Organizations Institute at HEC Paris, and also board member, is one of the report's authors. In this interview, she comments on the risks and challenges for companies and for board members.

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A REPORT ABOUT CURRENT TRENDS REGARDING EXPECTATIONS OF SOCIAL IMPACT

In the ESG triad, the "S", for Social responsibility, seems to attract less attention than the "E" dimension. Yet it is just as crucial as the two other criteria and inseparable from them as the most recent report by the ESG Club of the *Institut Français des Administrateurs* (IFA), a French Directors' association, points out.

While traditionally such matters as the ecological transition, human resource management and interaction with the economic ecosystem in general have been the domain of the executive managers, board members can legitimately question, challenge and orient leaders especially since, in the words of the IFA report, the issue is about resilience and the future of the company. "Boards arbitrate between time horizons and must overcome cycles, as violent as they may be", write the authors, who have noticed a growing awareness of the social dimensions amongst board members.

WHAT ARE THE PRECISE INTERNAL AND EXTERNAL EXPECTATIONS REGARDING THE "S" DIMENSION? HOW MAY THE BOARD DRIVE CHANGE?

Regarding internal stakeholders, the report details the very high expectations of young people (in particular those between 23 and 38 years old) to address climate issues and a preoccupation shared across all age classes now : to find meaning in and at work. Many employees are striving for a good work/life balance and are eager for hybrid forms of work, with a balance between in-person and at-home work time. They expect companies to offer them the possibility to grow, through, for example, internal mobility, training, mentoring and efficient talent management.

To truly address all these points, "window dressing" will not do, and "a transparent, motivated and quantified roadmap" is required, warns the report. It sketches out structuring actions in terms of organization, talent management, well-being at work, and so on, with suggestions of initiatives to engage employees in operational projects, identify and retain talents, shift towards new forms of work contracts, and many other ideas.

Regarding external stakeholders, the report highlights growing pressures. For example, the Duty of Vigilance law was voted in France in 2017 and should be finalized at the EU level soon. According to this law, companies should be held responsible in case of serious violations of human and environmental rights in their own activities or within their supply chain. Today, more and more NGOs and communities sue companies mentioning this duty of care.

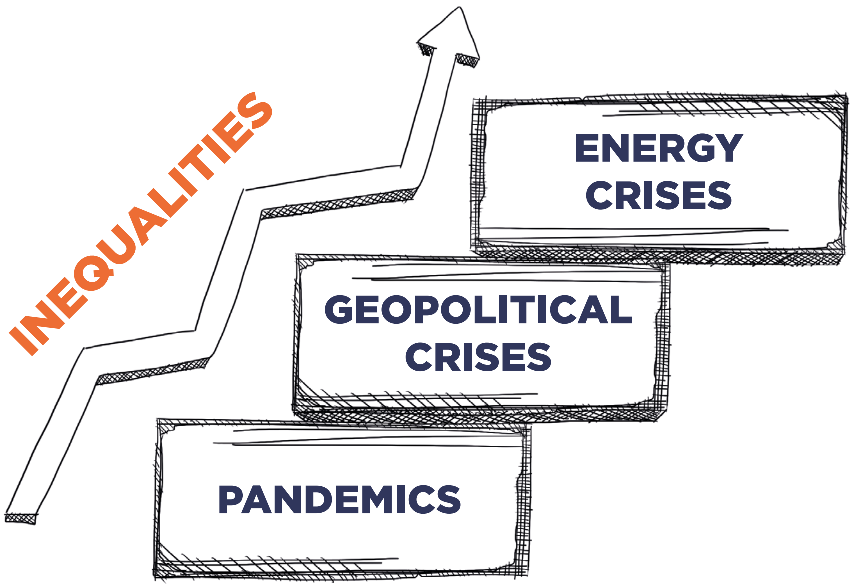
At the EU level again, the EU Corporate Sustainability Reporting Directive (CSRD), due to be adopted this year, should require all companies employing more than 250 people to report their social/societal impact using precise criteria. One of the objectives is for investors to be able to compare performance from one company to another including non-financial performance.

More broadly, inequalities tend to rise due to the pandemic, and the current geopolitical and energetic crisis. They can be violently impacted by the ecological transition, as shown during the Yellow Vests movement, which was triggered by the introduction of a new carbon tax. These rising inequalities tend to fracture our society and lead to growing discontent. This is why it is gradually becoming a necessity to share value more fairly.

DOES THIS MEAN WE ARE MOVING AWAY FROM SHAREHOLDER CAPITALISM AND TOWARDS STAKEHOLDER CAPITALISM?

Officially, we are moving towards stakeholder capitalism, as reflected by the US Business Roundtable of 2019, and by France's "Loi Pacte". But the mindset of many economic actors still remains focused on the shareholders supremacy… And I do believe that even stakeholder's capitalism is not enough considering the climate and biodiversity urgency and rising inequalities. There are trade-offs, companies prioritize some stakeholders, such as investors who are putting pressure, whereas poor workers in Africa, way down the value chain, aren't heard. So today we need companies to lead a deeper transformation, to redefine their purpose and transform themselves, creating a much more inclusive mindset.

Some business leaders have understood that rising inequalities are not sustainable and not beneficial for their business. Some of them even understand that at one point the "S" dimension could even become a source of competitive advantage. The lack of understanding and anticipation of the "S" factor as a systemic risk by many leaders can be a huge risk for them in the medium term, impacting their resilience and competitiveness.



RECOMMENDATIONS FOR ADMINISTRATORS

• Stay informed, get training
The board must set up efficient, durable information circuits to monitor social changes within the company, and relate them to global social trends that may affect the company.
For this, the board may rely on information channels such as the HR department, social media, or direct employee expression, or may invite external experts to board meetings.

• Anticipate and alert
Thus better informed, the board should be able to anticipate and adapt its support to the management team's strategy, in line with the company's mission.
To integrate its business and social strategy, the board must have at its disposal relevant indicators, and a clear operational chart, in order to alert managers if board members believe a course of action needs to be corrected.

• Change
The board must adapt its composition and rules to the company's social ambitions, for example members could rethink their roles and added value.
The board could change membership rules to better reflect the age, expertise, geographical make-up of the company as a whole, and work in a collaborative spirit to display an inspiring, inclusive leadership.

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Spotlight on the Social Dimension Measurement in ESG

Three HEC academics joined forces with an S&P Global social specialist in ESG research to bring out a landmark report on the social factors covered – and not - in ESG frameworks. "What Gets Measured" challenges traditional coverage of the social dimension in corporate ESG frameworks and suggests ways to ensure that what gets measured "matters for businesses and the people and communities they impact". We talk with HEC professor and co-author Marieke Huysentruyt.

Marieke Huysentruyt

This report focuses on the 'S' of ESG, environmental, social and governance issues. This incorporates many issues such as workers' rights in the supply chain. WHAT ARE FOR YOU THE MOST IMPORTANT ONES?

Well, that's a good question. We consider a firm as part of an ecosystem, and so if we want to understand the social dimension of a firm, we need to consider its entire value chain. That means we not only look inside the firm - for instance, at the working conditions, work-related rights and equal opportunities in the workplace - but we also look at rights and justice for workers in the supply chain, the impact that the firm has in the communities where it operates, on its end-users or consumers and the wider society. It's hard to single out which of these domains is most important. Traditionally, we've been focused first and foremost on employment practices, but now is the time to really open up and take stock of firms' social responsibility, the social role they play in a more holistic, comprehensive way. What's even more disconcerting is that the social dimension of firms has often been neglected, even outright ignored. This is in part because taking stock of the social scope of a firm can be quite complex, at times political and conflictual. Compared to say carbon emissions, measurement of a firm's social impacts is less standardized, and there is little agreement about which topics should be covered. As a result, I believe companies have stayed away from the "S" of ESG for too long. But in my opinion, this is bound to change. There has been a huge wake-up call in the past few years.

"We've seen the protests of the Yellow Vests and #metoo, and the Covid-19 crisis has certainly accelerated the movement to challenge what companies are doing in terms of their social dimension."

In fact, I believe that a company's social scope will become a critical driver of comparative advantage. Going forward, excellence on the social dimension may well make or break companies.

You collaborated with two fellow HEC professors, Leandro Nardi and Bénédicte Faivre-Tavignot, alongside S&P Global social specialist, Bruce Thomson, in a scientific approach to the issue, building a database to analyze the social factors in 18 ESG frameworks. COULD YOU DESCRIBE THEM?

The database we created brought together all the major ESG frameworks, on which there is detailed information publicly available, with a broad coverage and criteria that are sector-agnostic. And then, we sought to identify the dimensions along which these frameworks agree and differ. Our central question was: 'How can we make sense of those points of conflict and consensus?'.

In this study, you give 4 reasons for the blockage of social issues: business doesn't understand exactly what are social issues; the treatment of social questions is superficial; the measurement matrix and data is poor, and social dimensions are dominated by the "E" and "G" issues. HOW DID YOU ANALYZE

THESE CHALLENGES?

The first step was to take stock of which are the topics that are considered to be valid topics to have better understanding of what is the social impact of a company. Then, as I mentioned earlier, there's the question of how do you actually measure these? We also considered the synergies between environment, governance and social questions. These frameworks force us to consider those different dimensions as stand-alone dimensions, but of course what becomes very exciting is when there are major changes like the question of climate refugees. It's clear that they bring into play social issues that companies are confronted with, cutting across different topics and connecting with the environment and social challenges. However, the biggest obstacle we meet is the problem of coverage. It's the foundational problem. But then once we go beyond this paper, we discover that there are other issues. For example, do we use qualitative or quantitative measures, should they be comparative across firms, and so on? We are just beginning to make sense of what today is a very complex set of ESG frameworks, frameworks which are incredibly influential. Going forward, they guide investment decisions and investment resources of companies in terms of priorities.

IN ANOTHER INTERVIEW YOU SAY THAT LEADERSHIP IS AN IMPORTANT FACTOR IN MOVING ESG ISSUES.

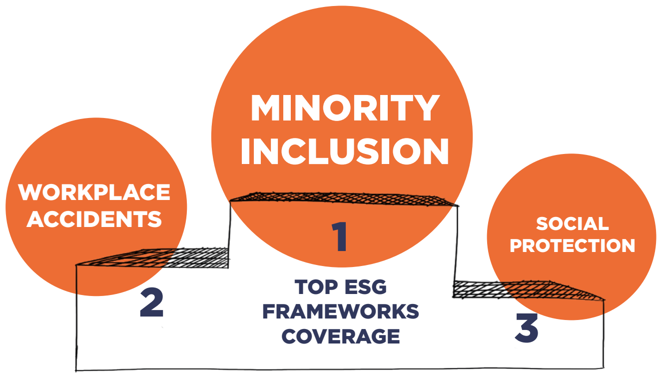
Yes, I believe leadership matters a great deal because it can create urgency. When it comes to advancing the social scope of business, I think the most appropriate posture for leaders is one of openness and humility. Practicing humility helps leaders embrace and accept uncertainty. It leads them to adopt a complex systems frame, be more willing to search for solutions to complex societal challenges in partnership. So, managers who want to excel by optimally setting the social scope of the firm are well advised to practice humility. One thing you should know is that when it comes to ESG frameworks and reporting, it's a necessary condition to have a leadership that is ready to acknowledge its starting point. This is, in all likelihood, suboptimal, far from perfect, but it also has the capacity to improve. ESG frameworks can help companies do exactly that – find ways to make progress. ESG frameworks make gaps or shortcomings more visible. Then, they encourage companies to regularly monitor and report on progress to all of their stakeholders.

THE DEBATE HAS EVOLVED IN TERMS OF THE RESPONSIBILITY OF BUSINESS. AS YOU POINT OUT IN YOUR PAPER, IT'S GONE FROM WHETHER COMPANIES SHOULD ENGAGE IN SOCIAL ISSUES, TO HOW THEY SHOULD ENGAGE.

Well, there's still quite a lot of distance to go. It is fair to say that today's major social problems – like growing inequality – challenge the credibility of business. And so, the conversation about should companies get involved is not over yet. There are still many companies that want to get their CO2 emissions down first and foremost and will do everything necessary to reach that objective, maybe to the detriment of human rights. So, we need to stay vigilant and keep pressing for action. At the same time, a growing number of companies are convinced that inequality matters and that they have a role to play, complementing robust political response. These companies often start with relatively well-defined projects, tackling one issue – for instance, making their goods accessible to the poor, not necessarily addressing the full value chain. What I find fascinating though is that engaged companies are increasingly building or joining ambitious coalitions, like *Les Collectifs* in France or the joint B4IG-WBCSD platform internationally – eager to tackle inequalities. There, you see companies putting their heads together, exchanging best practices about many social topics simultaneously– from living wage over forced labor and just transition.

FINALLY, LOOKING FORWARD, HOW DO YOU WANT TO TAKE THIS RESEARCH FURTHER, YOU AND YOUR ACADEMIC COLLEAGUES AT HEC WHO WORKED ON THIS REPORT?

Well, ideally what I would love to do is to work with many companies and many different organizations to test different ways to accelerate and change certain practices, managerial practices or even production processes. That could help a company to strengthen their social impact. I would like to test and experiment different ways of changing the status quo because I think that it will probably be part of the answer: developing new ideas, rigorously testing those in the field. In this way, the best and most promising ideas can be scaled up with a clear focus on how we can create a society that creates opportunities for all, inclusive, respecting justice and human rights principles that generate and share benefits fairly with everyone.



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A CEO-Led Coalition Works with Researchers to Measure their Impact on Society

Camille Putois is the CEO of Business for Inclusive Growth (B4IG), a coalition of more than 40 global businesses, representing 4.4 million employees. She discusses how this coalition strives for more inclusive practices and navigates the pros and cons of the different methods to measure progress on this crucial topic. For this, she worked with Leandro Nardi and Marieke Huysentruyt, researchers at the HEC Paris Inclusive Economy Center.

Camille Putois

CEO of Business for Inclusive Growth (B4IG)

WHAT IS B4IG AND WHAT IS ITS GOAL?

B4IG is a CEO-led coalition of companies united in the belief that they have a critical role to play to ensure inclusive growth and build a more sustainable economy. It includes Unilever, Danone, L'Oréal, Microsoft, Mars, Hitachi, Ricoh, etc. Our strength lies in our work with public and governmental partners, and our strategic partner, the OECD. We also partner with the International Labor Organization, trade unions, foundations, etc. The coalition aims to scale up business action on inequality, by advancing human rights, building inclusive workplaces, and strengthening inclusion in companies' value chains and ecosystems. The challenge today is to know how companies should go about making change.

WHAT ARE WAYS IN WHICH B4IG SEEKS TO EFFECT THESE CHANGES?

When it makes sense, our CEOs take a position or make a statement. In June 2021, for example, B4IG adopted a strong statement on the living wage, saying that companies must ensure that workers within their own organization and in their supply chains are paid a living wage. Another important statement in connection with COP26 was that companies should not forget the social dimension of their climate policies, and should anticipate, assess, and manage the negative social impacts of their actions. We also develop tools to help companies adopt more inclusive practices. For instance, we recently published concrete, practical recommendations (on ethnic diversity and inclusion, etc.) resulting from two years of work. Finally, we lead actions on the ground that bring together a handful of member companies for specific projects. Last week, for example, we kicked off a project in the United Arab Emirates to ensure fair recruitment practices for migrants coming from Southeast Asia.

HOW HAVE YOU BEEN WORKING WITH HEC RESEARCHERS RECENTLY?

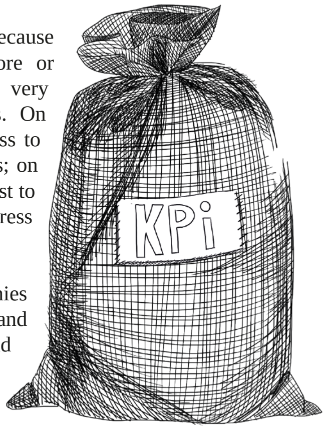
Each working group at B4IG is led by one or several member companies, and partners such as trade unions and academics participate to their meetings. The Impact Measurement working group aims to share knowledge on advanced methodologies for measuring impact and to encourage companies to pilot them. Leandro and Marieke have helped this group assess the pros and cons of the various methodologies. They talked about the four channels through which companies' impact measurement can be linked to social value creation: to signal an impact purpose, to create management tools to monitor the performance of the target populations, to assess causality, and to work out welfare gains. We discussed the central problems of using impact measurement tools: that they differ across projects, vary in their ability to assess causal impact, and can have high costs.

Leandro and Marieke have been helping us in collecting and creating a set of outcome and output indicators to cover each area of the pledge, based on indicators used in cutting-edge academic research on this topic, particularly in economics.

They have contributed to our working group focusing on helping young people access the labor market. Most companies support young people by offering, for instance, training and apprenticeships, but only a few of them measure the impact of these initiatives. The HEC team designed a questionnaire for companies to fill in and analyze their corporate policies. They provided recommendations on robust output and indicators to evaluate the outcome of their policies.

It's interesting but challenging because there are several methodologies, more or less advanced, and companies are in very different places with respect to this. On some topics, there is a high willingness to collaborate and share valuable insights; on others, companies see a strategic interest to differentiate themselves and make progress on their own.

The good news is that ever more companies recognize the need to try to improve and evaluate the social impact they have, and to be transparent about it.



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Schneider Electric: Testimonial of an ESG Leader

Schneider Electric (SE) is a world leader in energy management. Corporate Knights ranked it the world's most sustainable company in 2021. Knowledge@HEC met with Gilles Vermot Desroches, Director of Corporate Citizenship and Institutional Relations since 2020. A trained engineer, he has been designing Schneider's sustainability for the last 25 years. He discusses the company's understanding of ESG, its strategic efforts to develop its performance, and how to measure their impact.

Gilles Vermot Desroches

Director of Corporate Citizenship and Institutional Relations at Schneider Electric

WHAT PROMPTED SCHNEIDER ELECTRIC TO GO DOWN THE SUSTAINABLE DEVELOPMENT ROUTE?

Sustainable development arose from an assessment of environmental and social challenges, and a dialog with a certain number of investors. They were the first to question the company about its environmental and social practices and their contribution to the 17 UN Sustainable Development Goals (SDGs).
While shareholders are obviously interested in the company's profitability, they are more and more convinced that ESG commitments bring added value, innovation, differentiation and encouragement to mobilize teams, attract talents and customers. How did we achieve that? We have transformed our strategy, and, to do that, it was key to interact with institutes. For example, we applied the "reverse innovation" theory by working with HEC Paris researchers.

DO YOU THINK THE EU REGULATIONS ON STANDARDIZING ESG CRITERIA ARE USEFUL?

Some large companies are indeed committed; they have come up with numerous innovations and are drivers for other firms, clients, suppliers, investors, and civil society, etc. But you can never win in sustainability if you are alone. It's a question of value chain, of emulation. We collaborate more by sharing the same measuring tools. A company has no future if it doesn't innovate, and we innovate together. Taking ESG ranking into account to measure progress makes us able to review our practices on a regular basis and understand shifts in key trends, and gives us a more rational shared vision.
For instance, while SE may be ahead of the game on environmental matters, having published its pledge to move towards carbon neutrality in 2015 for COP 21, we now feel it's the human element that needs strengthening. It needs strengthening because there can be no environmental transition if it is not fair, because this transition cannot happen if we don't carry everyone with us, if we do not harmonize our value chain and, therefore, human rights issues. There must be respect to all our staffs, as well as those who work for our suppliers, and for our suppliers' suppliers, etc. That's why in early 2021 was created the Schneider Electric Corporate Citizenship department. It embodies the following vision: the planet has to be saved, and its inhabitants too. If the transition is not inclusive and fair, it will not allow people to build their future.

CAN YOU SHARE SOME EXAMPLES OF SOCIAL INITIATIVES SUPPORTED BY SCHNEIDER ELECTRIC?

In 2004, SE implemented a goal of providing social insurance for all collaborators, and their families, and this in more than 100 countries. SE pioneered this measure, which became essential by 2020 for the 8,000 major companies in the race for ESG ranking.
Then there is also the responsibility to train and help each generation to be part of the energy transition. For SE, this is also a way to anticipate the skills of tomorrow, which are vital for the energy transition as well as for the company's renewal. Notably, this is why SE commits to train one million young people, especially from the bottom of the pyramid, in energy skills all over the world.
Education is an essential catalyst for the youth inclusion and for a just transition. Skilling and empowering them enables them to actively define their future and their place in a complex and fast-paced world. This commitment is something of a flagship for all we are doing.

WHAT WAYS HAVE YOU FOUND TO MEASURE THE RESULTS OF YOUR SOCIAL INITIATIVES?

I believe that everything can be measured if the ESG strategy is a good one.
Since the early 2000s, SE has set a continuous improvement process in its practice. The Group defines specific objectives that are measured quaterly and audited yearly by a third party. In 2020, SE defined six new pathways for the 2021-2025 period in a dashboard named the Schneider Sustainability Impact (se.com), with 11 precise goals. One of them is to create equal opportunities with two quantified commitments. The first one is to increase gender diversity in hiring, and the other one is to provide access to green electricity to 50 million people.

Believe me, the more ambitious the indicator, the greater the progress! And measurement is key.

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Do Employee Shareholders Care about their Employers' ESG Performance?

The Environmental, Social and Governance (ESG) performance of companies has become an increasingly significant factor influencing investor sentiment in recent years. But does this hold for all investors? A recent study by HEC Paris Finance researchers Maxime Bonelli and François Derrien, with Marie Brière, Head of Investor Research Center at Amundi Asset Management, investigated the response of French employee shareholders to ESG performance through their personal investment behavior in their employers' share schemes. The results show that these employees have a distinctly different response to the ESG performance of their employers: one that is focused on their personal welfare.

Maxime Bonelli
PhD Student in Finance
HEC Paris

François Derrien
Professor of Finance
HEC Paris

Employee shareholders can represent a significant investment group in certain companies. In the US, employees own 8% of the stock in their companies. In France, around 51% of all employees have access to employee stock schemes and in 2018 their shareholdings represented approximately 3.5% of the total capital of French firms. But to invest, do employees need to love their company and approve its ethical performance?

GROWING ETHICAL CONCERNS FOR INVESTORS – BUT WHAT ABOUT EMPLOYEES?

The performance of companies in relation to ESG standards helps socially conscious investors screen their investments. Such considerations are becoming increasingly important to investors. But we wanted to find out if this is true for all elements of the investor community, particularly for employee investors.

In theory, employee share ownership should be a motivational tool for workers as well as a useful savings instrument for the employee and a potential source of finance for the company. Such schemes are widely encouraged through tax breaks and other government incentives.

Our quest was to better understand to what extent the ESG performance of a firm affects its employees' loyalty. So, we decided to analyze the willingness of employees to invest in their business's stock as a function of its ESG performance.

Our hypothesis was that an employee's decision to buy the stock of their employer reflects their satisfaction with the firm's policies. Increased employee satisfaction leads to increased employee loyalty and, this in turn, leads to an increased willingness to invest in the company through stock ownership rather than other investments.

To explore the link between employees' investment decisions and the ESG practices of their employers, we were able to access an anonymized dataset on French employees enrolled in company-sponsored savings plans. The data was supplied from Amundi Asset Management, the leading asset manager for employee savings plans in France that manages some €66.8 billion in employee assets. It enabled us to analyze the monthly investment behavior of more than 380,000 employees.

To measure the ESG performance of the companies, we collated ESG incidents recorded in the RepRisk database. RepRisk screens media, stakeholders and third-party sources for news and information related to companies' ESG practices providing daily counts of negative ESG news at the company level. The ESG data is also classified in distinct ESG issue categories. Essentially, we used the RepRisk negative news count as a proxy for negative ESG practices and then investigated how this relates to the investment decisions of employees.

NEGATIVE ESG NEWS TURNS EMPLOYEE INVESTORS OFF

We first found that employees are significantly less likely to invest in their company, or invest considerably less, following negative ESG incidents. Our analysis of the data, when controlling for other factors such as cyclic economic and company characteristics, indicates that the likelihood of an average employee investing in their company stock drops by eighteen percentage points (46% relative to the full sample mean) when the number of negative ESG incidents at the company doubles over the year.

In cash terms that is an average individual reduction in investment of €377 over the year. This is economically significant and large relative to the typical annual employee investment in their company's stock of around €500.

We also wanted to better understand the motivation behind these investment decisions, and could understand the factors more precisely behind investment behavior and to relate it to the three classes of ESG performance.

ME, ME, ME?

We found that these investment decisions did not respond to governance-related events, and, in some cases, even appeared to respond positively to negative environment-related incidents. With further analysis, this astonishing result was largely driven by employees working in more polluting sectors, whose loyalty with respect to their employers appears to increase following negative environmental incidents.

Overall, we found that the satisfaction and loyalty of employees is unrelated to the environmental performance of their companies. We also found that employees who tend to invest in Socially Responsible Investment funds and younger employees – both factors associated with greater environment consciousness – are only slightly more sensitive to negative ESG incidents involving their company.

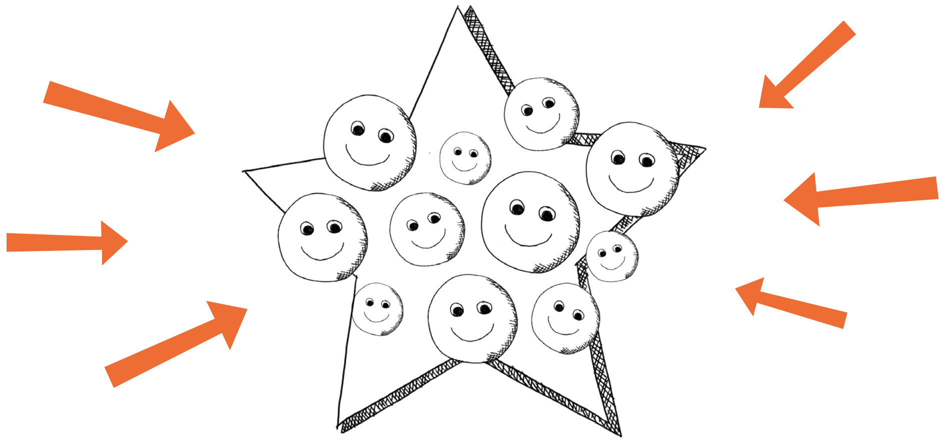
Actually, the most important drivers of investment decisions were related to social-related reports such as overwork, low remuneration, spying on workers, harassment, employee suicides, or discrimination against trade union membership.

Among these social incidents, those relating directly to the employee's own working conditions were the most likely to influence investment decisions. We also found that French employees respond much more to such social events occurring in France than those happening in the same company but abroad.

Our findings suggest that employees' decisions are driven mostly by ESG practices that directly affect their everyday life. Personal benefits are the key determinants of employee satisfaction and loyalty with respect to their employer. Employees, it seems, are not altruistic, but focus on their own self-interest rather than wider ESG factors when considering their investment decisions.

Contrary to other studies and current views of investor decision-making, our empirical evidence suggests that overall investors tend to monitor the ESG performance of companies, and this is a significant factor in their investment decisions. However, a specific class of investors, the company employees, clearly have a tight focus only on their own well-being.

With the increase of employee activism, it is important to understand whether employee interests are aligned with those of shareholders and other key stakeholders. These results can improve our understanding of the trade-off faced by firms between the benefits associated with employee shareholding and any potential tension this could create with other dimensions of the business.



Based on an interview with Maxime Bonelli and his working paper, "Altruism or Self-Interest? ESG and Participation in Employee Share Plans" co-authored with François Derrien of HEC Paris and Marie Brière of Amundi Asset Management.

READ THE LONG VERSION ON KNOWLEDGE@HEC

Teaching Inclusive Economy at HEC Paris by Challenging Organizational Beliefs

At present, companies understand the urgency to act in favor of the protection of the planet by reducing their carbon footprint but do not often see the business case underlying social impact. Yet businesses that fail to act on social and economic inclusion will find it harder and harder to operate. This is why it is crucial to teach new ways of building strategies to reduce inequalities and fight against poverty. Bénédicte Faivre-Tavignot explains how this emerging subject is taught at all levels at HEC Paris in order to change organizational cultures from within.

Bénédicte Faivre-Tavignot

Associate Professor (Education Track Faculty) of Strategy and Business Policy and co-founder of the S&O Institute at HEC Paris

WHY SHOULD BUSINESS CARE ABOUT SOCIAL IMPACT?

Climate change is accelerating, with consequences on biodiversity. But widening and rising inequalities are a major threat to our society too and hinder the urgent ecological transition. However, there is growing awareness and increasing pressure on companies to act. These come from multiple directions, including from regulators, financial institutions, the younger generations and consumers. Failing to address social impact will mean failing to attract young people, as well as many other risks.

Some companies understand the link between climate change, biodiversity and social inequality, and the systemic risk linked to rising inequalities, including pioneers such as Danone and Schneider Electric who co-created in 2009, with other companies, the Action Tank Social Business, an incubator of social businesses led by big companies together with civil society's organizations and public actors. But many other companies simply still do not see the business case for change, on the "S" dimension at least.
The impact of the Yellow Vests Movement in France is increasing pressure on the French government regarding lower standards of living, highlighting the rising social discontent that is apparent in France and beyond. We do believe that there will be no ecological transition if no social transition happens, and that business has a role to play in the transition.

IN WHICH FUNCTION OF BUSINESS IS IT URGENT TO ACT?

Nearly all functions are concerned with the social dimension. Key functions are probably R&D and marketing, as they start with products and services design, based on precise life-cycle analysis. Similar to environmental life cycles, social life-cycle analysis should also be developed, leading to new design practices.

Then in supply chains, where social impact can be very detrimental, sustainability is possible, but is challenging to address. Raw metals are materials used to manufacture many different devices, in the digital economy or the 'green' business. Their extraction leads to poor working conditions for workers and pollutants impacting the health of employees and the biodiversity. Yet the business community prefers to turn a blind eye because changing requires revolutionizing too many areas.

Over time it is becoming increasingly difficult for businesses not to take this seriously, especially as the US and EU have enacted binding legislation. In France, companies must comply with the "Duty of Vigilance" law, a moral duty to respect human rights and minimize adverse environmental impacts. In Europe, the EU Corporate Sustainability Reporting Directive (CSRD) will require all companies of more than 250 employees to disclose their environmental and social impact at the start of 2024.

Thus, in higher education, finance and accounting disciplines are undergoing a profound transformation, where professors, sometimes challenged by their students, decide to further their course on these new standards. For example, HEC Associate Professor Luc Paugam, recently trained on extra-financial rating at the CFA Institute, will teach the evaluation of companies with regard to ESG criteria in his course on financial reporting.

WHAT INDICATES THAT THE PURPOSE OF AN ORGANIZATION - DELIVERING SHAREHOLDER VALUE - IS CHANGING?

The Friedman doctrine with its shareholder theory, is progressively losing weight. Pressure from regulators and NGOs is taking hold. Critically, at the end of 2019, the Business Roundtable released an Updated Statement on the Purpose of a Corporation, diverting away from shareholder primacy in the USA. This explicitly outlines responsibilities of companies to customers, employees, suppliers, communities and shareholders. The 181 CEO signatories committed to leading their companies in this way. In parallel, companies are moving towards a regenerative business approach (i.e. quitting extractive business models to find ways to make positive contributions for nature and society).

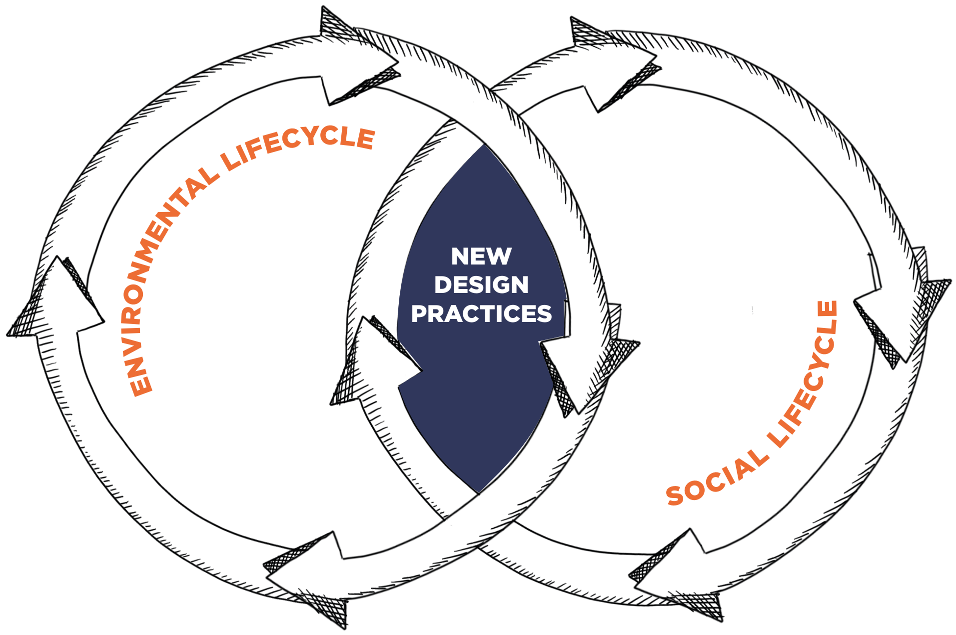
HEC Paris also has an important role to play in changing organizational cultures, by training its students to think in more sustainable ways and, moving forward, bring a new mindset into organizations moving forward.

HOW IS THE ENVIRONMENTAL AND SOCIAL TRANSITION TAUGHT AT HEC PARIS?

HEC Paris has a responsibility and is committed to integrate the great challenges of the social and ecological transition in all programs. Recently, we developed a compulsory course for all first-year students called ‘The Planetary Challenges’, to enable students to develop critical thinking skills around socio-environmental issues, with a focus on the interlinkages between climate change, natural resources and social inequalities. It aims to advocate a new way to look at business—within planetary boundaries and taking into account fundamental social needs.

For the executives, we launched the Executive Master Change and Sustainability, which includes the Sustainability Essentials Certificate, built in partnership with the Stockholm School of Economics. Participants learn how to turn sustainability into opportunities and identify innovative sources of competitive advantage and value creation. They understand how each key function of the company is being impacted by the sustainability approach, and how it can transform through disruptive business models.

We also co-created the program “Lead Campus, Sustainable Leadership in Africa” training managers and leaders based in Africa on business and sustainability. We lead it in partnership with the French Development Agency (AFD), the University Muhammad VI in Morocco and the University of Cape Town in South Africa.



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