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# ESG Now Podcast

# "Does Social Matter?"

**Transcript, 26 July, 2024**

**Mike Disabato (00:00):**

**What's up everyone, and welcome to the weekly edition of ESG now, where we cover how the environment, our society and corporate governance effects and are affected by our economy. I'm your host Mike Desto, and this week we try to answer another age old question for you in 10 minutes. Is the social pillar in the ESG ratings model that we have a useful factor to focus on when investing. So thanks as always for joining us. Stay tuned. One could argue the social pillar in our ESG ratings model is more nebulous than the environmental or governance pillar. Social denotes a concern around how a company and its products affects and are affected by society. And society is a multifaceted thing, not something as easily defined as say a ton of CO2 or whether the chair of the board is the family member of the company's CEO. That perception of a measurability can lead to skepticism from an investor when talking about the social pillar in our model,**

**Liz Houston (01:03):**

**When I speak to people, I do find that the S pillar, the social risks that a company faces and their management of them, there's so much more skepticism around whether that can be financially material for companies. Then I think there is instinctively for the environment or governance. That**

**Mike Disabato (01:25):**

**Is Liz Houston, my colleague and one of the guests for today's show. What we were talking about was the study that she completed on the financial performance of the social pillar, along with Hin Wang, who's the other guest on today's podcast and another of their colleagues, Shah, who is not going to be on today's podcast, but was very involved in the study and very much deserves a mention. Now, initially I had asked Liz to tell me how social factors are perceived in the market, and she thought they were sort of the ignored middle child of the ESG acronym,**

**Liz Houston (01:58):**

**And I think some of that is a kind of underlying fear that anything to do with social must be vaguely political or too wooly to actually be taken seriously. There's a fear that it's just a bit too touchy feely as a subject, and I think this stems from an understanding, a misunderstanding of what's actually in a social assessment of a company. So when you start talking about the underlying risks and opportunities that we're looking at, people suddenly relax because there's a feeling that actually, yes, I do instinctively understand that these things can be material for a company. So if we look at human capital, so instinctively, do you think that the productivity of a company's workforce will have an effect on their profits or could have an effect on their profits and people say, yes, actually that makes complete instinctive sense to me. Do you that a company's products, do you think the quality of those products or their safety record is likely to be material to their profitability? And people say, well, yes, I completely get that case. Like Boeing, people understand, oh, I see product safety and quality can be material to a company's results. So taking the time to speak to people about the**

**underlying risks that we are looking at makes a huge difference to how they feel about the social risks overall.**

**Mike Disabato ([03:31]):**

**Those risks are grouped into themes in our social pillar that are then broken down even further. And the breakdowns of the themes themselves try to capture, for example, how a company treats its employees or whether a company's relationship with local communities could impact its license to operate. We also look at social opportunities, whether or not companies are well positioned to benefit from we call social trends. Now of course not all of these things that we look at are relevant for all companies. Mining companies, for example, they need to think about how protests could disrupt operations. Banks on the other hand, need to think about consumer financial protections and so on. But that difference there brings me to the next criticism that people throw at social. They say it's complicated when you're looking at climate change, for example, there's a reassuring scientific metric that people can rally around carbon emissions and focusing on one metric may be an oversimplification, but simplicity could certainly be alluring. So what goes into an analysis of financially, material, social risks and opportunities, and is there any of that alluring guiding metric that we could point to?**

**Liz Houston ([04:41]):**

**I think we do have to concede that point on the social pillar that there isn't one killer metric that's going to answer all of your questions and be the answer to all your problems. So the data that you look at will vary depending on the risk that you're assessing. That doesn't mean however that it's subjective. So some examples of the kinds of data that we would look at would be hours lost to injury, regulatory warnings, product safety recalls, external certification rates, or even things like the nutritional content of your food products to see how aligned you are with trends to healthier eating. So you do have to tailor the information that you look at by the question that you're asking, but you absolutely do not compromise on the quality of the answer. With**

**Mike Disabato ([05:29]):**

**The ESG ratings model, the quality of the answer is partially seen in how financially material it is. Can we tailor the fabric of society into a useful signal that one might want to use to assess market performance, prove that not being an as to your employees and actually helping them grow and feel useful and part of a wonderful system whether those sort of human capital development factors are actually good business. In short, can we show that there is a relationship between the social pillar and market performance, and is that relationship seen across the globe or is it just that social issues are important for some regions and less important for others? Now, again, we're talking about market performance here, not in the real world. Well, here is where Chin Chin is going to come and be the next guest because she's the best kind of financial fundamental analyst, the one that will agree to be recorded.**

**Xinxin Wang ([06:22]):**

**What we found is that companies that score high on the social pillar in M-S-C-I-E-S-G rating outperform their lowest scoring peers across all major regions over the last 11 years. Not only that, we also found that the highest scoring companies on each of the three themes on which we assess social risk, which means human capital, product liability, and stakeholder opposition outperformed the lowest scoring over the past five years. And off the social pillar themes, we found that human capital was the most widely relevant for companies. Perhaps unsurprisingly, given the near universal importance of the employees.**

**Mike Disabato ([07:13]):**

**It's not that other factors weren't useful, it's just that human capital development within the social pillar showed the most relevance for historical market performance. And since it's the most relevant, I just wanted Liz to jump back in and give a good solid definition so it can stick into your mind like glue.**

**Liz Houston ([07:29]):**

**We are looking at a company's ability to get the best out of its employees, whether they're their own employees, whether they happen to exist in the supply chain, whether they're contractors, but it's things like, do you have the best employees? Can you attract them? Are they leaving in their droves after very short periods of time? Are they safe while they're at work or are things like injuries and fatalities going to disrupt your business?**

**Mike Disabato ([07:57]):**

**Okay, good. Thanks to the human encyclopedia, that is Liz Houston. We all know what human capital development is and maybe we have a better insight as to why it is so relevant in assessing past market performance. Now, there's one other really interesting thing about this data that's its shape. It created a straight upward line on the graph from point A to point Z, a linear line, and sure, that seems pretty tame as far as interesting things go, but I thought it was pretty surprising to see and so did Liz.**

**Liz Houston ([08:28]):**

**Honestly, it's not often in life that you see one of those charts that goes bottom, left, top right in almost an unbroken fashion. So if you think about the study period, so this is 2013 through today. If you think about the number of market regimes that we've had during that period, we've had extremely low interest rates. We've had geopolitics, we've had a pandemic, we've had interest rate shocks, inflation, all of the different things that have happened to the broader market during that period do not seem to have impacted the ability of the S pillar to be an indication of performance gap between the best and the worst companies out there. That's kind of surprising to me. It's just marched on regardless.**

**Mike Disabato ([09:20]):**

**When I asked hin a similar question, she focused on not so much the data as you might expect, but on the durability of the social theme as an important investment strategy. One that remained even as other investment themes are getting more attention**

**Xinxin Wang ([09:36]):**

**Nowadays, the buzz is all around climate change and energy transition, and that's drawing the investors' attention, myself included. But if you think of it, human capital is really in the center of all of these. It's the bare rock of everything that we do, and it's not surprising. Maybe it's perhaps it's unsurprising to actually see that the market consistently value this key element even as investment themes come and go. And that's what is surprising to me. Also, as a reminder to all of us that despite the ever-changing trends, the contribution of people is always recognized and appreciated by the market. So that's what's really surprising to**

**Mike Disabato ([10:23]):**

**Me, right? The attention the environment has gotten from the investment community I think is very justified as well as governance. But we can't forget the main purpose here of everything the economy is supposed to set up to help people live more comfortably and freer from burden. Now, sure, the social pillar is an attempt to measure any of that, but it does concern people and their working environments, and it shows that those companies that respect and protect their workers, that consult communities before starting projects that may upend their livelihoods, those companies perform better than their more obtuse peers. Now, of course, it's annoying to need to give a financial justification as to why you should treat your workers well or the community that you operate in, but annoyance does not negate a reality that you seem to need to do that. So let's at least rejoice in a way that the data shows the importance of the social pillar, or at least I'm going to do that. And that's it for the week. I wanted to thank Liz and Chen for talking to me about the news with a sustainability twist. I wanted to thank you so much for listening. If you like what you heard, don't forget to rate and review us. That puts us up on podcast lists and more people can find us. And if you want to hear myself or any of the other ESG now podcasts every week, don't forget to subscribe wherever you get your podcasts. Thanks again and talk to you soon.**

Speaker 4 (11:58):

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