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ESG and the battle between compliance and the "S"

In 2019 Shell had more Greenhouse Gas (GHG) emissions than the country of Japan – the world's third largest economy in nominal Gross Domestic Product (GDP) terms.

Shell and all its peers in the oil and gas sector are clearly major contributors to GHG emissions – no surprise there. Shell, with an ESG score of AA according to MSCI[1], one of the leading ESG research firms, is just one level away from the best possible ESG score according to MSCI. In fact, Shell has a better ESG score than Tesla (ESG score of A), a company that is developing electric vehicles that will help to reduce global GHG emissions in the transport sector. There clearly are a couple of things to unpack here:

- How can a single company have more GHG emissions than the third largest economy in the world? The answer lies in how GHG emissions are measured. Seventy-eight percent (78%) of Shell's GHG emissions in 2019 came from Scope 3, Category 11: use of sold products. This therefore includes you and me filling our vehicles with petrol and all the you's and me's in Japan. As long as there will be a demand for fuel driven vehicles, planes, electricity generation, etc., Shell will continue its oil and gas operations and its Scope 3, Category 11 emissions will remain a significant contributor to GHG emissions. This does not make Shell, or its industry, a villain. As long as there is a market for oil and gas, it will be illogical and irresponsible for oil and gas companies to not supply the demand.

- How can a company that is a major contributor to GHG emissions have a better ESG score than the company that has global GHG emissions reduction at the core of its value proposition? The answer lies in how ESG ratings are determined. Most ESG rating agencies do not take a company's nominal GHG emissions into account in their scoring, but rather measures a company according to its industry peers' *emissions intensity* and the plans it has in place to reduce its financial risks from an Environmental, Social and Governance perspective. There is much more nuance to this (more than can be covered here), and it differs from rating agency to rating agency, but the core principles seem to hold: to get a good ESG score, you need to do better than your industry peers; have good plans covering the E, S and G; and execute consistently on your plans. It is therefore possible to get a great ESG score without being a 'green' company. It is equally possible to have decarbonisation at the core of your business model, but not have a great ESG rating.

***Emissions intensity** refers to the amount of GHGs emitted per unit of output. It is usually measured as grams or kilograms of GHGs emitted per unit of energy produced, product manufactured, or economic activity generated.*

So, how are Shell's GHG emissions and its ESG score relevant to the S in ESG for insurance companies in the South African context? The principles are the same: you can meet all the social metrics in order to get a good ESG score, and you can be a level 1 BBBEE company, without having a sustainable impact on the socio-economy.

South Africa has not moved the dial much, at least not in the right direction, to remove inequality in our society since 1994. We have numerous laws and policies that is supposed to be driving economic transformation, and yet the divide between rich and poor continues to grow[2]. At the same time a large portion of our biggest companies are level 1 or level 2 BBBEE certified. Clearly there is a gap between true positive impact and what we report, or get accredited as, in South Africa.

[1] Morgan Stanley Capital International

[2] Reference Time Magazine, 13 May 2019

Regardless of the fact that the Global Reporting Initiative (GRI) and International Sustainability Standards Board (ISSB) reporting standards are being embraced more and more in South Africa, ESG legislation seems to be some way off. So, at this stage no need to worry about it? Let us wait for the legislation to be promulgated? That is fine if your investors do not really care about sustainability; your workforce is content to work for a corporate whose sole drive is shareholder value; your clients do not consider your company's sustainability performance when they are deciding which insurer to use; you do not believe the private sector has a role to play in creating a just society; and you do not have children that you want to create a sustainable future for.

However, if you believe that sustainability is more than compliance, then waiting for the promulgation of ESG legislation is not an option.

With the large investments into ESG compliance, initiatives and tools in the developed world, South African insurance companies can benefit. The Environmental and Governance components of ESG in the African context will not differ much from what is measured, monitored and done in the developed world. A lot of the learnings, tools and frameworks could therefore be applied as is in Africa. Where there will be a difference in Africa is on the social element.

Given how different the socio-economic construct is around large companies in Africa when compared with the developed world, the key social considerations for African companies will have a distinctly different flavour. Whilst considerations such as diversity, equity, inclusion, prevention of Gender Based Violence (GBV) and eliminating human rights abuses from your supply chain will be as important as in the developed world, we will have a key additional component: how do we make sure our local communities benefit from our operations on their doorsteps. The great advantage is that there are many past experiences and practices to learn from already. Even though the S is much more complicated than the E and the G, we already know what the major pitfalls are, because we have been doing this in some form or another for many years already. Think of all the billions of Rands that have already been spent through Corporate Social Investment (CSI), Enterprise and Supplier Development (ESD) and social upliftment projects.

Creating long-term social sustainable value is therefore nothing new to us: we have had to deal with it from a social licence to operate perspective and from a legal and policy perspective, for decades. Unfortunately, we still miss the mark too often.

Why is the S so elusive if we have been at it for so long? There are many reasons, and they vary from the obvious to the nuanced. A couple of the more common reasons are:

Intent

If your company's intent is only to be legislatively compliant, reach your localisation targets (BBBEE in the South African context), or maintain your social licence to operate, then it will be almost impossible to achieve sustainable impact through your social expenditure.

To demonstrate why we are seeing so little impact from the social investments we are making, let us consider two of the most common social spending areas: infrastructure and goods.

Infrastructure: This includes things like upgrading or building schools, crèches, clinics, playgrounds or parks, or funding a borehole, soccer pitch or taxi rank. Even though this is easy and will undoubtedly get the support of the local municipality and other relevant government entities, these projects are seldom sustainable because once the infrastructure is there, it needs to be staffed, maintained and serviced. If the local municipality or government entity that will be responsible for staffing the clinic, maintaining the playground, or providing water, electricity and books to the school does not have the means or skills to do so, these projects soon become white elephants. Similarly, if there is no competent entity with the required funding to make sure the borehole equipment such as pumps and motors are maintained and fixed when broken, then these boreholes do not last long.

If a company funds a school, borehole or clinic, did the company meet its CSI spend targets? Probably. Has the company ticked its compliance boxes? Probably. Did the company create sustainable value for the community? Not unless they also made sure that the supporting mechanisms are all in place.

Goods: This includes things like giving computers to schools in need, distributing sanitary pads once off during women's month, distributing food packs, etc. Whilst all these things add some value in the short-term, they generally do not enable long-term social upliftment unless they are continuously repeated or well supported. Taking the examples listed above, let us see what needs to be done to make them sustainable:

- Donating computers to a school in need can only add real value if the school does not have electricity problems, has a well-functioning security system that will prevent theft and someone at the school has the necessary knowledge and training to get the most out of the computers and can convey this to the learners. Can donating computers add long-term value? Of course it can. But only if we also make sure that everything else that is needed for the value to be unlocked, is in place. Merely donating computers is unlikely to have a sustainable impact.

- Once-off donations of usable products such as sanitary pads or food can add significant short-term value, but unless we make sure that the women in need, or the people that are hungry, have a means of sourcing these products going forward (i.e. partnering with non-profits that get wider funding and provide these goods on a continuous basis), we are only soothing our own consciences by once-off donations.

These examples hopefully demonstrate that it is possible to meet our CSI spending targets and achieve some impact through the donation of goods, but if we are serious about sustainability and creating long-term impact, we have to be more invested than merely donating these goods.

Money

Where we do see companies being intent on making a real difference in their communities by channelling their social expenditure into economic diversification and upliftment projects, sustainability is regularly missed because they overestimate the impact that can be created with the funds they have available. Even if you identify the right projects, the right beneficiaries and you bring the project to fruition, it still does not guarantee sustainability. The reality is that most beneficiaries need continued support with business and financial planning. They need training and coaching for many years until they understand their tax, maintenance and managerial duties and have grown their businesses to be financially sustainable and independent from the sponsoring company. To get this right there needs to be money, effort and love put into these businesses after the ribbon has been cut and the boxes have been ticked.

Collaboration

One of the quickest ways to ensure failure is to think you know – sitting in your comfy office, getting a good salary every month – what your target community needs and you do not co-create the projects with them. Another is to merely ask the community leaders what they want and give that to them: what community leaders want and what the communities need are often misaligned. If your intent is to make the S sustainable, then the best way is to follow a co-creation approach where you bridge the gaps between what your communities want and what they actually need.

Some other areas of collaboration where social projects fail from a sustainability perspective are: we do not have the required government departments all aligned; we think we need to do and fund everything on our own instead of collaborating with other companies, funders, financiers or investors; or we do not bring in the right skill-sets onboard: people that have actually set-up Small, Micro and Medium Enterprises (SMMEs) before.

There are many more reasons why our social expenditure, too often, misses the long-term sustainability mark, but this does not have to be the case. Some of the key things that can be done to make the S less elusive are:

- Ensure you understand your target community's context. Do not think you know. There are fool-proof ways to get this right.

- Ensure you bridge the gap between what your host communities want and need. There are many tools that have been developed to assist with this.

- Co-create the projects that you will fund with your host community and the relevant government entities. There are many frameworks to ensure you de-risk this process and achieve alignment.

- Identify the right beneficiaries: entrepreneurial skills are more important than social stature when we develop new businesses in our communities. There are many tools that have been developed to assist with the identification process.
- Collaborate with government to make sure you understand their objectives and constraints.
- Set the projects up in a way that will enable impact funds or other financiers and investors to come on board to scale the impact you catalysed. There are numerous consultants that provide services across both the social and financial sectors that can assist to bridge this gap.
- If you do intend to fund infrastructure projects, ensure the relevant government entities have the capacity to manage, staff, maintain and service the infrastructure. There are many consultants that can assist with these audits and with the subsequent capacitation, if required.
- Ensure the beneficiaries of your social upliftment projects have access to financial, managerial and business strategy support services so that they can diversify their client base and mature their businesses and their own skills to the point where they are not reliant on your company for the long-term sustainability of their business.

We have enough success stories across the continent to know that long-term sustainability of social upliftment projects is achievable. If we do it right, it does not even have to cost more money than we are already spending on it. The S does not have to be elusive.

If Shell can get a higher ESG score than Tesla, then it is certainly possible for any insurance company in South Africa to get a great ESG score while creating a material and sustainable impact. Does it however make sense to only try for compliance when real impact is possible? Not in my mind: we simply have too much to lose if we do not get it right.

In the words of Madiba: "Sometimes it falls upon a generation to be great. You can be that great generation. And of course the task will not be easy. But not to do this, will be a crime against humanity."