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THE SOCIAL IMPACT OF BUSINESS IN FRAGILE AND CONFLICT-AFFECTED SETTINGS:

Contributing to the SDGs and reducing local ESG risks by using Human Security and Positive Peace

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> There is a need to broaden the definition of materiality to not only include risks and opportunities to the company, but also include risks that matter to local communities and other stakeholders and move towards a 'bottom-up' approach.

This policy brief examines a novel evidence-based approach that clarifies the material issues relevant to the social impact by businesses and investors operating in Fragile and Conflict-affected Settings (FCS) using the concepts of Human Security and Positive Peace. It is shown how this approach helps to measure contributions to the SDGs and to identify and reduce local Environmental, Social and Governance (ESG) risks to improve people's wellbeing. The brief is based on the ideas put forward in a discussion paper written at the request of LSE-IDEAS[2], as well as on the discussions held with different potential end users of the new approach during a series of webinars in October and November.[3] In light of the current crisis caused by the COVID-19 pandemic, the approach also serves to guide private sector actors in their efforts to move from response and recovery to renew in order to face the new reality and make sustainable changes in their business strategies and operating models towards a more resilient future that offers better protection against precarity and crisis.

Over the last decades, there have been increasing public expectations for business actors to contribute positively to Environmental, Social and Governance (ESG) outcomes and to the Sustainable Development Goals (SDGs). Companies are increasingly mainstreaming ESG performance in their annual reports, using internationally accepted standards such as those by the Global Reporting Initiative (GRI). In fact, the share of publicly traded companies included in the S&P 500 index that publish a sustainability report has increased from 20% in 2011 to 90% in 2019.[4] At the same time, there is a lack of knowledge on how to measure the actual impacts of ESG practices of businesses, and there is no globally accepted ESG standard. The same gap applies to companies' SDG contributions. The disconnect between the SDGs and 'financial materiality' in relation to the goals, stand in the way of proper sustainable impact measurements. Instead, there is a need to broaden the definition of materiality to not only include risks and opportunities to the company, but also include risks that matter to local communities and other stakeholders and move towards a 'bottom-up' approach.

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CHALLENGES IN FRAGILE AND CONFLICT-AFFECTED SETTINGS (FCS)

It is clear that if companies already find it difficult to reduce local ESG risks under "normal" circumstances, it is even more challenging to do so in fragile and conflict-affected settings. But given the current global crisis as a result of the Covid-19 pandemic, fragility can be considered the new normal. This makes it even more important to look at the specific challenges that fragility brings, and how businesses can best deal with it. When operating in a context of fragility and conflict, many companies do not realize that they are always an actor to the drivers of conflict and that they are inherently part of the local political economy in FCS. Therefore, they also see no reason to get involved in its resolution. This phenomenon casts doubts over the current use of 'do no harm' approaches by companies.

At the same time, it can be extremely challenging and in most cases undesirable for companies to get involved in efforts that aim to reduce conflict or build peace, but which depend heavily on externally led top-down peacebuilding efforts that often bypass local community needs and experiences. It is true that generally local drivers of conflict tend to be specific and that might support the claim that companies can best contribute at the local community level. This calls for a shift in focus towards more business-oriented assets based on ESG community impact level criteria that can potentially contribute to peace in local communities. For private sector actors operating in FCS, such an approach seems more natural. This represents a powerful shift in mindset from looking at the issues through a conflict lens and at the factors that drive violent conflict toward the conceiving of peace in an active and "positive" way, also called Positive Peace.[5] Peace is better understood as a continuum that requires progress in all aspects of sustainable development and possible entry points for an active business contribution by working towards Positive Peace and Human Security become more obvious.

NEW APPROACHES FOR MEASURING THE "S" IN ESG

In FCS, 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. Therefore, a new approach is proposed for measuring social impact in FCS where traditional methods of monitoring and evaluation of ESG issues at country level are particularly inadequate.

Many companies acknowledge that current standards are incomplete, costly and time-consuming to implement, due to their complexity and difficulty to measure. This applies in particular to the "S" (social issues) of ESG. Even though it is clear that there are measurement challenges for social issues, it is also increasingly recognized that social issues have high relevance in terms of risks and potential benefit - from improved business performance to better relationships with local communities.[6] Human rights risks are often the starting point when reporting on the social element in ESG although the criteria have a much broader view of social impact. The UN Guiding Principles on Business and Human Rights (UNGPs), for example, aim at minimizing the negative impact of business activity on human rights. Applying the UNGPs means working *towards a standard* that minimizes those negative effects, but this does not mean that the company contributes actively to sustainability. The purpose of ESG criteria is to enhance positive impacts by *setting standards* to evaluate companies on how far advanced they are with sustainability and measure these impacts over a longer period.

FCS related risks and material impact carry particular definitions and meaning. ESG rating agencies note that company reporting on the UNGPs, for instance, demonstrates a clear lack of stakeholder consultations and also point to a lack of country risk data as part of most risk assessment policies. In general, there is a need for more on the ground data on the socio-economic dynamics in relation to conflict and security in FCS, and to the presence of any vulnerable groups in order to identify material impacts and define thresholds.

When applying "enhanced" human rights due diligence, as recommended by the UN Guiding Principles for conflict-affected settings, this is already a step in the right direction by adding a conflict lens to the process, more specifically by carrying out an analysis of conflict dynamics and conflict drivers. However, it is still providing a false sense of security because the process cannot guarantee a social license to operate in FCS, neither will it provide guarantees that people's security will actually improve as a result of any risk reducing measures taken.

So far, ESG efforts have focused mainly on establishing policies and processes, as well as providing basic reporting, whether qualitatively or through a selection of ESG-related KPIs. Typically, there has been less focus on the impact on the broader environment or society as a whole. Under pressure from investors, 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.

HUMAN SECURITY AND POSITIVE PEACE APPROACHES FOR BUSINESSES OPERATING IN FCS

By using Human Security (HS) as a holistic approach to address multidimensional risks for businesses operating in FCS, fragility, human rights and sustainable development are brought together, offering a basis for identifying thresholds of people's resilience. It takes into account a wide variety of risks to people and points to the level of corporate impact on their well-being. The Human Security Business Partnership Framework goes a step further in operationalising this approach.[7] It mobilises a diverse range of actors, utilises flexible and issue-specific processes, and creates a culture of collective action, operating in tandem with local, national and international dynamics. For instance, global environmental changes can trigger a series of regional side effects (e.g. droughts or floods) and have a large impact on people's livelihoods more locally (e.g. income levels, food security) which in turn is likely to affect people's health more individually (e.g. malnutrition or COVID-19 vulnerability).

A Human Security approach has clear advantages to existing approaches to measure risks to people:

- The approach brings to light underlying issues that need to be addressed to prevent or mitigate HR violations that are missed by human rights due diligence processes.
- With regards to the SDGs, the HS approach serves to inform how actions by companies on the SDGs can be risk-responsive, thereby creating positive impacts on multiple fronts which will help to unpack the SDGs and identify where sustainability can be 'located' and stimulated.
- The approach takes a holistic approach in order not to miss any connections between various risk dimensions that fall within the ESG criteria.

On a practical level, this means that any efforts to limit the various HS risks faced by people translates immediately into interconnected economic, environmental and social effects that serve to improve people's dignity and survival chances. Specific actions taken by companies to improve HS will result in impacts that protect people as individuals from particular threats they may be exposed to – be it personal, economic, political, environmental, or community, health or food-related. This chimes with the aims of the 2030 SDG Agenda which envisages actions on multiple fronts to build the resilience against crisis, underdevelopment, conflict, lack of governance and climate change.

So, how does this new approach translate into a measurement tool? The entry point for companies is to take HS risk-informed and risk-responsive actions and to organise their SDG contributions according to the multiple risk dimensions (see Figure below). Instead of selecting SDGs based on their general alignment with the core business as many companies are doing at present, HS 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 as a result of the risk-informed actions. From a measurement angle, HS connects interrelated material ESG issues that allow composite indicators to be created to cover sustainable development, security and human rights dimensions.

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 factors and SDGs (Figure by authors)

In addition, by identifying and measuring levels of Positive Peace (PP) in a defined area, the background conditions for HS—both the threat to HS and the resilience against the threat – that make up the environment are uncovered. It is generally acknowledged that increasing levels of PP offer more HS guarantees for people. This improved HS automatically reduces the ESG risks for companies. On the other hand, deteriorating levels of PP that reach a specific threshold will offer indications that the exposed risk has become a threat to people's security with implications for the company and the business activities. Such a set of "red flags" could be built into a company's risk management system, which is already being piloted by a number of multinational companies. It also aligns with the trend of companies and financial institutions to integrate their risk management and sustainability strategies, because it is realised that they are strongly interconnected.

The PP framework operates as a system and can be applied at the national, subnational and local levels.[8] It does not specifically set out what interventions should be done for each of the eight Pillars to create social benefit as these very much depend on the cultural norms and development path of a specific country or community. What is appropriate in one community, may not be appropriate in another. What the Positive peace framework offers is guidance for actions that fit within the interconnected pillars. The more pillars to be influenced through social and economic impact interventions, the higher the impact on human security and sustainable development.

Current social impact assessment tools that focus on Key Performance Indicators (KPIs) fall short in accounting for the types of risks companies and local population face in these environments. A major advantage of the new PP and HS approach is that it could potentially help with preparatory risk assessments for operating or investing in FCS and identify what issues to tackle in terms of their materiality to the business. As stated before, this would not only limit the risks to people affected by the business, but also increase the attractiveness of investing in FCS because of a lower risk profile., which would be important given the low risk appetite of many investors. A key condition for this to succeed is that materiality should also consider the impacts on the local communities in FCS. This means that a multi-stakeholder approach with local community consultations is desired. The degree to which local stakeholders should be involved in any decision-making depends on the intensity and salience of the local impacts. Also, a bottom-up materiality analysis would reveal if issues are within the control or influence of companies. This will then give greater clarity over the corporate responsibility towards communities - especially in FCS where government institutions are very weak or completely absent – and meet the higher expectations that responsible investors are having nowadays.

IMPROVING EXISTING STANDARDS TO REDUCE THE COMPLEXITY OF IMPACT MEASUREMENT

Based on the consultations held for this research, it was often repeated that it is important that the HS and PP approach does not add another layer to the existing frameworks and instead offers a way to strengthen the work already in place by tying it together. Given the fact that companies will face greater accountability for their social performance in the future, this will place higher demands on tracking and reporting. In response to this, the HS and PP approach is designed in such a way as to reduce the complexity of existing processes. Furthermore, it is clear that companies will need to develop more collaborative solutions to measuring their social impact. Here, the Human Security Business Partnership framework developed by LSE-IDEAS[9] can serve as a model for collaborative partnerships between public, private and civil society actors to focus on collective challenges faced by companies and communities in an effort to seek shared value and benefits in the form of reduced risks and improved SDG contributions.

The approach is not only valuable to companies and investors, but also to standard setting organizations, such as the Global Reporting Initiative (GRI) and Sustainability Accounting Standards Board (SASB). They would be served by a more complete identification of materiality, thus taking a holistic approach regarding the reporting on a company's significant impacts on the economy, the environment, and society, i.e. the overall impacts on local people. Such a holistic approach that takes local materiality as a starting point could also make clearer what 'significant' impact is, both positive and negative.

The proposed approach also presents a way for disclosing positive contributions through community engagement which has been a missing element in the company reporting as monitored by ESG rating agencies – which is now focusing more on identifying risks and negative impacts. Rating agencies could stimulate companies to seek more local community engagement as a way to start identifying new building blocks for measuring the social impact and how to turn these into measurable indicators focused on improving HS and PP.

We conclude that the combined HS and PP approach is capable of measuring a company's local contributions to the SDGs and determining the materiality of multidimensional ESG issues that can define corporate social responsibility. This requires an on-going process that can lead to proactive, coherent business processes, thus making progress on implementation of current standards while strengthening Human Security and Positive Peace for local people and communities.

POLICY AND PRACTICE RECOMMENDATIONS

For policymakers of governments and multilateral institutions:

- Support the inclusion of Human Security and Positive Peace approaches in preparatory risk assessments when supporting Private Sector Development in FCS.
- Promote efforts to integrate HS and PP approaches in standards for ESG risk assessments to demonstrate materiality and genuine SDG contributions in FCS.
- Support research (including case studies) that will assess the suggested positive relationship between ESG risk management and financial performance of companies operating in FCS.
- Create monitoring processes for investments in FCS that incentivise the contribution to positive impacts, while reducing the actual risks.

For businesses and investors:

- Define the nature and scope of corporate responsibility in FCS according to material issues that are localised and people oriented.
- When investing in FCS, increase the attention on social risks (the "S" of ESG) by assessing risks that are common or overlapping between people, communities and business.
- Use 'local' risks as a starting point to generate SDG contributions that create actual improvement in people's wellbeing and security.
- Include HS and PP as part of process to connect local impact to corporate level KPIs (key performance indicators).
- Adopt multi-stakeholder approaches, including partnering at local level to ensure genuine local community consultations, (e.g. through using the Human Security Business Partnership framework) to improve accountability of social performance in FCS.

For financial institutions:

- Shift the emphasis from minimizing ESG risks and preventing harm towards encouraging positive contributions on HS and PP, as well as on the SDGs, by companies.
- Integrate risk management and social impact assessment procedures.
- Apply HS and PP to generate a continuum of positive impacts between sustainable development, human rights, peace and security.

For standard setting organizations:

- Identify materiality by using HS and PP to adopt a holistic approach regarding corporate impacts.
- Provide companies with more guidance on how to apply a multidimensional materiality principle in FCS and suggest procedures to define local material issues and their interconnectivity, including the involvement of local communities as key stakeholders.

For ESG rating agencies:

- Include HS and PP approaches in ESG risk assessments in FCS with the aim to set a new ESG-HS risk standard for high-risk contexts.
- Expand ESG criteria to incorporate more localized HS risks
- Initiate or join collaborative partnerships to test the new approach and improve tracking and measuring of social impact by companies in FCS.
- Stimulate companies to seek more local community engagement to create building blocks for measuring social impact and the development of KPIs (key performance indicators).

ENDNOTES

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