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Environmental, social and governance goals are seemingly ubiquitous. ESG criteria have become a popular rubric to assess the investment worthiness of companies; in parallel, companies are increasingly looking to those metrics to measure progress toward better and more responsible corporate citizenship.

Although debate continues as to the appropriateness of ESG factors as a proxy for organizational fitness and responsibility writ large, there is no doubt that stakeholder interest in these factors is so sufficiently pervasive that responsible business management now requires organizations to have an ESG policy or, at a minimum, assess the risks of not having one.

As a further signal, regulators in the U.S., including the U.S. Securities and Exchange Commission, are increasingly focused on whether companies' actions are consistent with their ESG messaging, while corporate leaders like Bank of America Corp. CEO Brian Moynihan, speaking at the 2023 World Economic Forum in Davos, said official sustainability and ethical global standards are vital to "align capitalism with what society wants from it" so that companies can be objectively evaluated regarding their ESG initiatives.[1]

ESG criteria, therefore, serve many purposes.

Beyond regulatory requirements, they are helpful for providing organizations with criteria by which to operate and hold themselves accountable and offering baseline criteria against which their performance can be measured or ranked.

They also provide a way for businesses to show that they value being good corporate citizens, follow international norms, and care about consumers' and shareholders' increasing focus on nonfinancial outcomes.

Critically, measuring ESG criteria can help companies demonstrate their commitment to that focus. In order to effectively measure success on ESG criteria, companies need to create or adopt standards from which an assessment can be made.

This is an easier task for some ESG factors than others.

For environmental factors, for instance, it is not surprising that greenhouse gases and climate targets have become a key proxy for assessing environmental risks and liability.

This is because greenhouse gases, as compared to other environmental factors, are relatively straightforward to quantify, with direct emissions measured as Scope 1, emissions from energy use as Scope 2 and emissions along an organization's supply chain as Scope 3.

These Scope 1, 2 and 3 emission categories establish a basis from which companies can set their environmental targets and assess their progress toward meeting them. They also offer a way to assess companies' environmental track records.

The social aspects of ESG, while equally important, are challenging to evaluate because what is and is not a social criterion that a company should claim responsibility for is difficult to define — and even more difficult to measure.

Take, for instance, this description offered by Reuters in a July 2022 article: "The social component of ESG covers all the ways companies interact with their employees and the communities in which they operate."[2]

As there is an absence of an established set of regulatory expectations, a three-tiered approach similar to the framework for greenhouse gas emissions could serve as a basis for creating similarly useful metrics for developing and measuring social goals.

This rubric, if adopted by companies, could make developing goals and measuring their progress far more straightforward and uniform. Equally important, it could help companies communicate more clearly with key stakeholders concerning their ESG goals and progress.

The Social Criteria Conundrum

Identifying what should fall under a company's social impact responsibility is undoubtedly a challenge.

In a 2021 Global ESG Survey by BNP Paribas, 51% of the 356 institutional investors surveyed found the "S" to be "the most difficult to analyze and integrate," concluding that "there is an acute lack of standardization around social metrics."[3]

The SEC, for example, has provided guidance and proposed rules regarding climate disclosures, but it has not specifically addressed how companies should handle disclosures related to social commitments.

Depending on the company or the organizational mission, social criteria for which the company or organization could fairly be held accountable can look very different.[4]

But, if no uniform classification system exists for social criteria, against what baseline or aspiration should it be assessed? How can it be measured if there is no uniform, systematic method for doing so?

This makes identifying and tracking the "S" at best highly frustrating and, at worst — and certainly to its detractors — meaningless. Thus, the current state, without a clear framework, hampers the ability of companies focused on social criteria to leverage success in that area, despite having made significant socially oriented commitments.

International Frameworks Related to Social Responsibility

Guidance related to the establishment of social goals can be gleaned from various international bodies, which offer several potential models for consideration.

The United Nations has embraced principles governing the social aspects of business behavior through the lens of human rights. In particular, the U.N. Guiding Principles on Business and Human Rights directs businesses to "prevent, mitigate and, where appropriate, remedy human rights abuses that they cause or contribute to."[5]

According to the U.N.'s principles, this means adopting policies and processes that uphold those commitments, with an expectation that governments will police businesses to ensure that those outcomes come to fruition.

Likewise, the Organization for Economic Cooperation and Development Guidelines for Multinational Enterprises and the associated OECD Due Diligence Guidelines for Responsible Business Conduct provide principles and standards for responsible business conduct, as well as practical steps to implement those principles.

These guidance documents aim to help enterprises "avoid and address adverse impacts related to workers, human rights, the environment, bribery, consumers and corporate governance that may be associated with their operations, supply chains and other business relationships," consistent with the U.N. Guiding Principles and the International Labour Organization Tripartite Declaration of Principles concerning Multinational Enterprises and Social Policy.[6]

Other global bodies have similarly established social responsibility-related standards, such as the International Organization for Standardization, a global collective of national standard-making bodies — the United States' standard-making ISO counterpart is the American National Standards Institute.

ISO's equivalent is ISO 26000, the standard designed to "help organizations effectively assess and address social responsibilities," which is very similar to the full gamut covered by ESG. These social responsibilities are defined by ISO to include responsibilities "relevant and significant to their mission and vision; operations and processes; customers, employees, communities, and other stakeholders; and environmental impact."[7]

Proposal for the Development of Consistent Assessment of Social Criteria

To assess how proposed social criteria can be implemented by a particular organization, groups should consider organizing social issues akin to the way an organization's affiliated greenhouse gas emissions are divided or grouped.

Applying the Scope 1, 2 and 3 greenhouse gas emissions rubric to a social criteria construct could result in a similar three-tiered system.

Scope 1 Social Criteria could pertain to social issues in an organization's direct control or ambit: for example, policies related to employees and direct community engagement, such as diversity, equity and inclusion policies, living wage, work-life balance and sponsored community service activities like pro bono.

Scope 2 Social Criteria could be tied to the records of the entities with which the organization does business: i.e., has the business from which the organization procures supplies, or with whom it contracts for an additional workforce, adopted strong and measurable social metrics — and are they abiding by those social metrics?

Scope 3 is the most difficult to define. Scope 3 Social Criteria could represent an issue that can be tied to the mission of the organization or sector in which the organization operates, such as a goal to support the distribution of clothing to the homeless for a textile manufacturer or a commitment to improving bee habitat for a company that produces honey.

For a law firm, Scope 3 Social Criteria may include efforts or a commitment to improving access to justice either writ large across a category of the population, like political refugees, or within a specific geographic area where the law firm does business.

Scope 3 could also be thought of as any other social impact-related activities through which the organization touches upon a social issue and works to support positive change related to that social issue.

Over time, and as the practice of categorizing social criteria into scopes advances, one might see a coalescence around certain social issues by economic sector or business type.

Scope 1, 2, and 3 Greenhouse Gas Emissions Criteria Reviewed

To understand how the Scope 1, 2, and 3 greenhouse gas emissions accounting approach could be applied to identifying and organizing social criteria metrics, it is instructive to review their accounting principles. Below is an overview based on the U.S. Environmental Protection Agency's Center for Corporate Climate Responsibility, which is instructed by the Greenhouse Gas Protocol, a nonprofit standard-setting entity.

- Scope 1 emissions are classified as direct greenhouse gas emissions that occur from sources that are controlled or owned by an organization — i.e., "emissions associated with fuel combustion in boilers, furnaces, vehicles," according to the EPA.

- Scope 2 emissions are indirect greenhouse gas emissions associated with the purchase of electricity, steam, heat or cooling. Although Scope 2 emissions physically and technically occur at the facility where they are generated, they are attributed to the greenhouse gas inventory of the organization that purchases the energy because those emissions are considered to result from the organization's energy use.[8][9]

- Scope 3 emissions result from "activities from assets not owned or controlled by the reporting organization" but are emissions that the "organization indirectly affects in its value chain," per the EPA.[10] Scope 3 emissions, sometimes

referred to as "value chain emissions," include all sources attributable to the organization that don't fall within the organization's Scope 1 and 2 boundaries.

Structure of a Scope-Based Social Criteria Classification Approach

While the Scope 1, 2, and 3 greenhouse gas emissions accounting approach is not without its flaws, it nevertheless has proven to be effective at providing a way to organize and track an individual organization's emissions, thereby making it possible to set baselines, establish reduction targets, track progress toward those targets and identify ways to address barriers to achievement of the targets.

It also allows others to evaluate a company's total emissions and its progress toward addressing them, which can serve to inform an investor, partner or consumer in determining whether to do business with that entity.

In these ways, the scope approach provides value as a model for organizing and tracking the social aspect of ESG criteria.

The three-scope approach could provide a structure for a particular entity to organize the social values and responsibilities identified by other standard-setting entities, such as but not limited to the ISO 26000 social responsibility standard, the U.N. Guiding Principles on Business and Human Rights and the OECD Guidelines.

In this way, the three-scope approach we suggest would create some consistency across standards, making social responsibility commitments easier to identify, track and measure by businesses and those who track business behavior,[11] despite the variability between organizations.

Below is an example methodology for classifying social criteria based on the Scope 1, 2 and 3 accounting approach:

Scope 1 Social Criteria

This category features social criteria over which a company arguably can exert direct influence or control.

Scope 2 Social Criteria

What is the social impact record of those entities from which the company transacts or procures supplies and materials?

This may mean that companies will need to put in place policies that allow them to assess the entities from whom they procure goods and services and find alternatives for those with poor social records or rankings.

Scope 3 Social Criteria

What social impacts can logically be tied to the mission or sector in which the company operates, or which affects the business of the company? Conversely, what does the company do that affects others in a social capacity?

Like emissions up and down a company's value chain, the Scope 3 Social Criteria category is much more far-reaching than the policies a company can control related to its immediate employees or community, as well as to those with which it immediately transacts.

The bedrock for Scope 3 Social Criteria therefore could be topics that the organization should or could logically concern itself with. It could also include basic issues related to social impact that it is not directly involved in but could affect its business in some way.

The Stanford Innovation Center identifies public health and its social determinants, racial equity, income equality and financial inclusion, and workforce development as potential social impact issues relevant to certain businesses. An individual company's Scope 3 social impact criteria could be based loosely on and expound upon these four topics, or the company could add new categories entirely based on its sector, mission and location.

As more companies establish ESG policies, standardizing an approach to social impact criteria will make the process far more efficient and more meaningful. Companies will be able to lead on social impact criteria, creating greater self-

determination and control.

Establishing clear ground rules also will give companies certainty and the tools to assess their efforts at a time when they are increasingly considering their social impact on internal stakeholders, such as employees, and on external issues, such as their communities.

Furthermore, having a sound approach to social impact criteria is bound to make companies better prepared to address community concerns and embark on more transparent and meaningful interactions that lead to relationships of trust with community counterparts.

A strong social platform, therefore, is essential for corporate credibility and good business in the current ESG-attuned business climate. The three-scope approach can help companies as they seek to develop goals and communicate progress.

Footnotes

[1] Bank of America CEO says new ESG rules are needed to reboot capitalism, CNBC, Jan. 18, 2023, https://www.cnbc.com/2023/01/18/bank-of-america-ceo-says-capitalism-needs-cleaning-up-with-new-global-esg-rules.html.

[2] Explainer: What is the 'S' in ESG investing? https://www.reuters.com/business/sustainable-business/what-is-s-esg-investing-2022-07-19/.

[3] The ESG Global Survey 2021. https://www.theia.org/sites/default/files/2021-09/The%20ESG%20Global%20Survey%202021.pdf.

[4] According to the Stanford Social Innovation Review, [o]ne of the biggest challenges in measuring social impacts has been the absence of a reliable, quantitative measurement standard. The result is that every company (and NGO) defines, measures and reports every social impact differently. For investors, this results in unreliable, incomparable, and low-value data that cannot be used in financial models. While there have been a few attempts to create frameworks for reporting social impacts, most have fallen short. https://ssir.org/articles/entry/fixing_the_s_in_esg.

[5] The UN Working Group on Business and Human Rights, The UN Guiding Principles on Business and Human Rights: An Introduction, https://www.ohchr.org/sites/default/files/Documents/Issues/Business/Intro_Guiding_PrinciplesBusinessHR.pdf.

[6] OECD Guidelines for Multinational Enterprises, 2011 Edition, at https://web-archive.oecd.org/2023-06-27/95735-48004323.pdf; and Due Diligence Guidance for Responsible Business Conduct, at http://mneguidelines.oecd.org/OECD-Due-Diligence-Guidance-for-Responsible-Business-Conduct.pdf.

[7] https://asq.org/quality-resources/iso-26000. (emphasis added).

[8] How to move from net zero to net impact. https://ssir.org/articles/entry/fixing_the_s_in_esg.

[9] https://www.reuters.com/business/sustainable-business/what-is-s-esg-investing-2022-07-19/.

[10] https://www.epa.gov/climateleadership/scope-3-inventory-guidance.

[11] See ISO 26000 Core Subjects of Social Responsibility (https://asq.org/quality-resources/iso-26000).

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