**Food for thought: Ingredients for a novel method for ESG and social impact measurement using the Human Security approach**

LSE IDEAS

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## Executive Summary

This paper examines the challenges of ESG and social impact measurement. It starts with the current state of play of social impact measurement, and then investigates the potential of the Human Security (HS) approach as a means to achieve both more realistic assessments of impact from the ground up and taking the community perspective into account.

The paper is directed at practitioners and provides food for thought on how to improve social impact assessment by using the HS approach. It provides ingredients of an improved social impact measurement method from a Human Security (HS) perspective that proposes a context-driven approach, linking ESG issues to a wide variety of every-day (personal, economic, political, environmental, community, health, food or technology-related) risks people face. This holistic approach takes into account human rights, security and development, and looks at risks both from the perspective of businesses as well as the people that the business is impacting. Ultimately, the purpose is to reveal the effects of company operations and investments on those risks.

The paper proposes a novel measurement methodology for social impact measurement based on the Human Security approach, that consists of the following steps:

- Step 1 – Set boundaries to the assessment
- Step 2 – Measure direct and indirect social impacts
- Step 3 – Assess (positive and negative) contribution to human security
- Step 4 – Determine value creation areas, set key risks and opportunities and prioritize management response

Compared to existing social impact methodologies, the proposed methodology adds a number of indicators that are currently not considered and provides the following complementary elements:

- It is more participatory by engaging with and involving local stakeholders comprehensively and continuously in the impact measurement process.
- It is an iterative process that builds and constantly re-assesses by reference to and dialogue with local stakeholders.
- It allows for temporary fluctuations and variations that are particularly salient to fragile and conflict-affected settings (FCS), where instability and volatility are commonplace.
- By taking a holistic approach, it is geared towards prevention of negative impacts while maximizing positive impacts, for the benefit of all stakeholders involved.

Further development of the proposed method is needed by bringing together the two ingredients (dimensions of human security and value creation areas for local engagement) and the proposed steps into a full-fledged social impact measurement methodology.

## 1. Goal of this paper

This paper looks at ESG and social impact measurement. It starts with the current state of play of social impact measurement, and then investigates the potential of the Human Security (HS) approach as a means to achieve both more realistic assessments of impact from the ground up and taking the community perspective into account. It builds on the results of a study into nine major ESG (Environmental, Social and Governance) frameworks and standards, which assessed to what extent they converge with the Human Security (HS) approach (Van Dorp, Smits and Gehoel, 2024).

The current paper is directed at practitioners and provides food for thought on how to improve social impact assessment by using the HS approach. In addition to traditional understandings of value that ESG strategies generate, such as risk reduction and financial attractiveness, in this paper, we examine deeper categories of value creation which make the case for a more profound and meaningful ESG strategies, which are related to novel types of social impact measurement.

This paper outlines ingredients for an improved social impact measurement method from a Human Security (HS) perspective that proposes a context-driven approach, linking ESG issues to a wide variety of every-day (personal, economic, political, environmental, community, health, food or technology-related) risks people face. This holistic approach takes into account human rights, security and development, and looks at risks both from the perspective of businesses as well as the people that the business is impacting. Ultimately, the purpose is to reveal the effects of company operations and investments on those risks.

## 2. The growing importance of ESG

Public expectations of the private sector to contribute positively to Environmental, Social and Governance (ESG) outcomes have increased significantly over the last decades. It has become increasingly mainstream to report on ESG and SDG performance through internationally accepted standards, such as the Global Reporting Initiative (GRI) standards, the SDG Impact Standards and the Equator Principles. However, there is a lack of knowledge on how to measure the actual impacts of ESG contributions of businesses, especially social outcomes.

Moving away from a more traditional (and increasingly outdated) focus on Corporate Social Responsibility (CSR), today's responsible businesses operations use ESG criteria not as an 'add on' to the core business activities, but as an integrated part of their business strategy. Unlike CSR, ESG demands metrics. ESG activity is now seen as vital to understanding corporate purpose, strategy and the management quality of companies. Evidence of ESG compliance is also key to investment decisions. Asset management firms and pension funds expect business leaders to focus on ESG impact. Having positive outcomes based on ESG factors is no longer just a bonus, but something shareholders demand, because they believe it is going to drive growth, market share and profitability.

Furthermore, new binding regulations, such as the European Union's Corporate Sustainability Reporting Directive (CSRD) and the Corporate Sustainability Due Diligence Directive (CSDDD) are providing additional pressure on business efforts to assess their ESG impacts. In particular the CSDDD will have far reaching implications for a large number of both EU-based and non-EU based companies.[3] It is essentially a corporate due diligence duty for large companies to identify and address adverse human rights impacts (such as child labour) and environmental impacts (such as pollution) in their own operations, those of their subsidiaries and in their supply chains. As of 2027, this Directive will become mandatory, and non-compliance will have material impacts for the companies involved. It will increase the urgency and need of showing positive ESG impacts and minimizing risks for companies and investors.

There is sufficient evidence that successful ESG and SDG impact management strategies are a key element to create financial value for investee companies and investors.[4] For instance, widely accepted disclosure standards, such as the standard developed by the Task Force on Climate-related Financial Disclosures (TCFD), facilitates the exchange of information between investors and investee companies whereby investors derive meaning from that information. Investors may also require that their investees comply with certain ESG standards (e.g. the IFC Performance Standards) or embed sustainability into management systems and decision-making practices. That way, value is created that can take different forms, either immediately or more long term (e.g. reducing exposure to company risks and being more financially attractive to other investors). Another consideration is the risk of being accused of green and social washing, which can be reduced by having realistic and credible measurement methods in place. At the same time, it is important to take note of the current pushback against ESG, especially in the US.[5]

All of these developments show the importance of a more robust ESG implementation and measurement practices. ESG rating agencies such as MSCI and Sustainalytics that monitor and evaluate material ESG impacts use different definitions of ESG performance and as a result may give different ratings to the same company. For investors, the "S" in ESG can be the most difficult to assess. There is a need for more on the ground data on the socio-economic dynamics of business and investment operations. In fragile and conflict-affected settings (FCS), conflict and security and the presence of vulnerable groups has a particular bearing in considering what are material impacts and the ability to define both risk avoidance/mitigation and thresholds for business-induced positive change.

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[3] The CSDDD will apply to approx. 6 000 EU-based companies, and approx. 900 non-EU companies; European Commission, 2024.

[4] Studies have shown that ESG and SDG engagement can help protect long-term investment value and create more financial value than "standard" investments (see among others Blackrock & Ceres, 2015; Global Research Institute DWS, 2018; UN PRI and ICGN, 2018; Whelan, Atz & Clark, 2021).

[5] See among others Tariq Fancy's The Secret Diary of a Sustainable Investor; https://medium.com/@sosofancy/the-secret-diary-of-a-sustainable-investor-part-1-70b6987fa139 .

## 3. Social impact measurement: current state of play

In recent years, there has been a visible shift from environmental to social impacts with two key questions animating the debates: 1. What does social impact mean exactly? and 2. How to measure social impact?

A recent review of 68 papers in the field of social impact measurement (SIM) finds that there is no set definition of social impact and points at a wide variety of interpretation. Drawing from the papers reviewed in their study, Feor et al. (2023: 22) provide the following definition of social impact:

> *Social impact is the result of a deliberate intervention by an individual, community, or organization with the objective of causing a positive effect on social, environmental, and economic well-being.*

This definition of social impact focuses on positive impact. In contrast, a definition by the Centre for Social Impact encompasses both positive as well as negative social impacts (Ramia et al., 2021: 5).

> *The intended and unintended social consequences, positive and negative, of programs (interventions, policies, plans, projects) and any social change processes invoked by these.*

Looking at the existing definitions of social impact, they can broadly be distinguished into the positive social impacts of interventions by businesses to support community development or any other social goal, versus the social impacts (both positive and negative) of a business' operations in a certain setting. In other words: to what extent is the company "doing good", versus to what extent is the company "creating good or bad social impacts" for its workers, communities and other stakeholders. Combining the above definitions, and focusing on the social impacts of businesses, we propose the following definition for the purpose of our paper:

> ***Social impact comprises of the social consequences - direct or indirect, intended or unintended - of a business' operations, interventions, policies, plans or projects, and any social change processes invoked by these, whether positive or negative.***

Another important question is how to define direct and indirect impacts, which can be defined as follows:[6]

- <u>Direct impacts:</u> Impacts largely within a company's control. These impacts can be inputs or outputs that arise from the day-to-day activities of a company. Examples include: creation of jobs within a firm, the sale of a product, the (non-) adherence to a certain code or standard, the violation of human rights standards of employees or community members.
- <u>Indirect impacts:</u> Impacts that are not in the company's control but within the company's influence, which can also be characterized as "knock-on effects" of the direct impacts. Examples include: the creation of jobs to MSMEs or farmers

[6] These definitions are loosely based on World Bank Group (2008: 23)

within the supply chain, the indirect contribution to human rights violations committed by a non-state armed group by paying illicit taxes at roadblocks, the lack of service provision by the government because of tax avoidance by the company.

Apart from the lack of a universally agreed definition, there is also a lack of agreement on how to measure social impacts. The most common challenges identified across the literature were related to the complexity of measuring social impact and the absence of standardized measurement models and tools. Other challenges included the lack of data or data systems and insufficient financial, human, and time resources (Feor et al. 2023: 827). A study that compared the approaches to the 'S' in ESG of 12 rating-agency approaches found several problems in measuring social sustainability (Platform on Sustainable Finance, 2022: 25). Among others, it was found that social measurement is focused on what is most convenient, not what is most meaningful. Also, the lack of consistent standards that underpin the measurement of social sustainability leads to higher costs and creates confusing 'noise' across the ESG industry.

Selecting the right indicators is an important part of the social impact measurement process and is highly dependent on the availability of data. An indicator is defined as a means to measure the level of change resulting from a planned intervention designed to create a social impact. There are two different approaches when measuring impact: standardized and customized. According to Feor et al. (2023: 825), measuring social impact can be done either through a standardized approach that promotes comparability of indicators, or by developing customized indicators based on stakeholder needs. There is also a middle ground, using both the standardization and customization of indicators when measuring social impact. An example are the SDGs, which provide a good selection of common indicators that practitioners can use as a starting point when developing their own customized social impact indicators. This provides both the main advantage of a standardized approach, which is the opportunity for comparability, while also allowing practitioners and stakeholders to measure in a way that suits their unique needs.

Recent research by Shift (2024: 4), which focused on designing better social indicators and metrics, showed that ESG data providers are not paying sufficient attention to targets for addressing impacts on local stakeholders who are vulnerable to harm from typical industry practices.[7] Overall, it was found that the most-used social indicators offer very little insight into the actual inner workings of organizations, and that it is often more important to measure whether something is being done, but not whether it is being done well. This is in line with our earlier conclusion on the lack of knowledge on how to measure the actual impacts of ESG contributions of businesses and the need for more on the ground data on the socio-economic dynamics of business.

[7] The research was based on the analysis of almost 1300 indicators and metrics used in ESG data providers' products or reporting requirements; Shift, 2024

As a final remark, it should be kept in mind that the most important social impacts depend on the regional and national legislation and the local context, so there is always a need to translate social impact measurement into a context specific guidance.

## 4. The role of local inclusion, community engagement and participation: why they matter and how?

One of the major challenges in measuring social impacts is local engagement. As part of the engagement mechanisms, many widely accepted ESG performance and SDG impact frameworks acknowledge and have incorporated concepts of local inclusion, community or stakeholder relations, and participation. However, these concepts have a high qualitative dimension that is very context specific. As such they are often dismissed inside companies as too subjective or not standardisable or quantifiable. Moreover, the way engagement with local communities is designed and implemented is instrumental to arrive at a real understanding of what matters in terms of impact and therefore how impact can be assessed. Therefore, it is the quality of local engagement that is a crucial variable for corporate activities, in terms of long-term trust, confidence and a continuing ability to operate in an area, thus an essential part of their sustainability, especially in frontier markets and fragile settings.

The difficulty lies in translating principled frameworks and performance standards which are currently part of the responsibility and accountability discourse, into outcomes consistent with strong, meaningful and durable local engagement. In many cases, as set out in our companion paper 'Mapping of ESG frameworks', the concepts inherent in current standards on impact and responsibility have not been clearly defined and guidance is limited on how to realize conditions for strong relationships between business and local stakeholders and the inclusion and participation of those affected by business and investment decisions (Van Dorp, Smits and Gehoel, 2024: 9). This weakens both corporate due diligence as well as the intended environmental and social impact that investors are looking for. It also suggests that strong local engagement is an often neglected but nonetheless potentially critical element in compliance with ESG issues and impact objectives between investors, portfolio companies and other stakeholders. Therefore, in any social impact measurement model, local inclusion, community engagement and participation need to be included to ensure that local voices are being heard and their perspectives taken into account.

## 5. The value of a Human Security approach for ESG and social impact measurement

Determining social impact on the basis of current standards offers a starting point for defining a company's responsibility and its boundaries. Corporate responsibility is typically defined by reference to existing guidelines and standards, but also how they relate to materiality of the business in question. When it comes to fragile and complex settings and in dealing with challenges across extended supply and value chains, this perspective of how to manage corporate responsibility is often inadequate. Partly driven by past experiences, including (fear of) shutdowns and new demands from investors and regulators, a number of DFIs, investors and multinational companies are working to develop specific policies and operational guidance for high-risk contexts which involves conflict-sensitive approaches and an increased focus on the risks for people and communities that are impacted by businesses. In high-risk contexts, the challenge of impact measurement requires an outside-in and bottom-up approach in order to bring to light ESG issues which are relevant and applicable to the communities where the company operates. A process is required to then feed these back from the ground and country level to inform global indicators that are measured at headquarters in line with the company's existing standards, metrics and objectives.

Human Security (HS) focuses on the most fundamental rights – to life, basic needs and dignity and it emphasises the importance of the local context in which these rights are exercised. HS is addressing the various challenges present in a specific time and place, while providing people with the means to address these challenges. HS therefore has a strong preventive dimension which not only covers the mitigation of risks and ensuring that affected people have access to remedy but that they can make tangible improvements in their everyday life. This approach empowers people to address the root causes of the risks and fragility they face, rather than merely reacting to the impact of external economic activities. In short, Human Security serves to protect people from threats by addressing real practical concerns related to human rights, peace and development. In addition, HS, in contrast to human rights, focuses more explicitly on the creation of positive impacts.

An HS approach emphasizes the connections between people's rights and needs, making it relevant for developing new thinking in relation to social impact. It has the ability to demonstrate the actual relationship between E, S and G issues. This is an essential prerequisite for companies that want to maintain their social licence in areas of operation, and their ability to demonstrate Do No Harm. For instance, a focus on HS can reveal how land rights and ownership are connected to people's economic, environmental and food security and how these in turn also confer people's dignity and sense of cultural belonging. It is the ability of HS to encompass the breadth of issues that affect people's everyday lives which makes it not only a lens for risk management but to reflect outcomes which are highly consistent with the goals and targets of the 17 SDGs, for example. As noted above, current ESG risk and social impact assessments fail to consider such a holistic perspective, often resulting in corporate activities creating unintended negative consequences for local communities and facing costly operational disruptions.

Instead, a Human Security (HS) approach for businesses can bring together the 'human elements' of human rights, security, and development. It is an inter-disciplinary concept that displays the following characteristics: it is people-centred, multi-sectoral, comprehensive, context-specific and prevention-oriented. In short, Human Security (HS) takes a holistic approach that helps clarify how diverse issues — ranging from deprivation in all its forms to violence and environmental degradation — interact and require comprehensive, context-specific solutions. As such, it does not add another layer to the existing frameworks but rather strengthens the work already in place by tying it together.

## 6. Ingredients of a novel method for social impact measurement

Following the above observations, we believe that there is scope for an improved ESG and social impact measurement method from the perspective of Human Security (HS). Such a method proposes a context-driven approach, linking ESG issues to a wide variety of every-day (personal, economic, political, environmental, community, health, food or technology-related) risks people face whether they are rights, security or development related, and revealing the effects of company operations and investments on those risks.

Our proposition is that this not only reflects the true level of risk and the complex roots of risk on the ground, and thus is a more salient basis for generating measurement indicators. The proposed method also aims to draw attention to the need for improved interaction with local communities on ESG risks and impact, and what kind of added value this will produce for companies, investors and other (local) stakeholders. For instance, if an exchange of information on ESG risks and impact between investors and investee companies is enhanced through local, granular and timely data as a result of the HS approach in exposing and understanding localised risks, impact measurement should take this into consideration. On the other hand, ESG impact metrics that do not take into account this bottom-up, outside in approach may be faced with a valuation risk (e.g. litigation risk by failure to disclose the known ESG risks or non-compliance with the new CSDDD regulation). The key to this approach is on collaborative and participatory ESG and social impact measurement by private sector actors alongside community stakeholders.

The added value of the HS approach is in the ability to use the different dimensions of Human Security to define risks to people. In addition, by using the four value creation areas, it is possible to measure to what extent local engagement mechanisms increase value to companies and investors.

The novel method for social impact measurement consists of the following ingredients:

### 1. Dimensions of Human Security

The eight dimensions of human security provide the basis of our impact measurement approach. Each dimension has specific risks to human security of people, as indicated in the table below.

Table 1: Dimensions of Human Security

| **Dimension of Human Security** | **Examples of risks and impacts on people and communities** |
|---|---|
| Economic security | Poverty, unemployment, corruption, lack of access to land, water, electricity, credit or education |
| Food security | Natural hazards including droughts or floods, breakdown of supply chains, conflict leading to hunger and famine |
| Health security | Infectious diseases, malnutrition, lack of access to health care |

| | |
|---|---|
| Environmental security | Environmental degradation, resource depletion, contamination of water supplies, groundwater depletion, natural hazards including droughts or floods |
| Personal security | Physical (domestic/gender-based) violence, crime, terrorism, child/forced labour, injustices |
| Community security | Inter-ethnic, identity-based group grievances based on socio-economic & cultural inequalities, lack of social cohesion |
| Political security | Political polarization, repression, human rights abuses, corruption |
| Technology security[8] | Applying technology that is not benefiting or harming people |

In the novel method for social impact measurement, the different risks and impacts will be translated into a set of indicators that provide more relevant data on the true social impacts on people and communities as a result of company's activities.

2. **Value Creation areas**

In our companion paper 'Mapping of ESG frameworks and standards', four specific areas of value creation were identified through which local engagement mechanisms can increase value to companies and investors (Van Dorp, Smits and Gehoel, 2024: 11-12). These four value creation areas are:

1. Learning: Local engagement mechanisms that generate new ESG and SDG impact knowledge and the development of ESG risk and SDG impact management capacities.
2. Relational: Local engagement mechanisms fostering new and underdeveloped relationships with the investor/investee that enhance internal coordination and external collaboration.
3. Instrumental: Local engagement mechanisms that lead to better ESG and impact management practices that can take the form of changes in behaviour, policies and the use of enhanced sustainability tools.
4. Financial: Local engagement mechanisms that produce, among others, enhanced financial performance, long-term financial returns and short-term cost reductions.

As one of the ingredients of the novel measurement methodology, these value creation areas will be used to highlight and measure the way in which local engagement is being operationalized, and what impact it is creating, both positive and negative.

**Proposal for a novel method for social impact measurement**

To improve existing social impact measurement methods, we propose a framework that is measuring actual social impacts at any stage in the life cycle of a business operation, both from an inside out as well as from an outside in perspective. It aims to measure to what extent the company's impacts contribute to the development priorities of the

[8] Technology security was added by the UN General Assembly in September 2023 as a new dimension to human security; Consumer Technology Association (2023)

communities around the company's operations, and how the company is contributing to the different dimensions of human security.[9]

The proposed novel methodology consists of the following four steps:

**STEP 1 – Set boundaries to the assessment**
Determine the scope and depth of the overall assessment in terms of geographical boundary (local versus regional) and types of business activities to be assessed. This is an important first step as it will ensure that the assessment will be focused on the right set of stakeholders. The right balance needs to be struck between having a large enough scope and depth to be comprehensive, but also specific enough to be meaningful for the local stakeholders involved.

**STEP 2 – Measure direct and indirect social impacts**
Identify and measure the direct and indirect social impacts arising from the company's activities, mapping out what impacts are within the control of the company and what it can influence through its business activities. This will lead to a 'potential' or 'preliminary' measurement from an inside out perspective by the company itself, which needs to be recalibrated through integrating the stakeholder engagement and participation of those who are impacted through the HS approach.

**STEP 3 – Assess (positive and negative) contribution to human security**
Assess to what extent the company's impacts contribute to the development priorities of the communities around the company's operations, and how the company is contributing to the different dimensions of human security (Ingredient 1). Local stakeholder engagement is a key component of this step. A representative group of stakeholders can be engaged to assist the company in prioritizing the development issues for the assessment area. Different engagement tools can be applied here, including field surveys, power analysis/power walks, trend analysis, or consequence diagram development. The assessment can be more geared towards qualitative or quantitative measurement, depending on the specific needs and the available resources and time.

**STEP 4 – Determine value creation areas, set key risks and opportunities and prioritize management response**
Based on steps 2 and 3, the value creation areas for local engagement are determined (Ingredient 2) and the key risks and opportunities relative to the company's social impact are defined. This will usually require a collaborative effort by internal and external stakeholders in a workshop setting. Based on this, an appropriate management response needs to be formulated to improve the company's social impact and its contribution to human security.

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[9] The methodology was inspired by and is building on the Measuring Impact Framework developed by the World Business Council for Sustainable Development and the International Finance Corporation; See: World Bank Group, 2008

Compared to existing social impact methodologies, the proposed methodology is using the Human Security dimensions, adding a number of indicators that are currently not considered. Also, the four value creation areas are providing a new way of assessing local engagement of companies. More specifically, the methodology provides the following complementary elements:

- It is more participatory by engaging with and involving local stakeholders comprehensively and continuously in the impact measurement process.
- It is an iterative process that builds and constantly re-assesses by reference to and dialogue with local stakeholders.
- It allows for temporary fluctuations and variations that are particularly salient to fragile and conflict-affected settings (FCS), where instability and volatility are commonplace.
- By taking a holistic approach, it is geared towards prevention of negative impacts while maximizing positive impacts, for the benefit of all stakeholders involved.

Further development of the proposed method is needed by bringing together the two ingredients (dimensions of human security and value creation areas for local engagement) and the proposed steps into a full-fledged social impact measurement methodology. This will be done by LSE IDEAS in close consultation with a number of interested parties, including companies, investors and standard setting organizations, to ensure that the methodology is actually responding to their needs and provides a solution to some of the gaps in current impact measurement methodologies.

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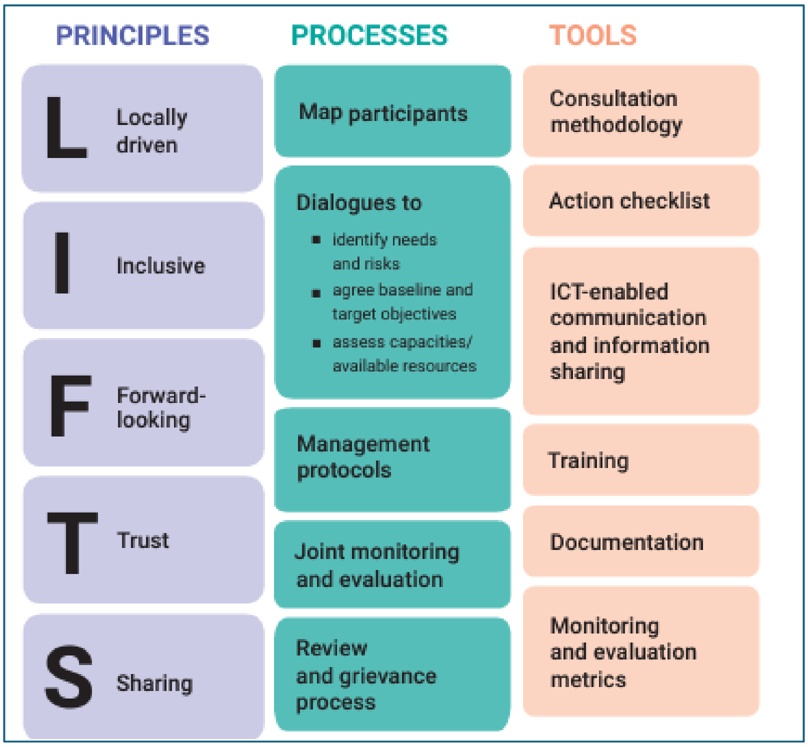
## Annex A: The Human Security Business Partnership Framework[10]

The Business and Human Security Initiative at LSE IDEAS, the foreign think tank of the London School of Economics and Political Science, supported by the United Nations Trust Fund for Human Security, seeks to support the engagement of the private sector in multi-stakeholder collaborations at the local level to achieve sustainable development outcomes. This Framework is a unique guidance tool to help companies, investors and other financial actors manage practice challenges and translate global ethical standards on responsibility and social impact into actions at local level and achieve positive social impacts. It sets out practical, innovative steps for businesses to meet their commitments to the Sustainable Development Goals (SDGs), to set and deliver on ESG impacts and develop state of the art corporate social responsibility and stakeholder engagement strategies.

The HSBP Framework consists of three pillars: principles, processes and tools. Each pillar connects to the others and defines the spirit and ethos of a new type of engagement between the private sector and other actors locally, while proposing practical actions to assist the private sector increase ESG performance and achieve the ambitions of the SDGs. The Framework uses the UN definition of human security (General Assembly resolution 66/290 (2012)). This highlights the importance of people-centred action, the comprehensive nature of risk that individuals face, and the need for integrated solutions that can prevent vulnerability and future crises.




[10] LSE IDEAS, 2021