A Framework for Constructive Capital:
Investment, Integrity, Impact

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Part Four: Supportive Trends in Responsible Business and Investment

The role of business in its broader economic, political, and social context is central to CIPE’s work on Constructive Capital. The changing parameters of responsible business and investment, along with shifting societal expectations, offer new prospects for engagement and impact.

Such developments can shape strategies for Constructive Capital, both in theory and in practice. As noted in Part Two, a values-driven private sector is one of the Cornerstones of Constructive Capital. The supportive trends described here reinforce this foundation. They also underscore the links between investment, integrity, and impact – notably through ESG strategies.

I. Context

A responsible private sector can make enduring contributions to strengthening Constructive Capital and curtailing Corrosive Capital. By way of background, the evolution of both responsible business and responsible investment are briefly described. These movements are converging in a meaningful way, driven by the power of capital decision-making and allocation.

Programs for corporate social responsibility (CSR), which developed alongside business compliance and ethics programs, were initially based on community outreach and philanthropic efforts. In 2000, the UN proposed a “Global Compact” with business focusing on voluntary commitments regarding human rights, working conditions, environmental measures, and anti-corruption. Other multi-stakeholder initiatives also responded to a range of relevant topics and industries, raising standards and encouraging companies to report on their activities. Corporate responsibility became defined through managing risks and mitigating negative impacts – and eventually through identifying positive opportunities. Corporate responsibility now embraces broader questions of sustainability. It guides multiple aspects of company values, strategies, and operations with influence across multinational supply chains.

Emerging on parallel tracks, responsible investment originated in the “socially responsible investment” initiatives of the 1970s. This has moved into the mainstream and is now re-shaping the corporate responsibility movement. During the first decade of the 21st century, the corporate responsibility agenda focused on climate change and environmental sustainability, poverty and development, as well as labor and human rights. This perspective continued over the last decade, even as the climate crisis intensified, inequality widened, and human rights abuses persisted. Critics perceived a disconnect between corporate policies and actions, between commitments and impacts.

At the same time, the view took hold that capital – mobilized by investors and deployed in the financial markets – held a key that could unlock progress. It could bring the weight of asset allocations, as well as direct engagement and shareholder advocacy, to bear on public companies. Institutional asset owners and managers, plus a few sovereign wealth funds, began to see ESG risk factors as potentially material to investment decisions and outcomes. This laid the basis for “ESG investing” driven by environmental, social, and corporate governance factors. As discussed below, mainstream investors across different asset classes have gradually embraced the agenda. For example, JP Morgan estimates that assets referring to ESG principles may soon represent 44% of global assets under management.
Within this context, Part Four of the report takes up four developments: Business and Human Rights; Due Diligence Initiatives; Responsible Investment and ESG; SDG 16 and Transformational Governance.

II. Business and Human Rights

The UN Guiding Principles on Business and Human Rights, endorsed in 2011, created for the first time a globally authoritative standard on business and human rights.\textsuperscript{110} The UNGPs establish the state duty to protect human rights, the corporate responsibility to respect human rights, and the shared obligation to ensure access to effective remedy for victims of business-related human rights harms. The UNGPs have been reinforced in numerous other global and regional standards and frameworks. Notably, the OECD has included the business responsibility to respect human rights and due diligence for responsible business conduct in the OECD Guidelines for Multinational Corporations.\textsuperscript{111}

The UNGPs do not mandate a specific form of government regulation applicable to companies operating within or from their territory. Instead, their implementation relies on a “smart mix” of measures to ensure that states meet their duty to prevent and address business-related human rights abuses, and to ensure that companies meet their own responsibilities to respect human rights, including through due diligence.\textsuperscript{112} Such measures may include legislation, regulation, policy guidance and support for companies, as well as incentives.\textsuperscript{113} Large multinational companies are expected to establish human rights policies and report on their implementation in practice.\textsuperscript{114} Overall, company disclosures are being subject to greater scrutiny. Several human rights-focused corporate benchmarks have also emerged, clarifying industry risks and related issues.\textsuperscript{115} While aimed at companies and a range of stakeholders, these benchmarking initiatives are also proving to be useful to investors.

In the decade since their endorsement, the UNGPs have been taken up by governments, companies, and many civil society organizations.\textsuperscript{116} As a result, the due diligence process has become an important way for companies to demonstrate respect for human rights and manage risks. The stakeholder pressures continue to grow, not just about inputs but about outcomes. Moreover, the expectations placed on multinational corporations are extending to their suppliers, especially in labor-intensive industries. This sharpens the focus on problems of forced and child labor, human trafficking, and modern slavery. At the same time, enhancing compliance throughout global supply chains can pose local challenges. CIPE’s work in emerging markets confirms the need to educate and support businesses in implementing practicable measures to minimize risks and safeguard their operations.

Finally, the business and human rights agenda has generally been considered as separate from environmental and climate issues. Yet, given the mounting climate crisis, impacts on human rights are becoming part of the discourse. The climate justice agenda highlights disproportionate effects in the Global South, as well as in poor communities within both rich and poor countries alike.\textsuperscript{117} Thus, companies are beginning to identify and manage their environmental and climate impacts through the lenses of inequality and social injustice.

III. Due Diligence Initiatives

The question of due diligence in human rights, as well as in environmental matters, is tied to the governance of corporate risks. Across jurisdictions, there is growing interest in strengthening due diligence and disclosure requirements. This has been influenced by the UNGPs, but also builds on current mandatory disclosure and transparency legislation related to specific issues. Examples include conflict minerals and modern slavery. Resources such as the OECD Due Diligence Guidance for Responsible Mineral Supply
Chains and the OECD Due Diligence Guidance for Responsible Business Conduct help companies to identify and manage risks as well as to comply with government mandates.\textsuperscript{118}

Such disclosures were initially opposed by some companies and industry associations due to concerns over compliance costs and administrative burdens. With time, they gained business support for helping to strengthen supply chain oversight and risk management of legitimate human rights and environmental issues. However, there is still a large gap in knowledge and capacity between multinational corporations and local businesses that needs to be addressed, especially in emerging and frontier markets. Select regulators, investors, activists, and other stakeholders have appreciated the heightened transparency and accountability enabled by these disclosures. Nonetheless, this points to another challenge regarding the risk of Corrosive Capital. There is no global consensus on these issues. Some countries allow, or indeed in certain cases encourage, their companies to operate according to a different set of principles to gain an unfair competitive advantage.

While several countries have adopted or are considering legislative measures, one significant example will be noted here. By 2024, the EU is expected to enact mandatory due diligence requirements regarding human rights and environmental issues. The scope will include EU companies above certain size and turnover thresholds, as well as comparable non-EU companies that are active in the EU.\textsuperscript{119} Referred to as the EU Sustainable Corporate Governance Initiative, this is part of a post-pandemic recovery package and growth plan as well as a response to climate change. It should be noted that other provisions within this ambitious Sustainable Finance Package are also of relevance to Constructive Capital, including those on sustainable investment taxonomy and corporate sustainability reporting.\textsuperscript{120}

Such initiatives may accelerate the take-up of mandatory environmental and human rights due diligence legislation in other jurisdictions. Moreover, companies within supply chains will be encouraged to implement policy and transparency commitments, due diligence systems, and grievance mechanisms if they want to be attractive partners to global businesses. At the same time, the distinct elements of ESG will become more integrated – and G will become more actively applied to E and S – as companies across the value chain move to strengthen their governance of environmental and social issues. As mandatory disclosure requirements take hold, companies will become more consistent in reporting of ESG data. However, many companies are concerned about the scope of such requirements and the related operational burdens. Regulators need to consider due diligence obligations in consultation with the business community. The risk management and transparency associated with such efforts, if effectively implemented, may help to enhance flows of Constructive Capital and root out Corrosive Capital.
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IV. Responsible Investment and ESG

A. Overview

The term “ESG investing” refers to the practice of considering environmental, social, and governance factors in investment decisions alongside purely financial factors. Environmental factors focus on climate change, toxic pollution, land and water, biodiversity, and deforestation. Social factors focus on labor and human rights, local communities, and issues of inequality and discrimination. Governance factors focus on roles and responsibilities of corporate boards, executive management, and shareholders (for public companies), as well as on compliance and risk management processes. Overall, ESG investing seeks to evaluate corporate performance on these three sets of factors to inform investment decisions, reduce risk, and enhance long-term if not short-term performance.

Early impetus for ESG came from an UN-led initiative in 2005, when a group of the world’s largest institutional investors created the “Principles for Responsible Investment.” Signatory investors commit to six principles to integrate ESG issues into investment analysis and decision-making processes, and to demonstrate active ownership. The PRI initiative is now an independent organization, with continuing UN support. It conducts research on emerging issues and offers a range of resources and engagement opportunities. As of 2021, the PRI had more than 3,800 signatories, representing approximately US $121 trillion in assets under management.

This global reach to companies around the world creates new opportunities to heighten environmental and social priorities, mitigate risks, and improve corporate governance. However, ESG investing is still an evolving field. Metrics are currently inconsistent, and overall impact is difficult to assess. Of course, CIPE recognizes the growing significance of the ESG agenda as well as its potential in relation to Constructive and Corrosive Capital, especially in emerging and frontier markets.
B. Company Engagement

One important aspect of ESG relates to company engagement and shareholder advocacy. While the ESG investing market remains dominated by North America and especially Europe, it is rapidly growing in the Asia-Pacific region. Stock exchanges, which can significantly influence how large numbers of companies govern themselves, are also increasingly involved with the ESG agenda. As part of the Sustainable Stock Exchanges (SSE) initiative, several exchanges have launched ESG guidance programs for their listed companies.\(^{125}\)

The rise in ESG investing is primarily driven by the continued long-term performance of ESG funds, along with the growing awareness among mainstream investors that ESG factors are material to financial performance. However, with the UNGPs and guidance from the OECD regarding the applicability of the MNE Guidelines to institutional investors, there is also a growing acceptance that investors share responsibility for the impacts of their investments through the performance of the companies in which they invest. The EU has redefined the role of institutional investors as financial actors by requiring disclosure of the steps they have taken to address the adverse environmental and/or social impacts of their investment decisions.\(^{126}\)

The expansion of ESG investing is also reflected in and reinforced by the approaches that investors use to engage with companies in their portfolios. Investor strategies include dialogue with company management, shareholder resolutions and proxy voting, multi-stakeholder standard-setting, and in rare cases, divestment. BlackRock, a front-runner on stewardship priorities and engagement, reported a record $10 trillion in assets under management as of January 2022.\(^{127}\) Also noteworthy is the announcement from the Glasgow Financial Alliance for Net Zero.\(^{128}\) Major banks and financial institutions with more than US $70 trillion in assets under management have pledged to cut the “carbon content” of their assets by 2030 and to work towards “net zero” emissions by 2050.

Climate change, human rights and other issues have also become crucial factors for identifying and assessing risks in investment portfolios. ESG investing is increasingly seen as an extension of established due diligence practices. The COVID-19 pandemic has strengthened this understanding, with record inflows into ESG funds. The crisis has also heightened attention to the “S” in ESG given the need to address risks to worker health and safety, as well as to labor conditions in global supply chains.\(^{129}\)

C. ESG Standards and Reporting

As indicated, various trends are driving the mainstream acceptance and expansion of ESG considerations in business conduct. The growth of the ESG market has also led to the proliferation of disclosure requirements and assessment procedures. Company reporting on these factors can be inconsistent and difficult to compare. Moreover, numerous commercial firms now offer analytics-driven ESG information. Underlying the complexity are jurisdictional variations in regulatory oversight as well as legal interpretation of issues such as materiality. Multiple efforts are currently underway for greater harmonization regarding both standard-setting and disclosure. The following are particularly relevant:\(^{130}\)

- The Sustainability Accounting Standards Board (SASB), an independent standards-setting organization, has merged with the International Integrated Reporting Council (IIRC) to create a new organization called the Value Reporting Foundation. It collaborates with bodies such as the Global Reporting Initiative (GRI) and Climate Disclosure Standards Board (CDSB).
• Several jurisdictions are examining ESG-related standards and disclosure requirements. For example, the EU will replace existing provisions under its Non-Financial Reporting Directive (NFRD) with a proposed Corporate Sustainability Reporting Directive (CSRD).

• The International Financial Reporting Standards (IFRS) Foundation launched a new International Sustainability Standards Board (ISSB) in November 2021 at the COP26 in Glasgow. The IFRS sets accounting standards that are already relied upon in many jurisdictions, and the ISSB will build upon existing non-financial reporting frameworks. The role of the ISSB is supported by groups such as the International Organization of Securities Commissions (IOSCO) and the World Economic Forum International Business Council (WEF IBC), as well as by the leading professional accounting firms.

Investors, companies, and professional services firms are closely monitoring these developments. Although the scope and timelines may shift, the preparation process is underway. This period of change will redefine corporate reporting – as well as accountability – for years to come. It also holds important implications for stakeholder engagement, long-term value creation, and the overall contribution of the private sector to society.  

V. SDG 16 and Transformational Governance

The UN Global Compact (UNGC) has developed an innovative framework that draws on trends in both responsible business and responsible investment. It is anchored in SDG 16 implementation and informed by ESG practices. This initiative on Transformational Governance is also forging links between corporate governance and public governance. As such, it reflects several themes of relevance to the Framework for Constructive Capital, including the reinforcement of the Cornerstones of Constructive Capital.

The UNGC addresses questions of rule of law and governance through its Action Platform for Peace, Justice and Strong Institutions. This collaborative effort is aligned with the Ten Principles of the UN Global Compact and the UN Sustainable Development Goals, particularly SDG 16. It helps companies to identify business risks and opportunities, engage in stakeholder dialogue with civil society and other actors, share best practices, and demonstrate leadership. Selective advocacy by companies – together with business partners and civil society allies – could support the foundations of Constructive Capital to the mutual benefit of economies and societies. The Action Platform is also a complement to the “shared space” approach in supporting the rule of law, accountable governance, and civic freedoms.

In September 2020, in commemoration of the 75th anniversary of the UN and the 20th anniversary of the Global Compact, the UNGC issued “A Statement from Business Leaders for Renewed Global Cooperation.” More than 1,000 Chief Executive Officers from companies in over one hundred countries demonstrated their support for the United Nations and global cooperation through peace, justice, and strong institutions.

In June 2021, the SDG 16 Business Framework: Inspiring Transformational Governance was launched at the UN Global Compact Leaders’ Summit. Key points include:

• The SDG 16 Business Framework will help companies embrace transformational governance, a principles-based philosophy that calls on business to be more accountable, ethical, inclusive, and transparent as a driver to responsible business conduct, enhanced ESG performance, and strengthened public institutions, laws and systems.

• With the increasing overlap and urgency on ESG issues, transformational governance is a prism through which businesses can expand their understanding of the “G” in ESG. It demonstrates why and how businesses can assess and implement each target of SDG 16 through internal and external activities, including throughout their supply chains.
The SDG 16 Business Framework does not aim to create new legal commitments or standards, but to deepen the understanding of the role that business can play in advancing these issues. It can strengthen cross-functional engagement, while encouraging companies to assess their situation and identify opportunities for improvements. It can also help companies to incorporate such understandings into board and management oversight, values and culture, strategies, policies, operations, and relationships. The SDG 16 Business Framework now provides an extensive online resource that offers dozens of examples of company action on both corporate governance and public governance. Such examples could help inform the advancement of the Framework for Constructive Capital.

In conclusion, a Values-Driven Private Sector has been set forth as one of the Cornerstones of Constructive Capital, but it also serves to strengthen other Cornerstones. The way in which business operates, the culture it instils, and the relationships it maintains can all be sources of support. This overview of trends in responsible business and investment has highlighted improvements in corporate governance practices and risk assessment; new procedures for transparency and reporting; greater engagement in multi-stakeholder initiatives, and increased attention to a broad range of social and sustainability issues. One of the key challenges CIPE has identified is to translate the UNGPs and other international principles into actionable steps for mid-sized companies in emerging markets. The growing focus on impacts has further heightened expectations for all companies to align their commitments with meaningful actions. This begins with their own operations and supply chains. At the same time, businesses have new opportunities to support broader societal goals, helping to create an enabling environment for profitable and sustainable business models.
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The Center for International Private Enterprise (CIPE) is a core institute of the National Endowment for Democracy and a non-profit affiliate of the U.S. Chamber of Commerce. CIPE’s mission is to strengthen democracy around the globe through private enterprise and market-oriented reform.

Founded in 1983, CIPE partners with local business associations, chambers of commerce, universities, think tanks and advocacy groups worldwide to implement innovative, cost-effective, business-led solutions to complex policy and governance challenges.

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