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Impact-Weighted Accounts

Case Study: Testing Impact-Weighted Accounts by the Global Impact and Investment Stewardship Teams at BlackRock

Introduction:

In January 2019, Harvard Business School created the Impact-Weighted Accounts Project ("IWAI") to drive the creation of financial accounts that reflect a company's financial, social, and environmental performance. The team's ultimate goal is to create accounting statements that transparently capture external impacts in a way that drives investor and managerial decision-making. Since its inception, IWAI has created methodologies to quantify and monetize impact across environmental, employment, and product dimensions of corporate activity. Following publication of those methodologies, the team engaged across the spectrum of capital providers and users (including corporates, investors, non-profits, and intermediaries) to pilot aspects of the methodology, seek feedback on the relevant methodology's usefulness and fit for the chosen purpose within the piloting organization, and/or co-develop new applications.

Between October 2020 and April 2021, members of the Global Impact and Investment Stewardship Teams at BlackRock worked closely with members of the Impact-Weighted Accounts Team at Harvard Business School to pilot test IWAI product and employment-impact calculation templates. The Global Impact Team manages BlackRock's public equity impact investment strategy and the BlackRock Investment Stewardship Team (BIS) works across investment strategies to promote corporate governance and business practices that are aligned with the long-term economic interests of BlackRock's clients. The BlackRock working group consisted of Quyen Tran, Director of Impact Investing and Head of Fundamental Equity Sustainable Investment Research, investment analyst Daniel Concessi, who covers healthcare, software, telecommunications, and financial services, investment analyst William McSweeney, who covers financial and education technology sectors, and investment stewardship analyst Ariel Smilowitz, who is responsible for proxy voting and engaging with senior executives and board members of portfolio companies on matters related to corporate strategy, governance, and environmental and social issues.

Scope of the Work:

Following an introductory meeting in which the IWAI team explained the coverage and scope of the environmental, employment, and product pillars of research, the BlackRock team determined to focus their pilot on the product and employment pillars of research. The Global Impact Team views impact through a product lens, that is, the impact investing strategy invests in companies whose core goods and services address some of the world's great social and environmental problems. The BlackRock team proposed several companies for analysis. To examine whether impact companies, as defined by the BlackRock Global Impact strategy, have greater product impact than traditional firms, Safaricom was compared to traditional telecommunications companies. Similarly, the consumer finance product impact template, which focuses on credit card payment services, was examined for applicability across other credit card, lending, and payment services. Lastly, the employment impact methodology was applied to

Merck & Co. (Merck), Intel Corporation (Intel), and United Parcel Service, Inc. (UPS). Each implementation was paired with a member of the IWAI team for the pilot.

The IWAI and BlackRock team initially met as a group weekly. As the working pairs between BlackRock and IWAI began, they determined the cadence of contact and pair meetings. Usually bi-weekly, the full teams gathered to discuss cross-cutting takeaways and progress.

Key Takeaways:

This report seeks to memorialize key learnings from the BlackRock team's reviews and co-development efforts with the IWAI team.

Consumer Finance: Product Comparability and Scalability

For companies within the same industry and market, the product templates helped to generate a number of key findings, including the amount of impact generated, as well as the drivers of that impact. An additional important finding of the product impact workstream was on comparability between companies and the scalability of the IWAI approach across different markets, industries and impacts. The team determined that within a Global Industry Classification Standard (GICS) sector, across which IWAI has organized its product research, there are three levels of scalability, pictured in Exhibit 1:

- Different inputs: Companies within the same industry & market can be readily compared using the data from the respective companies with the same industry assumptions as is the case with American Express and Discover.
- Different assumptions: Companies within different markets and or tangentially related industries within the same sector (i.e. credit card lending can be similar to auto loans or student loans) can be compared but require not only the company inputs but also modifications to the impact template assumptions to match the context. This is the case with American Express and JCB as well as with AT&T, Verizon, and Safaricom.
- Different impacts: Companies with different business model within the same sector (i.e. payments, lending, and banking operate with different business models and require different templates). However, the previously developed industry templates and guidance paper can provide a problem-solving approach to constructing the new industry template. This is the case with calculating the impacts for PayPal, a payments services company, by modifying the consumer finance template.

Telecommunications: Impact Firms Outperform Traditional Telco on Product Impact

There are clearly potential and practical use cases for a product template within the telecommunication sector. The findings from each of these variables can, at the very least, directionally aid an investor's assessment of a telecommunications company's overall value proposition. In other instances, the product template can provide great insight into the magnitude of the value proposition as well.

- The template is helpful in attempting to quantify some of the most subjective investment variables, like brand loyalty and customer perception, that are highly relevant from an investment standpoint.
- We found that impact can differ depending on 'when in time' the template is used to quantify impact; for example, telehealth was not widely used as a medium to communicate with patients

until the COVID-19 lockdowns, which means the cost of being offline was higher in the last 12 months than any other time in history. We have concluded that impactfulness of being connected to telecommunications is higher today than any other period in history (because of how so many services are digitally enabled and digitally dependent)

- The most impactful firms within telecommunications deliver significant underserved impact and basic need impact, getting new subscribers, who were previously not connected to the network.
- This template captures the key issues for general telecommunications firms – from the monopolistic / oligopolistic nature of the industry to reliability of service provision. We have found the template framework to be comprehensive in capturing impact metrics that are most impactful.
- This differential impact is before consideration of additional services or offerings leveraging the underlying telecommunications infrastructure, such as M-Pesa (mobile phone-based financial services including micro-financing, payments, and money transfer services) or Digifarm (mobile phone-based platform helping farmers benefit from integrated services), which can often be a part of a telecommunications company's value proposition.
- The market norm in the US is to include many services in a single priced "bundle," illustrating that certain market nuances can complicate the template's analysis
- Note: The comparisons / benchmarks made are for the Kenyan market rather than the US market

Employment Impact: Comparability and Communication

From an investment stewardship perspective, the IWAI Employment template provides an opportunity to identify gaps in a company's overall approach to human capital management and develop more targeted and outcome-oriented corporate engagements. Differences in company culture, benefits, salaries, opportunity for advancement and diversity, among others, can be challenging to compare using different metrics; monetization based on the impact generated for the employee and local labor community is a useful way of comparing organizations. Further, monetization can illustrate to corporate leadership the critical impact drivers for employees, which could help boards of directors and management better identify material business risks and opportunities (e.g. reducing turnover). It may also clarify concerns raised during engagement conversations by turning abstract concepts like location impact and wellbeing into more tangible terms. The followings are findings from the beta testing done by the BIS team:

- **All companies have room for improvement.** While all companies produced net positive employment impact, analysis by impact dimension (e.g. Wage Quality, Diversity) is critical to better understand the effectiveness of a company's employment practices. The IWA employment template is a valuable tool to analyze specific dimensions of impact to highlight best practices and identify areas for future development. Even Intel, which could be considered a "leader" due to its robust disclosures, revealed negative employment impacts. Further, it may not be possible to point to any "leaders" and "laggards" until a baseline of consistent reporting can be established—both across companies and year-over-year. That way, investors can measure a company's progress to mitigate negative employment impacts and business risks *over time*, and then compare that performance against its peers.
- **Standardized disclosures are critical.** None of the companies that were analyzed (Intel, Merck, and UPS) reported workforce demographic information in a uniform way. As a result, we had to

rely on third party data providers and other sources (e.g. Glassdoor) to help fill in data gaps, and it was difficult to draw conclusions about whether one company emerged as a best-in-class example of employment impact due to the significant disparities in scope and granularity of information. This bolsters the BlackRock Team's conviction that companies should provide robust disclosures on workforce demographics in line with regional frameworks such as the U.S. Equal Employment Opportunity's EEO-1 Survey, as well as the BIS team's approach to advocate for greater transparency and accountability.

- **It's not enough to have a representative workforce—it must also be equitable.** All the companies that were analyzed revealed a negative opportunity impact, which indicates that even if a company was able to recruit and retain a diverse workforce, some workers do not receive the same opportunities (e.g. advancement or wage quality, etc.) as others. Consistent disclosures across companies using the EEO-1 Survey creates comparable metrics to assess opportunity within and across firms and industries.
- **Companies aren't disclosing the right data to help us understand their approach to career advancement.** None of the companies that were analyzed disclosed information about internal promotion rates or transfers. If this was an area that the companies claimed was part of their overall human capital management strategy, it was difficult to fully appreciate whether these programs were actually effective.
- **Health and wellbeing – including paid sick and family leave, childcare support, and other factors – has a measurable impact on a company's workforce.** In the context of the COVID-19 pandemic, employee health and safety has come to the fore as a material business risk for companies and key stewardship topic for investors. That said, only some of the companies that were analyzed reported paid sick and family leave or related benefits. Given that this is an area of increasing importance, companies should enhance their disclosures so investors can make a more fulsome assessment of efforts to support workers' health and wellbeing.
- **Companies can make a significant impact for their workforce by focusing on improving wage quality.** Positive employment impact begins with quality wages, including paying all workers above a living wage, maximizing the marginal utility of salary expenditures, and ensuring equal pay for equal work. Of the companies that were analyzed, all were able to generate a positive overarching total impact due to their investments in salaries and wages. Specifically, Intel was the only company that released demographically disaggregated salary data, which greatly aided the analysis. With this in mind, boards should consider having more formal oversight of risks related to workforce compensation.
- **The employment template provides valuable analysis for company engagements.** Specifically, the findings from the beta testing of the template were used to inform the BIS team's engagement with UPS in April 2021 to assess the company's efforts to create a diverse and inclusive workplace. Based on their engagement and evaluation of UPS's disclosures and practices, BIS ultimately supported a shareholder proposal requesting more information on how the company measures the effectiveness of its programs.

Concluding Thoughts:

Broadly, the impact-weighted accounts framework can be an important tool that adds differentiated insight into investment research and stewardship analysis. Monetary terms facilitate communication and comparability. They also help to inform other factors used in due diligence and

valuation analysis, including insight to determine the appropriate Weighted-Average Cost of Capital (WACC) that should be applied to the business projections. IWA offers an eloquent and organized framework for impact quantification that should yield valuable insights to any long-term investment process.

Exhibit 1: Telecommunications Company Analysis

Dimension	Company Data	Industry Assumptions	Product Impact Range of Two Leading US Telco	Safaricom
Affordability	Revenue per user	Industry revenue per user	$0 to $439m (0 to 0.4%)	$0 (0%)
Underserved	Rural, emerging market, and lower income connections	Value of rural & emerging market connectivity	$577m to $4,980m (0.5 to 4.9%)	$110m (6.8%)
Effectiveness	Speed offered	Industry speed Value of time saved / lost	-$8,662m to $8,990m (-8.5% to 7.7%)	$1,887m (116.4%)
Basic Need	Users connected	Value of connectivity	$2,584m to $3,752m (2.2 to 3.7%)	$780m (48.1%)
Optionality	Customer satisfaction	Price rent from monopoly	-$2,097m to -$1,848m (-2.1% to -1.6%)	-$99m (-6.2%)
Efficiency	Emissions from use	Cost per ton of emissions	-$484m to -$422m (-0.4%)	N/A
Recyclability	E-waste generated & recycled	Cost & value per ton of e-waste	-$1,555m to -$1,281m (-1.5% to -1.1%)	N/A

Note: Impact figures provided are estimates from 2018 data. Product impact scaled by relevant revenue is provided in parentheses as (%).

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Exhibit 2: Applying the IWAI Template to Other Firms, Other Markets, and Other Industries

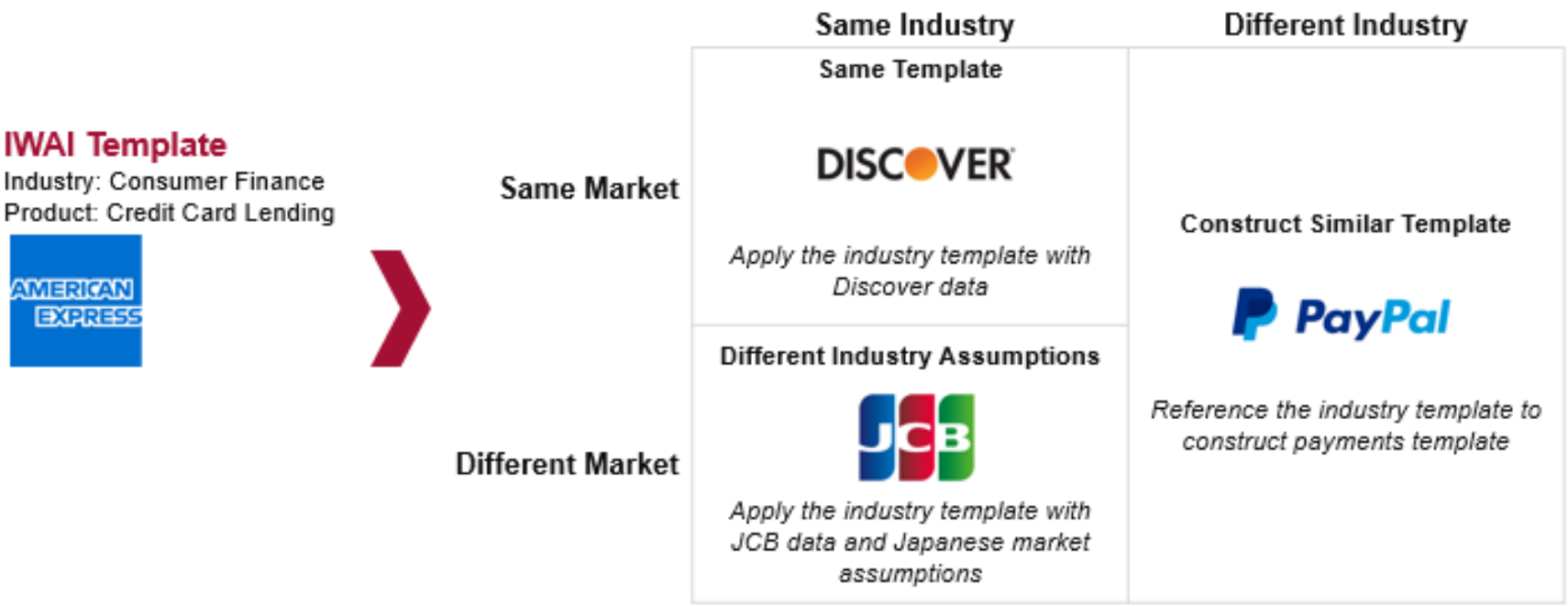

Exhibit 3: Illustrative 2018 Employment Impact Calculations

Dimensions	Company Data	intel	MERCK
Wage Quality	Average salary per occupational category	$7,161m (50.07%)	$2,457m (12.11%)
Career Advancement	Turnover rates, new hires (external candidates), average salary increase with internal promotion	N/A	N/A
Opportunity	EEO-1 report	-$860m (-6.01%)	-$171m (-0.84%)
Health and Wellbeing	Incident rates, paid family & sick leave, average amount of childcare support, etc.	-$189m (-1.32%)	-$59m (-0.30%)
Diversity	EEO-1 report	-$2,705m (-18.91%)	-$303m (-1.49%)
Location	Number of employees in each location	$314m (2.20%)	$71m (0.35%)

Note: Impact figures provided are unofficial estimates calculated by BlackRock and may differ from those published by the Impact-Weighted Accounts Initiative. Employment impact scaled by relevant revenue is provided in parentheses as (%)."