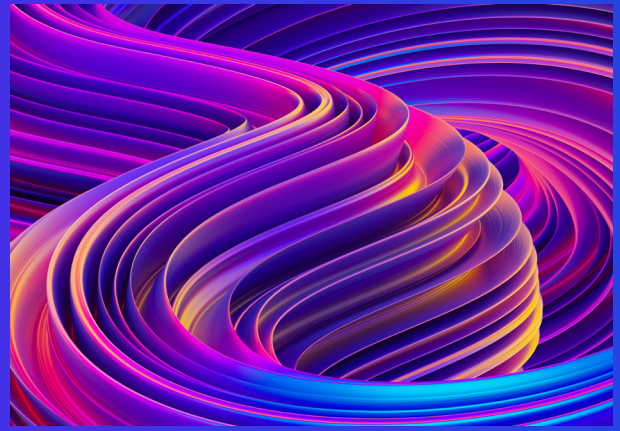




Houston Trend Talks

Social Solutions of ESG



Josh Galvan (00:0):

Welcome everyone to the Houston Trend talks podcast where we explore current challenges and opportunities facing Houston businesses. I'm your host, Josh Galvan, and I'm a partner at KPMG based in this fine city. Today, we have an episode that focuses on social solutions for the S in ESG. I'm joined by longtime colleague, Zoe Thompson, who's a leader in research and client service for social solutions as well as Jose Claudio Travino, who works in KPMG forensic with a focus on ethics, compliance, and human rights. Today we get to dive into what businesses are considering in their strategies and action plans for the S in ESG. We've seen the major increase in focus on the social dimension of ESG in recent times. This emphasizes the importance of how businesses address societal concerns and issues while creating positive impact alongside their efforts to environmental sustainability and good governance, both of which round out the E and the G in ESG. With Zoe and Jose Claudio here today, I'd like to begin by discussing how social awareness and action are evolving across businesses and industries today. Zoe, Jose Claudio, could you both kick us off by sharing some thoughts on the changes you've seen, and how companies are approaching social and the increased importance of this in business practice. Zoe, do you want to make a start?

Zoe Thompson (1:13):

Yeah, absolutely. Thank you, Josh, and great to be here with you and everybody today. So, a couple of things when people talk about Social. And I presume everybody on the call knows what we mean. But just to be clear, Social is really about how organizations impact communities and society. So that typically means looking at such topics as diversity and inclusion, human rights, supplier diversity, environmental justice, which is obviously really important to a lot of the companies that are based here in Houston. Really anything that's about how that organization addresses both the risks and the opportunities of interfacing with society. So, in the past people may have talked about CSR, and they talked about corporate social responsibility which for a lot of companies really meant, how are they giving back to the community. And that is absolutely important, and that is definitely still a part of it. But the definition and the understanding of Social has really expanded, and that's changed over time, and so now it looks at your workforce. How is your workforce showing up? how diverse is your workforce? We find that a lot of employees, current employees and future employees really care about the culture that they're experiencing.

Zoe Thompson (2:27):

It's also about your customers and suppliers. What sort of relationships do you have with your suppliers? Are they as ethical as you are? And then the community as a whole. What are you doing to promote job growth for example, what are you doing to work with the communities that the communities are also benefiting from some of the things that are happening with your business. So, we see companies understanding that the role is shifting, and they have a responsibility not just to go and give money, but to really be part of the community, and to share in the benefits and also mitigate the risks of their business.

Joshua Galvan (3:05):

Awesome. Zoe, thank you for that overview. And I definitely can identify with some of what you said there, especially the part around culture and how it leads to better, more collaborative, more productive working relationships. And of course, that's working in consulting. We know how important relationships are, and that culture alignment with our clients and not just creating a positive experience around a project, but for our people and our clients and ultimately our client's business and impact there. So that's really great, thanks for sharing that. Jose Claudio, anything else you'd like to add to this.

Jose Claudio (3:37):

Absolutely, Josh, and thank you for having me. As Zoe mentioned one of the pillars to an effective social strategy involves establishing ethical relationships with both customers and suppliers. So, in that sense, in our experience, companies are starting to take a more proactive stance towards social issues, not only inside their operations, but in their external ecosystems. And this is really a great thing to see. For example, companies are becoming more and more mindful of how important it is to achieve supplier diversity, to rely on responsible technology and to ensure that human rights are protected and preserved throughout the entire supply chain. Not just the first level or so-called tier one suppliers. Let's take, for example, the topic of making sure that a supplier has fair working conditions, which is a consideration or a salient risk in the world of human rights. Not too long ago we were engaged to assist the client with performing a compliance audit of their key suppliers in order to focus on the social compliance component. On one occasion, when we arrived at what we expected it to be well established based on the type of products that vendor was providing. Much to our surprise, what we found was a rather simple operation, involving a warehouse that had been set up behind the house of the company's owner. I should point out that when this vendor was on-boarded, our clients procurement process did not include enhanced diligence procedures that in the case of certain high-risk vendors it would include a site visit to confirm that the company's infrastructure and working conditions are up to par so back to the case, the fact that the company was operating out of a warehouse wasn't the real problem. The worrisome issue was that the vendor was operating with a workforce that was almost entirely comprised of undocumented migrants who were working on their very poor conditions one could even categorize them as forced labor. The employees had their passports retained, they were not allowed to take breaks, etc. And it's interesting that this particular vendor had signed a contract which included language related to the vendor's commitment to protecting human rights. We all know that as part of a standard and better practices in dealing with vendors, in this case our client had made sure that this language was included in all of their contracts, and the vendor had responded to self-assessment questionnaires indicating that the company was in compliance with all of the expectations of our clients. So, what this exemplifies is the importance of being very diligent during the vendor on-boarding process, and remembering that famous phrase in the world of ethics and compliance, one can trust, but one should always verify

Zoe Thompson (6:30):

You know, Josh what's really interesting and I don't know if people always fully appreciate this, but it's important to be focused on Social because we care about people, we care about our communities. But it is absolutely a business issue for the reasons that Jose just talked about. It's funny. I may have actually mentioned this to you when we were first talking about this podcast, but I was in the hospital about 6 weeks ago. Everything's fine. But I was talking with the doctor, and the doctor said so what do you? And I said, oh, I work with ESG, and I'm focused on Social. And he said, Yeah, too bad. It doesn't really make a difference with the business, and I said, Hold on. Now, at this point I was also on some heavy narcotics, so I was very candid. And I said, let's talk about supply chain resiliency. If you are working with a supplier that is using forced labor or is not using employees that are permitted to work. That's illegal. It's not just unethical, but it's illegal, and that could prevent your goods, your services, your products from getting to market. That's a supply chain resiliency issue. Of course, it's a moral issue, but it also impacts your ability to do business.

Zoe Thompson (7:42):

So, we've always talked in business about making sure we could allocate scarce resources. That's always that we can look at risk, we could figure out, what makes the most sense for the capital markets. And this is no different. This is taking a look and saying these risks that include not just financial risks, impact your ability to do your business. And that becomes a business issue. So, we're trying to help people understand that there's a social component. But it is really about being good stewards and being good businesspeople as well.

Joshua Galvan (8:12):

Yeah, fantastic examples thanks, and of course, for sharing the overview and some insight from really what's going on in business practice today. I mean, I have got to imagine that as employees become more familiar with these concerns, either they're bringing a knowledge of the concerns from their personal lives into the workplace, or vice versa that the more the company does about them to actually drive business change, the more the employee culturally identifies with the good intentions and the good practices of the company. So how are we seeing some of this take effect on those cultural and cultural identities of the workforce, let alone leadership decisions around workforce modeling and so on and so forth. Any perspective on that Zoe?

Zoe Thompson (9:01):

So, we are finding, and you know we've been talking about some of this for a while, that what a company does, how a company takes care of its employees, but also how it takes care of its customers, matters, and to be fair, some of that is somewhat generational. It's not a hundred percent generational. But we do see that younger employees are asking these questions. They want to know. They expect their companies to step up. They expect their companies to have opinions and perspectives, but they also want to look at what are the benefits that are being provided, what sort of programs are in place to ensure an equitable workplace? How are safety

concerns being addressed so that transparency is expected. And social media, of course, does help with that, because it's much easier to find out what is happening within the companies and to share that information. But we are finding that these questions are being demanded by employees before they come on-board, and that those are being carried through, and the benefits and how the companies are working. And then we find also as consumers when people are looking at where they want to buy goods and services that this matters, that it matters if the company aligns with their values. But it's not just performative. That's another thing that we see that people are becoming much more sophisticated. So, they don't just want to see the data. They want to understand the activities behind it. They're not just going to look and say, how diverse is it

Zoe Thompson (10:39):

At different leadership levels? What sort of programs do you have in place to ensure that bias has been removed from the hiring process. How much social mobility do you have within organizations? Are people able to come into your workforce at an entry level and then get promoted. What sort of pay equity do you have? Have you done analysis to ensure that employees are being paid fairly, up and down with the board. So we see a lot more questions from future employees as well as the employees, to ensure the companies where they are working are not just aligned in values, in speech, but also in practice.

Joshua Galvan (11:19):

Jose Claudio. Anything to add to that?

Jose Claudio (11:22):

Zoe has given us a very valuable perspective inside the company. I'd like to compliment and just share some of our views of what we're seeing in terms of how social innovation or social strategies are very much resulting in savings and efficiencies in operations, because it is very clear that having an effective third-party risk management process drives very meaningful impacts across the organization. So, the question many clients are asking us today is what this could look like. We had another experience with a client who was receiving a lot of pressure from their board as well as from a number of stakeholders, and they decided to adopt a more proactive approach towards their third-party oversight. And they chose to invest in putting forth better technology and data and analytics to enhance their third-party risk management program, but with a particular focus on monitoring and testing. And as a result, which I must admit surprised me because it didn't require necessarily a large reengineering effort or a significant investment in sophisticated tools or infrastructure, but rather in change in mindset and breaking down the typical silos that occur in organizations. This initiative contributed to improving the Company's ability to detect fraud on a more timely basis, and this translated to reducing the negative effects of these circumstances, let's not forget that it has been estimated that companies lose upwards of 5% of their revenues each year to fraud waste and abuse. So, I welcome our listeners to do a quick math in their heads as to what that 5% of revenue would represent. Preventing risks in the third-party space can and does result in significant savings and efficiencies.

Joshua Galvan (13:20):

Clearly, what you both said is that ESG and S, perhaps for today's podcast definitely matters to the business. And if I know business leaders, and I think I know a few. They do like data. They do like analytics. They do like reporting and insights and pretty charts and things on which they make decisions. Jose Claudio, you just started talking a little bit about better fraud detection. If you could summarize for us, what on a more, perhaps broad base are the types of metrics and reporting, or decision support systems are we seeing emerging around social solutions?

Jose Claudio (13:55):

Well, I know a perfect example for our audience, coming from a real-life example, we worked with a client not too long ago to assess and evaluate the degree to which it's whistleblower system, commonly known as the Ethics Hotline had been adopted, and how much it was trusted by its workforce in the multiple jurisdictions worldwide where the company operated. Let's keep in mind that a whistleblower or grievance mechanism is one of the pillars of a company's human rights policy as well as it's as the ethics of compliance program. So, in our experience, and something that has been very well documented, the way in which the company manages its whistleblower system and the various metrics that can be tracked provides an invaluable source of information that the company's ethics and compliance department can leverage. For example, metrics can help proactively address situations that surface in one jurisdiction. Let's say, a particularly worrisome sales practice is being detected or is being reported. Making sure that that behavior doesn't extend to other countries and other jurisdictions. Also, metrics can be helpful in focusing training and awareness efforts inside the organization, so as to bolster the trust in the hotline, measured by the number of reports that surface or where a particular issue is being recorded, and that's marking a trend, of certain messaging, and it needs to be reinforced. And last, but certainly not least, metrics can help respond more timely and more robustly the questions from very stakeholders, especially the board, so clearly the use of scorecards and again, this was just an example, as well as various KPI's can significantly contribute to maintaining both legal, regulatory, ethical standards in a company, and of course, help fulfill social commitments that the company has set forth.

Zoe Thompson (15:47):

And let's not forget about reporting. We've been waiting for the human capital disclosures from the SEC for a while, and many people believe it'll happen this fall, and that'll drive additional reporting standards and behaviors. But then there's also the CSRD, which is the corporate sustainability reporting directive and the devil materiality that is really driven by the EU. But this is a big 'but' that also affects large subsidiaries of non-EU companies that have substantial activity in the EU. So, we do have clients here in the US who are asking about double materiality. Which means they're looking at both those topics that have an impact on the company and the financial materiality as well as on people and the environment, and that can include human rights, that can include diversity, that can include all of this. So, understanding what are those reporting requirements that are either current for your organization or likely in the future is really important. We work with a lot of clients who even may say, you know, we are not necessarily impacted by this today. But we expect to be impacted. And so, do we have that data? Do we even understand where to get it? And if so, are we working in a way that's going to make it really easy, so that when we are required to report on this information it's not a huge burden on the company.

Joshua Galvan (17:08):

Thank you so much for being here again, and thank you for sharing your insights, around tips from the trenches, if you will, where you've worked with or had conversations with professionals in companies undertaking real social solution strategies. It's clear to me that we're all in a bit of a journey, and it will be exciting to be a part of it and to help companies focus on just that right recipe of social solutions that help make business work for them and work for their employees and their customers and suppliers.

That wraps up today's Houston Trend talks episode. We hope this conversation gives ideas and inspiration for social solutions in your business practices. Special thanks to my guests, Zoe, and Jose Claudio, who bring so much wisdom and energy to the topic. Thank you for tuning in today. Join us next time for another Houston Trend talks episode. Please connect with us on LinkedIn or any other KPMG resource that may be available online. Until next time. Take care.

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