GOVERNANCE & SUSTAINABILITY: INSIDE, NOT JUST BESIDE THE BUSINESS

REFINITIV®

DATA IS JUST THE BEGINNING™

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FOREWORD

Business leaders have a unique opportunity to transform their companies for the future, for a sustainable future. Traditionally, corporates' primary purpose has been maximizing shareholders value. However greater focus on sustainability in recent years has increased corporate accountability to all stakeholders and greater focus is placed on how corporate governance serves or fails to serve their interests. As a result we witness more corporate leaders improving their governance practices to enhance stakeholder relations.

And let's face it – transformation starts from the top. Is such transformation truly happening or is it more the talk, not the walk? This question inspired this **2020 Refinitiv ESG report - Governance & Sustainability: Inside, not just beside the business.**

ELENA PHILIPOVA
Head of ESG Proposition,
Refinitiv

INTRODUCTION

To sustain our future and continue to maintain a prosperous economy for this and future generations, new business models are required.

It is encouraging to see that more corporate executives are starting to integrate sustainability inside, not just beside the business. More importantly, such organizations are outperforming financially as a result of these structural changes and through the alignment of corporate purpose with profit. New business leaders are making genuine, fundamental commitments to all stakeholders.

But are these corporate shifts taking place at the scale and speed required to respond to the pressing environmental and social challenges that confront and threaten humanity?

Refinitiv®, in partnership with Prof. Andreas Hoepner and his financial data science colleague Gabija Zdanceviciute, take a deeper look into Refinitiv Environmental, Social and Governance (ESG) data to analyze whether corporate boards and structures are indeed changing and if such changes have an impact on companies' environmental and social performance.

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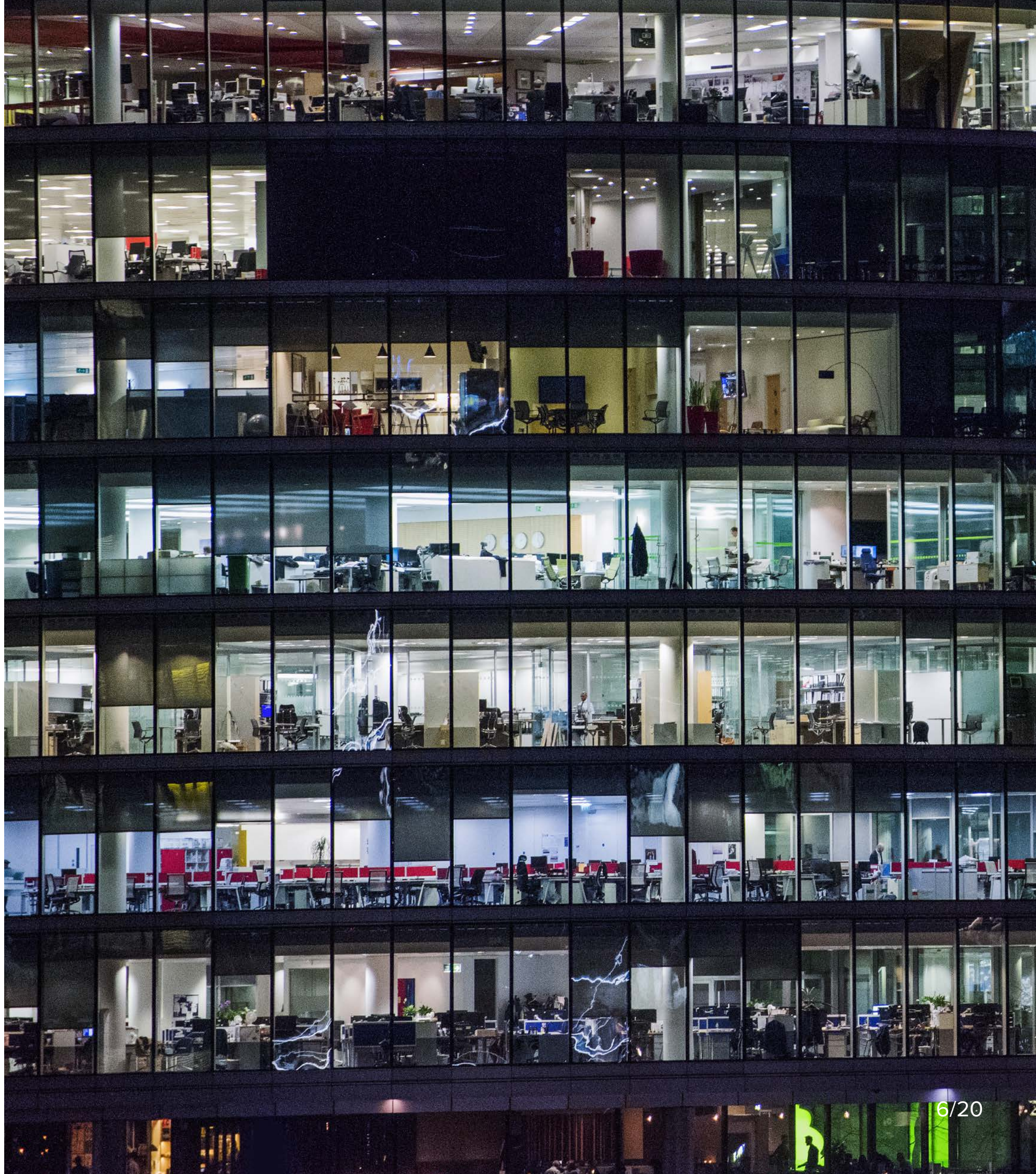
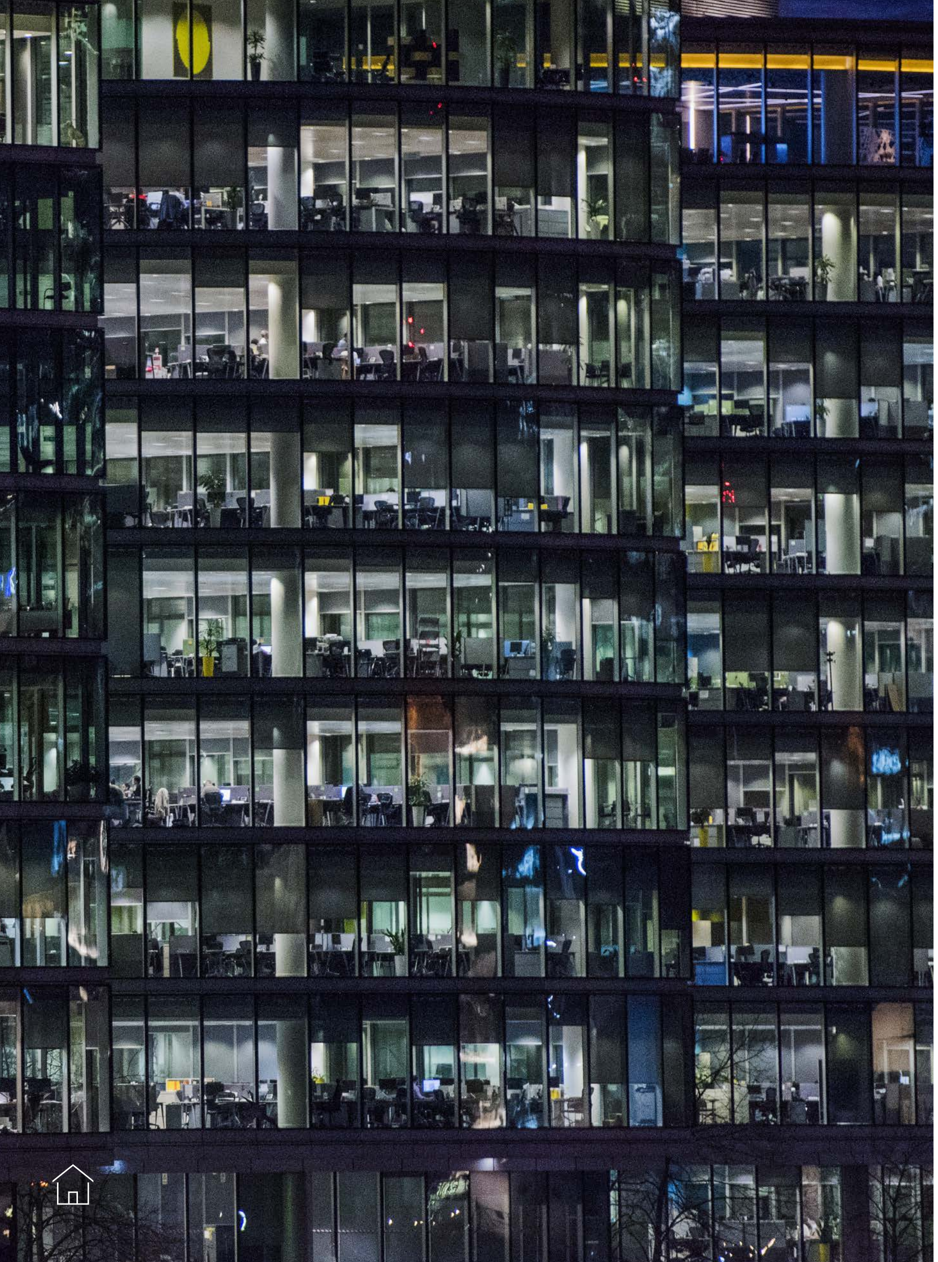
A DEEP LOOK INTO CORPORATE GOVERNANCE





The Refinitiv ESG database consists of more than 400, measures with history back to fiscal year 2002. In scope of coverage are more than 70% of global market capitalization. At the time when we extracted data for this study (November 2019), there were 5,584 active companies in the ESG database with complete ESG coverage for a minimum of three fiscal years.

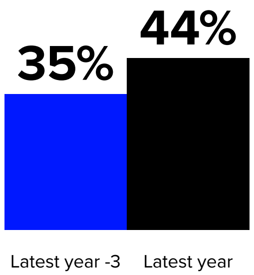
CEO COMPENSATION AND TOTAL SHAREHOLDER RETURN

Companies with CEO compensation linked to Total Shareholder Return (TSR) has increased from 35% to 44% in three years.

Shareholders remain a key stakeholder for corporate executives and their remuneration schemas. This is quite understandable as they finance the current and future growth of businesses. What is concerning, however, is the overwhelming focus on only this stakeholder group at the expense of all others; in particular, at the expense of society.

Are such companies transforming, adapting and elevating their purpose alongside the drive for profit? Or are they conducting business as usual at least in terms of their remuneration practices?

COMPANIES WITH CEO COMPENSATION LINKED TO TOTAL SHAREHOLDER RETURN



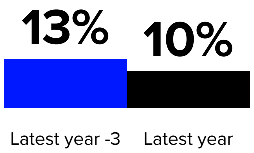
EXECUTIVE COMPENSATION AND LONG-TERM OBJECTIVES

Companies with Executive Compensation linked to long-term objectives has decreased from 13% to 10% in three years.

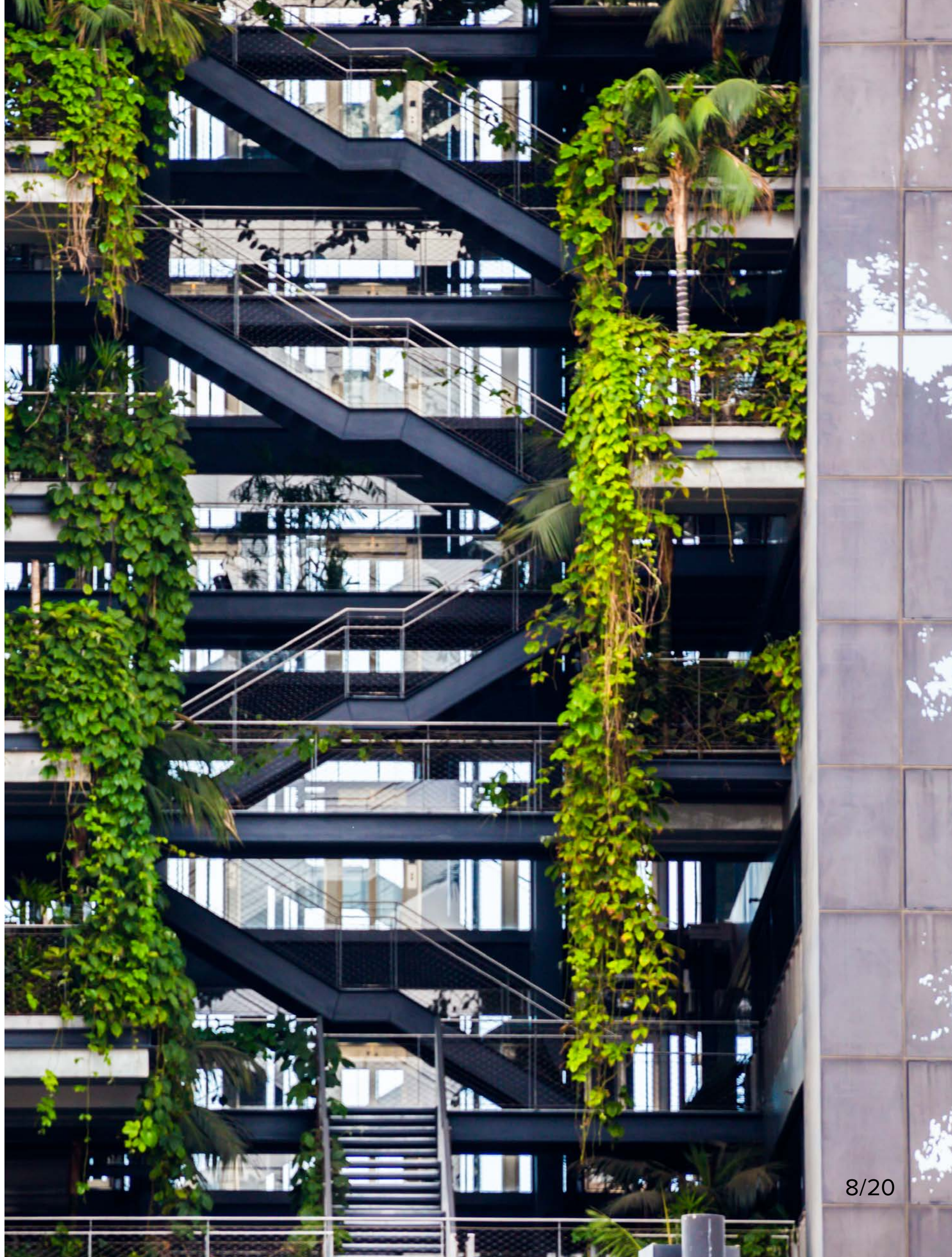
In recent years, interest in the corporate governance practices of public companies has been fast growing. This is especially true in Europe, where individuals and institutions are keen to ensure their investments in public companies are being managed well and in support of their long-term financial objectives. Despite this, globally, we see the challenge for companies to balance the demands of short-term investors with long-term value creation.

The decrease of the number of companies linking their executives' compensation to long-term objectives is a problematic trend, and comes at a time when industry bodies - locally and globally - and national regulators are highlighting the critical need to shift capital markets towards long-termism.

COMPANIES WITH EXECUTIVE COMPENSATION LINKED TO LONG-TERM OBJECTIVES



> Sustainability means making economic prosperity long-lasting, more socially inclusive and less dependent on exploitation of finite resources and the natural environment.
>
> **CHRISTIAN THIMANN**
> Chairman of the High-Level Expert Group, European Commission, January 2018

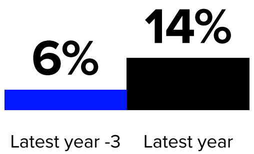


SUSTAINABILITY COMPENSATION INCENTIVES

Companies with sustainability compensation incentives for executives has increased from 6% to 14% in three years

The number of companies that link executives' compensation to sustainable targets has more than doubled in the last three years - but still only accounts for 14% of companies.

COMPANIES WITH SUSTAINABILITY COMPENSATION INCENTIVES FOR EXECUTIVES

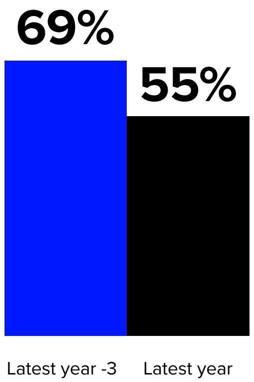


BOARD LONG-TERM COMPENSATION INCENTIVES

Companies with Board Member long-term compensation incentives has decreased from 69% to 55% in three years

As with corporate executives, we observe that fewer corporate board members are compensated for delivering on long-term results and objectives. Although long-term compensation incentives for boards are significantly higher than those for senior executives, the 24% decrease over three years is signaling a concerning trend.

COMPANIES WITH BOARD MEMBERS LONG-TERM COMPENSATION INCENTIVES



BOARD COMPOSITION

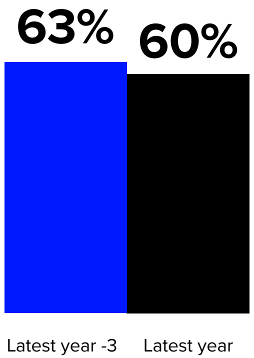
Board independence has decreased from 63% to 60% in three years.

The fundamental importance that corporate boards maintain independence is well documented in best governance practice guides and recommendations. Striking the right balance between independent board members and members from within the organization with internal expertise is essential. This balance seems to hover around 60% at a global level.

- Average board tenure remains flat at 7.6 years
- Board size remains flat at 9.6 board members

No significant change is observed at either the average board tenure or the board size at a global level.

COMPANIES WHOSE BOARDS DISPLAY INDEPENDENCE



GENDER DIVERSITY

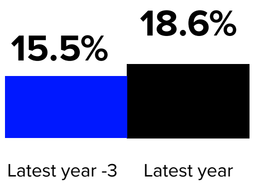
Board Gender Diversity has increased from 15.5% to 18.6% in three years

More companies are reporting on gender board diversity, however, women account for only 18.6% of board membership. Although this represents a 21% increase in three years, corporate boards remain far from being gender balanced.

Will the focus on reporting the gender composition of boards translate into more gender-balanced boards or is setting measurable performance targets the requirement which will result in significant improvements?

As we study the statistics on female board representation, it should be kept in mind that women are often appointed to multiple boards. This is a concerning trend, since it leads to members being overworked rather than truly developing and promoting diverse talent to the board.

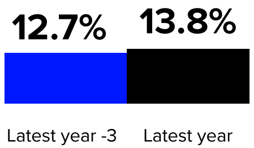
BOARD GENDER DIVERSITY

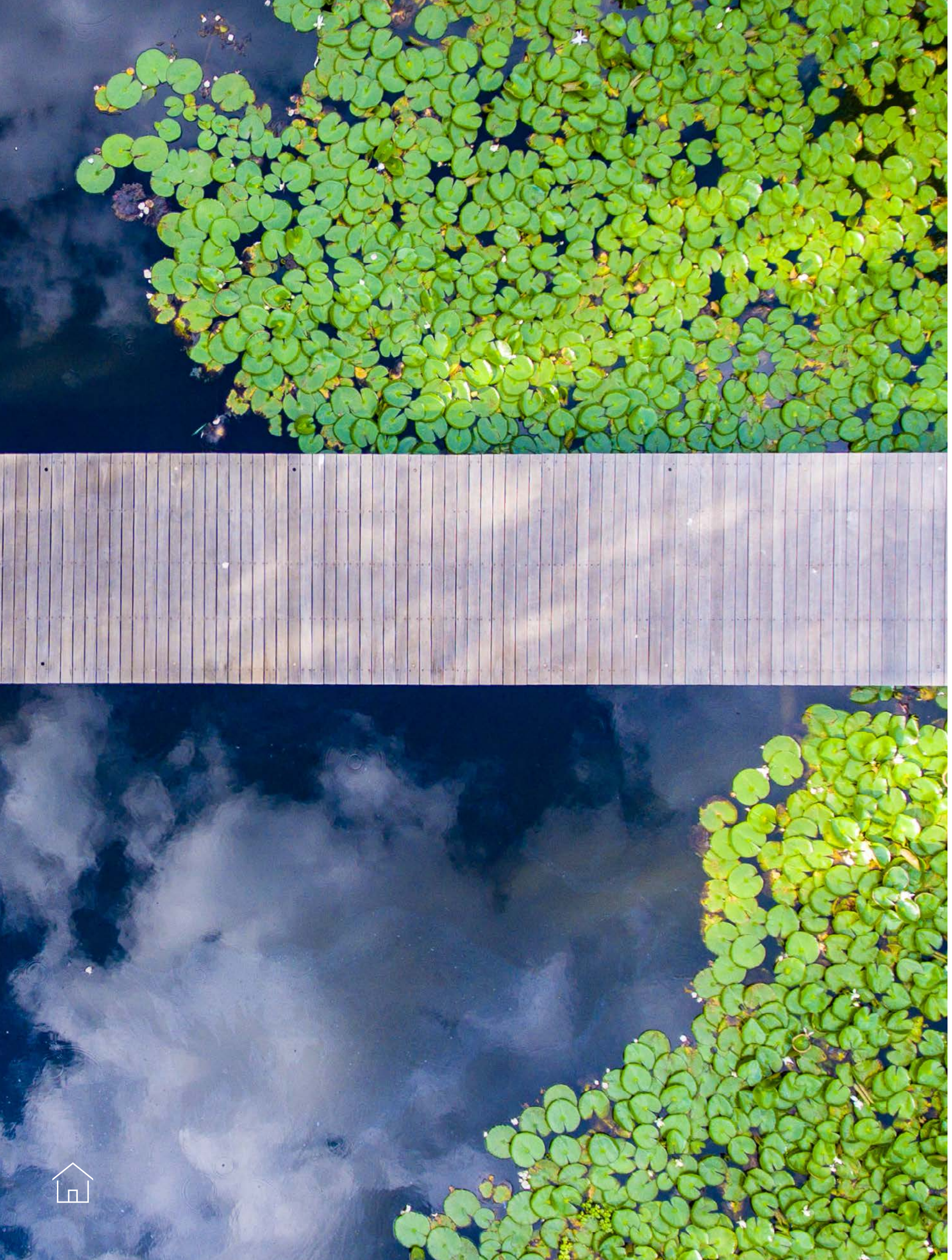


Executive Members Gender Diversity has marginally increased from 12.7% to 13.8% in three years

The gender picture at senior executives' level is even more gloomy with 13.8% of such roles held by women - a marginal 8% increase over the last three years.

EXECUTIVE MEMBERS' GENDER DIVERSITY





SUSTAINABILITY REPORTING

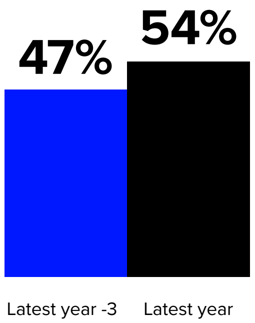
Companies reporting on sustainability has increased from 47% to 54% in three years

On a more positive note, we have observed greater corporate transparency and disclosure on ESG at a global level – a 15% increase over the past three years. This illustrates an important, positive trend: only what gets measured can be managed.

Companies utilizing external auditor for their sustainability reporting has increased from 21% to 25% in three years.

Even more importantly, the quality and reliability of ESG disclosure is improving as more companies are hiring third party auditors to verify their ESG data. This is a response to what investors continue to identify as one of the key challenges in sustainable investing today – the confidence in data is dampened by a perceived lack of reliability as companies across different industries disclose divergent metrics of their sustainability performance.

COMPANIES WITH SUSTAINABILITY REPORTING



ESG DATA ANALYSIS THROUGH REGRESSION MODELS AND MACHINE LEARNING ALGORITHMS

MACHINE LEARNING APPROACH

The machine learning approach involved conducting an array of univariate regressions at the global and continental level. As a result, thousands of regression outputs were obtained, which required feature selection. The selection was undertaken based on the explanatory power, effect size and conceptual heterogeneity of dependent and independent variables.

EXPLANATORY POWER IN A SINGLE REGRESSION ADJ KEY:

Above 50%

40 – 50%

30 – 40%

WOMEN MANAGEMENT AND EMPLOYEES

The percentage of women managers in a company leads to a 62% increase in the percentage of women employees.

Explanatory power in a single regression ADJ_R2: **69.26%**

The percentage of women managers leads to a 66% increase in the percentage of new women employees.

Explanatory power in a single regression ADJ_R2: **56.45%**

Women may be more confident of their career prospects in a company that displays a healthy gender balance at management level. Also, from the perspective of junior employees, women in senior positions, especially at the executive level, may be seen as role models.

> "It is increasingly clear that diversity of thought and thereby diversity of experience on various relevant aspects including gender, culture, generation and education is key to good governance. Every manager should be aware their biggest bias is probably the sample selection of their own experience."
>
> **PROFESSOR ANDREAS HOEPNER**
> Financial Data Scientist, University College Dublin

CSR SUSTAINABILITY REPORTING AND ENVIRONMENTAL EMISSIONS

Corporate Social Responsibility (CSR) sustainability reporting leads to an increase of 40% in a company's management commitment to and effectiveness in reducing environmental emissions in production and operational processes.

Explanatory power in a single regression ADJ_R2: **46.62%**

CSR sustainability reporting leads to a 40% increase in a company's management commitment to and effectiveness in achieving efficient use of natural resources in the production process.

Explanatory power in a single regression ADJ_R2: **40.44%**

CSR sustainability reporting leads to a 56% increase in the likelihood of a company setting targets emissions reduction targets or objectives to be achieved.

Explanatory power in a single regression ADJ_R2: **38.95%**

Companies that report on their CSR are likely to be more aware of their own ranking within the CSR standard and are more likely to set targets to improve their own performance. Such companies are also more likely to be aware of the need for and the benefits of, for example, reducing emissions or using resources efficiently.

WOMEN'S MANAGEMENT AND TRADE UNION REPRESENTATION

The percentage of women managers leads to a 28.5% decrease in the percentage of employees represented by independent trade union organizations or covered by collective bargaining agreements.

Explanatory power in a single regression ADJ_R2: **40.09%**

According to Charles (1983), practices within unions operate against the interest of women workers. Historically, trade unions have represented mostly blue-collar workers, who were primarily male. As a result, significant efforts are required to establish trade union policies which represent and address the interests and needs of women.

According to the 2006 European Trade Union Institute for Research, Education and Health and Safety report, "as long as there is not a critical mass of women involved in trade union bargaining and decision-making structures, one cannot expect collective bargaining to reflect issues that will promote and favor equal opportunities".

Thus it is possible to associate the decline in the percent of employees represented by the trade unions with an increase in the percent of women in management. Not only are women less likely to be represented by a trade union, but women also are more likely to understate the need for trade union representation.

ADDITIONAL ESG DATA ANALYSIS RESULTS

- The percentage of women managers in a company leads to a 14% decrease in the likelihood of that company producing products or services that foster specific health and safety benefits for the consumers.

Explanatory power in a single regression ADJ_R2: **41.7%**

- CSR sustainability reporting leads to a 7% increase in the percentage of new women employees.

Explanatory power in a single regression ADJ_R2: **38.33%**

- SVL indicator on the percentage of female executives leads to a 49% decrease in the likelihood of a company constructing nuclear reactors, producing nuclear energy or extracting uranium.

Explanatory power in a single regression ADJ_R2: **38.4%**

- SVL indicator on the percentage of female executives results in an increase in new women employees by 80%.

Explanatory power in a single regression ADJ_R2: **37.27%**

- The percentage of women on the board, adjusted for sector average, leads to a 48% increase in the percentage of employees represented by independent trade union organizations or covered by collective bargaining agreements.

Explanatory power in a single regression ADJ_R2: **35%**

- SVL indicator on the percentage of female executives, adjusted for sector average, leads to a 5.7% improvement in total water withdrawal (in cubic meters) divided by net sales or revenue in US dollars.

Explanatory power in a single regression ADJ_R2: **34.25%**

CONCLUSION

Good corporate governance is important for driving long-term value

Today, investors expect boards to understand and oversee material risks that may affect the company's future, including matters such as cyber or data risk, climate risk and human capital management.

This 2020 Refinitiv Report on Corporate Governance unveils that:

- Transparency is key – ESG transparent companies manage their ESG performance and risk significantly better than those that do not report
- Corporate executives compensation schemas remain primarily focused on shareholder returns and short-term targets
- With the current speed of change, we will experience gender inequality at the corporate leadership level for decades to come

We as an industry have a powerful opportunity to adopt common standards and accelerate the evolution towards sustainable financial markets, if market players can align around shared long-term objectives.

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