Spotlight on Social Responsibility Investing

THOUGHT PIECE

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The integration of environmental, social and governance (ESG) factors into a fundamental investment process continues to gain momentum as investors and other stakeholders place greater emphasis on corporate social responsibility.

The eruption of civil unrest in the wake of the Black Lives Matter movement has put sustainability and the "social" pillar of ESG at the front of investors' minds. Investors have often been hesitant to acknowledge the tie between social factors and improved financial performance, but a wave of thought pieces on the subject confirms the relationship. Research shows that higher employee morale is correlated to increased employee productivity and reduced turnover, which can have a positive impact on performance. Social responsibility impacts all stakeholders in an organization, including suppliers, customers and the communities in which they operate. Thus, we believe businesses that prioritize the importance of social responsibility are subject to less legal, operational and reputational risk and are more sustainable. At Aristotle Credit Partners, LLC we believe that a holistic approach incorporating analysis of financial data and various social factors results in an enhanced understanding of a company and, therefore, better investment decision-making.

Internal corporate social responsibility factors to consider when evaluating a company include workplace diversity, employee turnover, labor-management relations, safety and human rights. External factors to consider include corporate philanthropy and community relations. These factors form the framework for our social responsibility discussions with corporate management teams.

Since the onset of COVID-19, it has become clear that certain industries are more naturally disposed to the impact of social factors than others. We are seeing technology and financial service industries demonstrating the ability to quickly shift employees into long-term remote working. This adjustment lowers employee health and safety risk and embraces work-life balance, which could translate into improved employee morale. On the other hand, there has been reported mistreatment of essential, frontline employees in the health care industry with some facilities forcing workers to supply their own personal protective equipment, use the same equipment again and again, or go without. It is estimated that more than 3,000 health workers globally have died from COVID-19. Alarmingly, some health workers who raise safety concerns in the context of the COVID-19 response have faced retaliation, ranging from arrest and detention to threats and dismissal.

When it comes to reputational risk, various industries have made difficult decisions that have negatively impacted short-term earnings in order to protect company reputations. For example, during the recent civil unrest, retailers nationwide closed stores to ensure the safety of employees and for the overall well-being of communities. Amid store closures, some companies announced that impacted employees would continue to receive full pay and benefits for the duration of the closures. We are also seeing some company executives giving up salaries to prevent employee layoffs and/or reallocating their wages to charitable funds. These socially responsible changes not only promote employee safety but also reflect positively on the overall brand, potentially strengthening customer loyalty while simultaneously reducing operational, legal and reputational risk.

Historically, evaluating a company's social responsibility has come with various challenges originating in lack of corporate transparency and inconsistent quantification measures. Current events are serving as a catalyst for the evolution of solving these challenges, as more companies are becoming focused on the need to significantly evolve their social responsibility policies. We believe investors can play a major role in this evolution through direct dialogue with companies. In our view, directly encouraging best practices is a far more effective method of helping companies evolve their practices than just being an investor who utilizes negative screening. Furthermore, dialogue with companies about their ESG practices can provide important additional insights into not only corporate risks but also the strength of the management team. Together, we believe these factors can help investors improve risk-adjusted returns for client portfolios.

At Aristotle Credit, direct dialogue is a pillar of our in-house ESG research. To maximize the impact of our engagement activity, we not only communicate directly with management teams on ESG issues but also participate in an investor engagement pool managed by a third-party service provider. Through our ESG evaluation framework, we assess multiple social factors to arrive at our own proprietary rating for each issuer in which we invest.

As an asset manager that is a source of liquidity and capital to companies, we believe we are uniquely positioned to influence corporate sustainability factors and endeavor to do this to the best of our abilities. We also recognize our responsibility to apply these principles to our own firm by building our own diversity and inclusion program while also giving back to the community.

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