Reputation and social licence

Controversy exposure | Leadership | Stakeholder impact | Business ethics

Thematic overview

A company's social licence to operate is a measure of the level of trust between an organisation and its key stakeholders. If a company loses the trust of its stakeholders, its social licence to operate is also impacted and often results in negative consequences for its operating conditions. This impact can be as a result of regulatory intervention, community protests and disruption, customer-related controversies, unfavourable news and media, corruption and bribery, and shareholder activism.

Often, reputational and social licence related issues can have a cumulative effect on a business. That is, one seemingly minor issue associated with one stakeholder group, combined with another seemingly minor issue with another group, can have a 'snowball' like impact on a company's reputation. Certain businesses can also be more susceptible to reputational damage due to their size, history, or visibility to various stakeholder groups.

We believe that maintaining strong corporate ethics, building trust with stakeholders, and minimising controversy exposure which may lead to negative media, regulatory intervention or community activism helps to build trust and mitigates the impact of negative or controversial events on a business.

We view a company's social licence and overall reputation as a material driver of performance over the short and longer term. Within our ESG Framework we have identified four main drivers of social licence and reputation that are most relevant across the holdings in our portfolios: leadership, business ethics, stakeholder impact, and controversy exposure. These are assessed using a range of factors including corruption and bribery, anti-trust, the number of active and past controversies, and customer and community feedback.

2024 update

Materiality

This issue has not increased or decreased in materiality in the reporting period. It is a fundamental building block to company performance and is also extremely specific to each business and its local context. This is one of the most material thematics across most companies.

In 2024 we continued to see the global media, regulators and communities put pressure on companies that participated in unfair or unethical business practices, however, we also saw that the nuance in what is 'ethical' or 'fair' is changing and becoming more divisive between different regions.

For instance, within the Australian context, several companies including Mineral Resources, Steadfast, and Woolworths have faced share price disruption and backlash from shareholders due to controversies related to governance issues or concerns, as well as involvement in government inquiries and reviews. Conversely, in the United States, any backlash was more frequently associated with anti-ESG sentiments and resistance from customers, communities, and regulators regarding ESG-related targets and commitments.

For large multinational businesses, this dynamic, and maintaining a good reputation and social licence to operate, across multiple stakeholder groups, differing views, and vast jurisdictions has become more challenging and we expect this to continue into 2025.

Research

- Implemented a controversy risk monitoring process for portfolio holdings using third party ESG research provider information and news flow.
- Review of companies exposed to sanctioned regions and engaged experts to better understand sanction risk and impacts.
- Review of companies exposed to the Israel and Hamas conflict and the size of revenue exposed either directly through operations or indirectly through contracts.
- Detailed analysis of past and ongoing controversies in the banking sector to benchmark the extent and size of penalties for investment banks.
- Engaged with more than 15 Australian and global mining and energy companies to understand how social licence is measured and reported to senior management.

Examples of company engagement

CUSTOMER

We have been long-standing investors in Australian retail banks through our Australian equities strategies. Similar to all banks, Australian banks like CBA can be materially affected by deterioration in its social licence and relies heavily on customer, Government, media, and community trust to maintain a stable regulatory and customer environment. Throughout 2024, we started **engaging** with the banks again on their hardship policies as the cost of living crisis in Australia became more of a concern. We spoke to the CBA Chair of the Board and CEO about this on separate occasions, who both confirmed the banks current policies were able to manage the potential increase in hardship. It also confirmed that at this stage it was not seeing an increase in defaults, however, were proactively starting to engage with its customers to manage potential concerns. Leading into an election year, this will be a high priority issue to monitor throughout 2025.

PRODUCT SAFETY

Intuitive Surgical manufactures the Da Vinci and Ion Robotic Systems used in surgeries worldwide. The company has been assigned an **ESG risk level** of 2 under our ESG Framework mainly because of risks related to product quality, safety and the potential for reputational impacts. We generally engage at least once per year on this topic to track potential issues and controls. We **engaged** in April 2024 and confirmed that there haven't been any major recalls recently, and historical legal cases have largely settled.

CONTROVERSY

In 2023 we initiated an **engagement objective** for Qantas to implement the outcomes of its Governance Review and improve customer sentiment and overall social licence. Throughout 2024 we engaged with the company multiple times including through meetings with its CEO, Chair of the Board, and Head of Sustainability to monitor and understand progress any ongoing challenges the company was facing. We feel that the company has made significant improvements to its social licence and has addressed many of the specific issues from 2022 and 2023. Given how visible Qantas is as a brand, this remains a high priority engagement area for the company.

STAKEHOLDER IMPACT

In 2022 we established an **engagement objective** for Marsh McLennon related to the implementation of its client engagement principles and exposure to controversial projects or customers. Along with other large financial institutions, Marsh has been called out by non-Government organisations and community groups for its involvement with projects such as the East African Crude Oil Pipeline. Whilst the company cannot confirm its involvement due to client confidentiality, we have been engaging to improve its reporting and improve our understanding the implementation of its client engagement principles. Given the size and geographic reach of the company's various businesses, being exposed to one sensitive project is not likely to pose a material investment risk to the business. However, we believe that aggregating high-risk decisions across the firm over the medium-term could result in significant reputational damage.

BUSINESS ETHICS

We held two engagements with Procter & Gamble (P&G) in 2024. One was a general update on human rights, deforestation and packaging. The second was part of our review of companies with ongoing exposure to sanctioned regions. The purpose of the **engagement** was to better understand the reasons for operations in Russia and how US sanction legislation is managed. Through the engagement we confirmed that P&G has relocated non-essential employees out of Russia, has stopped investments into the region, and is producing essential productions only under a special licence. Sales from Russia are down to less than 1% of group revenue. As part of the meeting, the company also outlined the changes to its governance structures that were made so that the Russian business was the responsibility of the C-Suite rather than a second or third-line management team.

Woolworths ESG integration example: Evaluating the cumulative impact of individual issues on social licence

Woolworths is a large Australian supermarket chain with more than 1000 stores across the country. Between Woolworths and Coles, the other large supermarket chain, most Australians visit their stores at least once per week.

Throughout 2023 and 2024, Woolworths faced a number of individual controversies which we felt could have a significant cumulative impact on its social licence to operate and created a short and medium term investment risk for the business.

To better understand the implications of the various issues we completed a **risk assessment** to identify and map each issue against four impact dimensions including social licence, penalties and fines, employee sentiment and loss of customer. From this, we confirmed that the Government and ACCC pricing inquiries, the staff underpayment case, and the resignation of the CEO, presented the most material risks for the company. These reputational issues were compounded by a poorly managed interview with the CEO in late 2023 and growing stress around the cost of living in 2023 and 2024.

We **engaged** with the company throughout 2024 to actively monitor these issues and expressed our concerns to the CEO and Chair of the Board on multiple occasions.

Ultimately, financial concerns about Big W and the New Zealand supermarket business led to earnings downgrades for Woolworths. Combined with the governance risk from the early CEO departure and the media and social license risks from the ACCC investigation, we managed our position size accordingly throughout 2024.

REA Group sustainability example: Delivering products that build trust through accessibility

REA Group operates commercial and property websites such as realestate.com.au, flatmates.com.au, and property.com.au. It also owns Mortgage Choice Pty Ltd, an Australian mortgage broking franchise group, PropTrack Pty Ltd, a leading provider of property data services, Campaign Agent Pty Ltd, Australia's leading provider in vendor paid advertising for the Australian real estate market and Realtair Pty Ltd, a digital platform providing end-to-end technology solutions for the real estate transaction process. Internationally, REA Group holds a controlling interest in REA India, operator of established brands like Housing.com

In 2024, we initiated an **ESG and Sustainability review** for REA Group to confirm material ESG risks and considerations, the ESG risk level, and the SDG alignment score to determine its suitability for our Australian Sustainable Share Fund. To assist with completing this review we met with the General Manager, Sustainability and the Executive Manager, Product.

We **engaged** on a range of topics but were specifically interested in gaining further clarity on data privacy and cyber security practices, customer benefits and price transparency and arrangements with real estate agents. One feature raised by the company was the accessibility filters and options being added to the property websites. REA Group has a strategic focus on Diversity, Equity, and Inclusion and believes that access to jobs and housing is a basic right.

Learning about these additional features through engagement helped to strengthen our **sustainability analysis** and built a stronger picture of REA Group as a leader in diversity, equity and inclusion, both through its workforce initiatives and through product development and design. We believe these efforts help to support a good workforce culture, evidenced through its strong employee engagement scores, and strengthen its social licence to operate with key stakeholders like community groups, customers and Government. It also mitigates regulatory risks which may negatively impact the business.

Using these insights alongside company's disclosures, we confirmed an **ESG risk level** of 1 (low) and the company was approved by the **Sustainable Compliance Committee** for inclusion in the Australian Sustainable investible universe.

CASE STUDY

Merck engagement example: Evaluating drug pricing practices in the US health system

Merck & Co, also known as Merck in North America, is a healthcare company involved in research, development and manufacturing of important medicines in oncology, cardiovascular disease, diabetes and vaccines.

While competition between US healthcare companies has spurred innovation and development of life-changing treatments, the US system is a complex and often controversial space. Americans pay significantly more for prescription drugs compared to other countries, and insurance coverage remains a challenge. Pharmaceutical benefit managers, which are intermediaries between insurers, pharmacies and drug manufacturers, have been criticised for inflating drug prices.

Even though Merck's products are life-saving in nature, and deliver material health benefits worldwide, these system dynamics increase the value of maintaining a strong social licence and thereby mitigating regulatory burden and pressure from various stakeholders. Merck cannot fully mitigate these risks given many are outside of their control, but implementing controls related to transparency, fair pricing practices and access programs can materially help.

We **engaged** the company in 2024 to better understand how Merck manages these risks and uses its influence to support a more equitable health system.

We **confirmed** the following commitments:

- **Transparency:** Merck has been reporting annual pricing metrics for its medicines in the US. This helps to build trust and allows stakeholders to understand the company's pricing trends.
- **Fair pricing:** Merck aims to set prices that reflect the value of its products. This approach helps ensure that prices are fair and the business sustains itself over the longer term. The company is committed to not raising prices above inflation rates. This helps mitigate the impact of price increases on patients and the healthcare system.
- **Access Programs:** Merck offers programs to provide free or discounted products to uninsured or underinsured individuals.

We view these aspects positively but recognise that access to healthcare remains a contentious issue. We are therefore **monitoring** reforms in the US, such as the Inflation Reduction Act funded by drug rebates. We are mindful that these can have a negative impact to company earnings, but also recognise that changes to pricing can improve sentiment and have a net positive impact on the industry.