Responsible business with quality investments:
What it means and what it needs?

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Session 1: Financial market for businesses: support or barriers?
WHAT IS THE PROBLEM?
CRISIS, TRUST, WELL-BEING

OECD: BUSINESS AND FINANCE OUTLOOK 2019
STRENGTHENING TRUST IN BUSINESS:

«Following the global financial crisis, public trust in governments, corporates, financial markets and financial institutions declined as societies in many part of the world experienced an erosion of economic well-being»

WHY SHOULD WE CARE?
DISSATISFACTION!

Societal issues are rooted in people’s dissatisfaction with their experiences as consumers, employees, members of [...] organisations, or victims of dislocation or crises.”

WHAT IT NEEDS?

CHANGE OF A PARADYGMA = CHANGE MANAGEMENT
CHANGE OF A PARADIGMA = CHANGE MANAGEMENT

- Reputation
- Performance
- Trust
- Policy
- Paradigm
- Change
- Behaviour
- Mindset
- Change
Improving organisational performance will ultimately improve reputation

POSITIVE REPUTATION INCREASES TRUST

Source | Eyal Ert, Aliza Fleischer, Nathan Magen, Trust and reputation in the sharing economy: The role of personal photos in Airbnb, 2016 Elsevier Ltd., p. 64, available on https://doi.org/10.1016/j.tourman.2016.01.013
REPUTATION AND TRUST

3 FOUNDATIONS OF REPUTATION

- Economic performance
- Social responsiveness
- The ability to deliver valuable outcomes to stakeholders

### OECD TRUST MATRIX

Public trust in business and finance.

Facets of trust in finance, investment and business with respect to:
- **economic value**
- **fairness and integrity of conduct**
- **alignment with societal values**

<table>
<thead>
<tr>
<th>Economic Value</th>
<th>Fairness, Conduct, and Integrity</th>
<th>Values Alignment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Participants (narrow)¹ Predictability of general market and asset class performance and liquidity, such that participants can expect to receive investment outcomes relative to risks in a range of historical outcomes. Predictability of commercial behaviours through traditional and digital markets. Expectations of macroeconomic and macrofinancial policies conducive to stable growth that promotes investment and commercial benefits.</td>
<td>Expectation that behaviours align with established and explicit rules of acceptable conduct, which promote fair treatment, transparency, adherence to laws.</td>
<td>Behaviours that strive to achieve best practices beyond adherence and compliance, and which contribute to the reputation of the industry. Business cultures that promote behaviours and outcomes that align with societal values.</td>
</tr>
<tr>
<td>Society (broad)² Expectation that the aggregation of market and commercial behaviours results in economic benefits to society, through sustainable and inclusive growth, without the socialisation of losses to society.</td>
<td>Expectation that policies and oversight of rules of conduct ensure sufficient fairness, a level playing field, and tolerated conduct to ensure integrity of markets and commerce. Expectation that there is a competent enforcement mechanism in place to minimise egregious breaches.</td>
<td>Behaviours that are widely considered to be positive for societal well-being beyond the economic sphere. Alignment of business and finance sector behaviours with environmental, social, and governance factors, among others.</td>
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</tbody>
</table>

[...] a paradigm shift is a revolutionary **change from one way of thinking** (as embedded in paradigms and mental models), **believing** (as reflected in mindsets) and **doing** (as reflected in behavioral strategies and observable behaviors) **to another way**

MINDSET AND BEHAVIOUR CHANGE

- **Successful behaviours** - serves the paradigm and are part of it - are rewarded

- In turn it **reinforces the mindsets, mental models, and the paradigm itself.**

- The reciprocal reinforcement is powerful and can become **barrier to change**!

MINDSET AND BEHAVIOUR CHANGE

HOW TO MANAGE RESISTANCE TO CHANGE (LEWIN, 1951):

Forces driving change and forces restraining change tend to balance each other out to create and sustain dynamic equilibrium. *The harder you push for change by increasing the strength of the driving forces, the harder people resist the proposed changes.*
The state of being “blinds” from seeing opportunities to create change in their mental models (Armstrong, 1985).
WHAT IT MEANS?
RESPONSIBLE BUSINESS WITH QUALITY INVESTMENTS
OECD: RESPONSIBLE BUSINESS STRATEGIES

Box 2.2. Responsible investment strategies

A variety of approaches exist with respect to responsible investment. While there is no formal definition of these different approaches the below terminology has been associated with the described strategies.

**Responsible Investing** - often used as a catch all term that may encompass various strategies which take into account environmental and social issues in the context of investment decision making.

**Environmental, Social, Governance (ESG) Integration** - defined by the Principles for Responsible Investment (PRI) as “the explicit and systematic inclusion of ESG issues in investment analysis and investment decisions.” ESG criteria may be used primarily to identify financial risks posed by real or potential ESG impacts.

**Impact investment** - products or strategies that seek to generate positive social or environmental impacts alongside a financial return.

**Ethical investment** – products or strategies that are dictated by certain ethical or moral considerations. For example, exclusionary or screening processes which exclude investment in certain industries (e.g. tobacco).

INVESTMENT DECISION MAKING:

- Environmental and social issues
- Risk controls and governance processes – including unbiased and resilient algorithms
- Ethical or moral considerations

OECD: QUALITY OF FDI INVESTMENTS

Table 1. FDI Qualities by sustainability cluster and outcomes

<table>
<thead>
<tr>
<th>Cluster</th>
<th>Objective</th>
<th>Outcomes</th>
<th>Country coverage</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Productivity &amp; innovation</td>
<td>Provide information on the extent to which foreign MNEs and their linkages with domestic firms, including SMEs, enable productivity growth and enhance innovation capacity through knowledge and technology transfer.</td>
<td>Labour productivity, Labour productivity growth, Product innovation, Process innovation, R&amp;D expenditures, Use of foreign technologies</td>
<td>OECD, non-OECD</td>
</tr>
<tr>
<td>2. Employment &amp; job quality</td>
<td>Explore how FDI relates to employment and job quality in host countries, and to what extent the relationship is positive or negative. Job quality is essential to ensure that employees can work productively.</td>
<td>Job creation, Employment expansion, Wage levels, Job security (temporary work), Worker safety (injuries)</td>
<td>OECD, non-OECD, limited OECD</td>
</tr>
<tr>
<td>3. Skills</td>
<td>Investigate to what extent foreign MNEs invest in human capital and skills, directly through in-house worker and manager trainings, and indirectly through knowledge transfers to domestic firms.</td>
<td>Skill intensity, Technical skill shortage/surplus, On-the-job training</td>
<td>OECD, non-OECD</td>
</tr>
<tr>
<td>4. Gender equality</td>
<td>Examine how FDI is associated with gender equality in host economies. Effective participation of women in the workforce and equal opportunities at all work levels are not only desirable from a social perspective but can unlock economic opportunities.</td>
<td>Gender employment gap, Gender wage gap, Female top managers (female empowerment)</td>
<td>OECD, non-OECD, limited OECD</td>
</tr>
<tr>
<td>5. Carbon footprint</td>
<td>Study the extent to which FDI relates to carbon footprint, and how FDI is contributing to the low-carbon energy transition. The transition towards low-carbon energy/ electricity production is at the essence of the Paris Agreement and efforts to fight global warming under the SDGs.</td>
<td>CO2 emissions, Energy efficiency, Renewable energy</td>
<td>OECD, limited non-OECD</td>
</tr>
</tbody>
</table>

Note: The country coverage (OECD and non-OECD) broadly indicates whether FDI Qualities Indicators are available for OECD and/or non-OECD countries for a specific outcome. For each outcome, the exact country coverage will vary depending on data availability. Annex B provides an overview of all data sources used to construct the indicators.

FOREIGN DIRECT INVESTMENTS (DFI):

5 Sustainability clusters

- Productivity and innovation
- Employment and job quality
- Skills
- Gender equality
- Carbon footprint

25 outcomes

OECD: QUALITY OF FDI INVESTMENTS

FDI impacts on sustainability outcomes depend crucially on host country policies

Realising these positive economic, social and environmental outcomes from FDI is not a given

Maximizing socio-economic and environmental benefits and minimizing potential risks associated with FDI may not be a primary concern for profit-seeking investors and may not receive sufficient attention by policymakers seeking to attract investment

OECD: QUALITY OF FDI INVESTMENTS

PRODUCTIVITY AND INNOVATIONS:
Sectoral composition of FDI partly explains the relationship with productivity and innovations

POSITIVE VALUE:
Tends to be observed when FDI is concentrated in tipically more productive and innovative sectors (transport and equipment, chemicals, finance, communications)

NEGATIVE VALUE:
Tends to be observed when FDI is concentrated in lower value added sectors (food, clothing/ textile, health and hospitality sectors)

Relationship with **productivity and innovations**:

a **negative shift** in Netherlands, Canada, Greece for productivity and Japan, **Latvia, Korea** for **R&D intensity**.

Explanation: related to and dependent of sectoral composition of the FDI.

### FDI: LATVIA AND OTHER BALTIC STATES

<table>
<thead>
<tr>
<th>Industry</th>
<th>Estonia</th>
<th>Latvia</th>
<th>Lithuania</th>
</tr>
</thead>
<tbody>
<tr>
<td>Financial and Insurance activities</td>
<td>6 527</td>
<td>3 628</td>
<td>4 088</td>
</tr>
<tr>
<td>Real estate activities</td>
<td>3 480</td>
<td>2 396</td>
<td>2 821</td>
</tr>
<tr>
<td>Manufacturing industry</td>
<td>2 812</td>
<td>2 283</td>
<td>2 124</td>
</tr>
<tr>
<td>Wholesale and retail trade</td>
<td>2 521</td>
<td>1 750</td>
<td>2 106</td>
</tr>
<tr>
<td>Professional, scientific and technical activities</td>
<td>1 423</td>
<td>845</td>
<td>1 143</td>
</tr>
</tbody>
</table>

... in search for desired profile of investors ....

**Source**: LIAA informatīvais ziņojums 29.08.2019 Vēlāmā investora profils
CHALLENGE

The desire and ability to attract productive investment to:

- Increase labour market participation
- Boost business
- Boost productivity

To balance investments in human capital (health, education, skills) with investments in infrastructure and non-productive investment, such as: real estate and other consumption-related investments
# PRODUCTIVITY: MAIN FACTORS AND MEASUREMENTS

<table>
<thead>
<tr>
<th>Type of output measures</th>
<th>Type of input measure</th>
<th>Labour</th>
<th>Capital</th>
<th>Capital and labour</th>
<th>Capital, labour and intermediate inputs (energy, materials, services)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Gross output</strong></td>
<td>Labour productivity (based on gross output)</td>
<td>Capital productivity (based on gross output)</td>
<td>Capital – labour MFP (based on gross output)</td>
<td>KLEMS multifactor productivity</td>
<td></td>
</tr>
<tr>
<td><strong>Value added</strong></td>
<td>Labour productivity (based on value added)</td>
<td>Capital productivity (based on value added)</td>
<td>Capital-labour MFP (based on value added)</td>
<td>-</td>
<td></td>
</tr>
</tbody>
</table>

**Single factor productivity measures** | **Multifactor productivity (MFP) measures**

Labour + Capital = multifactor productivity

PRODUCTIVITY : MULTI-FACTOR PRODUCTIVITY

- OECD looks separately at the analysis of the overall contribution of multi-factor productivity – labour and capital productivity

- Limited group of countries for which data has been available mostly since 1985. Only 23 countries analysed: Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Japan, Korea, Luxembourg, Netherlands, New Zealand, Norway, Portugal, Spain, Sweden, Switzerland, United Kingdom and the United States of America

Why: Capital productivity shows how efficiently capital is used to generate output.

Definition: measured as the ratio between the volume of output, measured as GDP, and the volume of capital input, defined as the flow of productive services that capital delivers in production, e.g. capital services.

Capital includes:
- non-residential construction
- transport equipment
- other machinery and equipment and weapons systems
- R&D
- intellectual property products


THANK YOU!