IFVI/VBA: Adequate-Wages Public Comment of Positive Impacts®

Along with a case study on how this methodology could flip impact valuation results upside-down

positive impacts (PI) GmbH | Cologne | 30 April 2024

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Question 1 – Inclusion of both remuneration impact and living wage deficit impact within the scope of the Exposure Draft

1A. INCLUSION OF REMUNERATION IMPACT?

1A. BASED ON THE REASONS ARTICULATED ABOVE, DO YOU AGREE WITH THE INCLUSION OF REMUNERATION IMPACT AS AN ELEMENT OF POSITIVE IMPACT ON WORKERS, AND WHY OR WHY NOT?

No, for the following reasons:

> It **distracts** from **material impacts** on society that are linkable to **science-based targets** by binding resources and attention

> It lacks the remuneration of the top management and the payments to shareholders (dividends), i.e., and is therefore incomplete. If added, the value chain perspective **simply shows** the **total value added**[1] of a firm, which is and **should not be linked to any target** from a societal perspective (unless one is a fan of a centrally planned economy)

> It does **not provide any added value for management decisions**: Should the management pay more wages to push prices and, ultimately, cause inflation? What is the societal benefit of inflation?

> It is mostly "useful" for protecting/justifying the status quo of large companies with large amounts of negative impacts (externalities), which will not be paid by the workers/individuals that benefited from the wages they gained due to these negative externalities (see slide 10)

> Including wages/salaries and dividends into impact valuation potentially leads to upside-down impact valuation results (see next slides, notably slide 8), ultimately leading to the wrong (investment) decisions

1B. IS THE REFERENCE SCENARIO CLEAR?

1B. ... IS IT CLEAR HOW THE DEFAULT REFERENCE SCENARIO DRIVES THE EXISTENCE OF REMUNERATION IMPACT FOR WAGES BELOW A LIVING WAGE?

Yes

1C. REMUNERATION & LIVING WAGE DEFICIT IMPACT?

1C. DO YOU AGREE THAT BOTH REMUNERATION IMPACT AND LIVING WAGE DEFICIT IMPACT SHOULD BE INCLUDED WITHIN THE SCOPE OF THE ADEQUATE WAGES METHODOLOGY, BEARING IN MIND THEY ARE NOT ADDED TOGETHER, OR SHOULD THEY INSTEAD BE SEPARATED IN SEPARATE METHODOLOGY STATEMENTS?

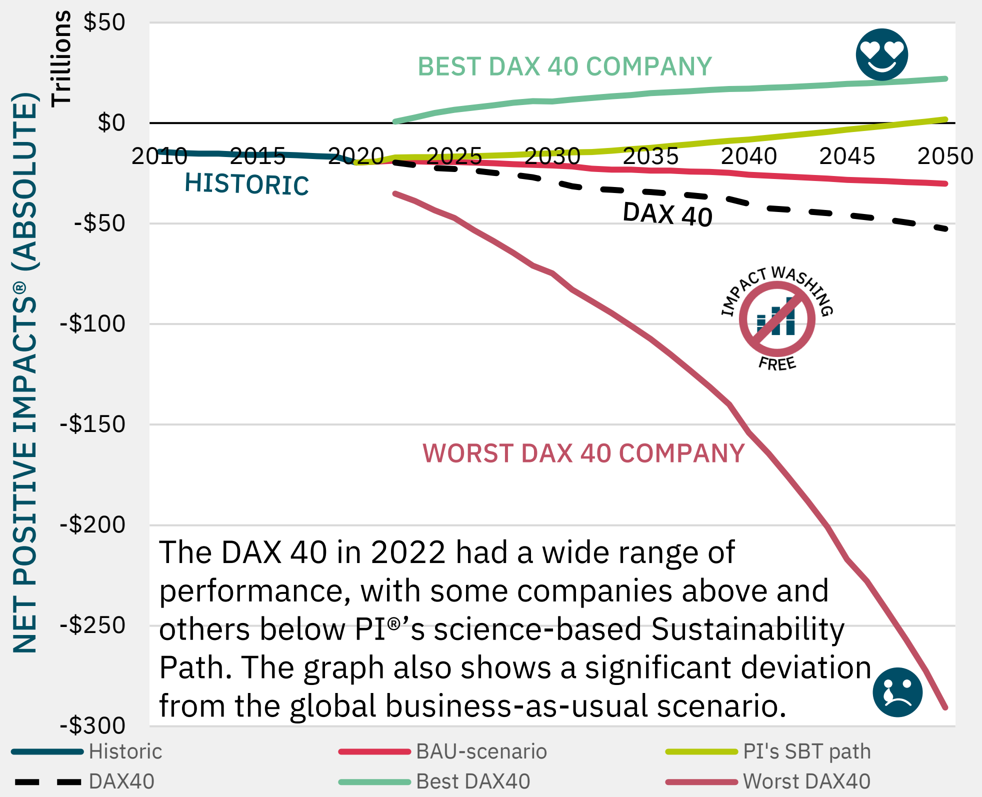
No, the adequate wages methodology should only focus on the living wage deficit impact for the given reasons in question 1A

1) Also known as revenue/global GDP contribution.

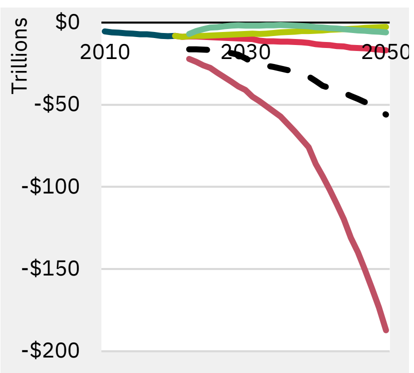
PI case study on the DAX 40, using PI's Net Present Impact® (NPI) KPI

If every company on the globe would perform as the Best/Worst…

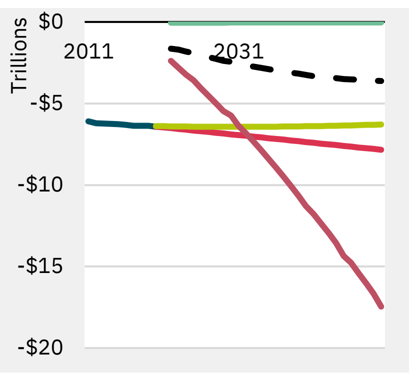
POSITIVE IMPACTS®: THE GUIDE TO A SUSTAINABLE ECONOMY



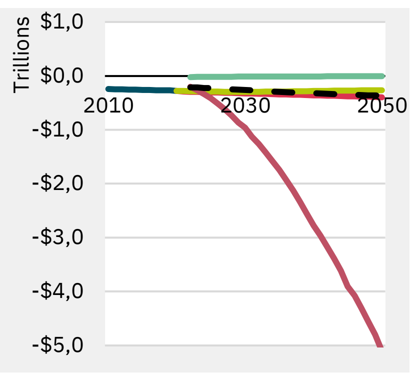
CLIMATE



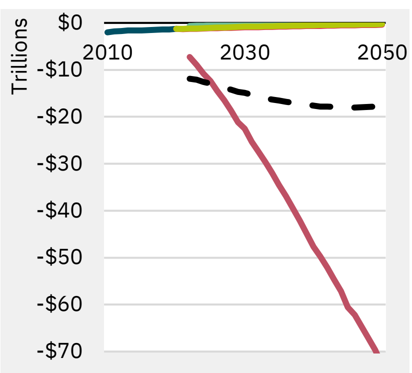
WATER



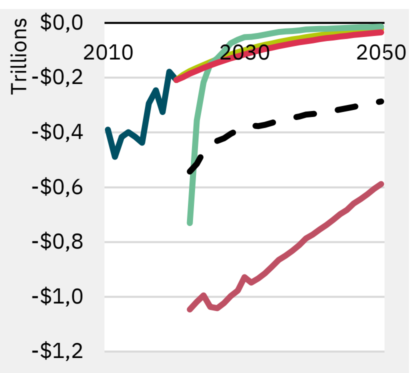
BIODIVERSITY (NATURE)[1]



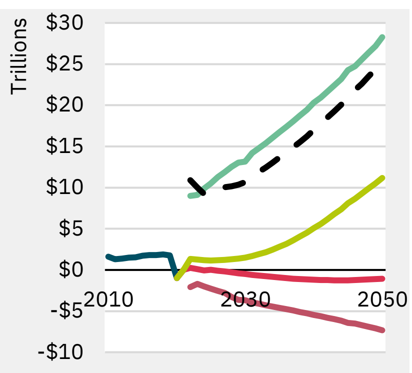
HEALTH



SOCIAL MATTERS



TAX (NET)



Source: © Positive Impacts® (2024), based on data and targets derived by: IPCC AR6, UNEP, "Azote for Stockholm Resilience Centre, based on analysis in Richardson et al 2023", ILO, IMF and OECD; **1**) Please note that climate and water also represent leading indicators for impacts on biodiversity & nature, and that the indicators covered under nature are amongst the most relevant ones. However, lagging indicators such as ' biodiversity loss could not be included as no company reports the number of species that got extinct due to their activities.

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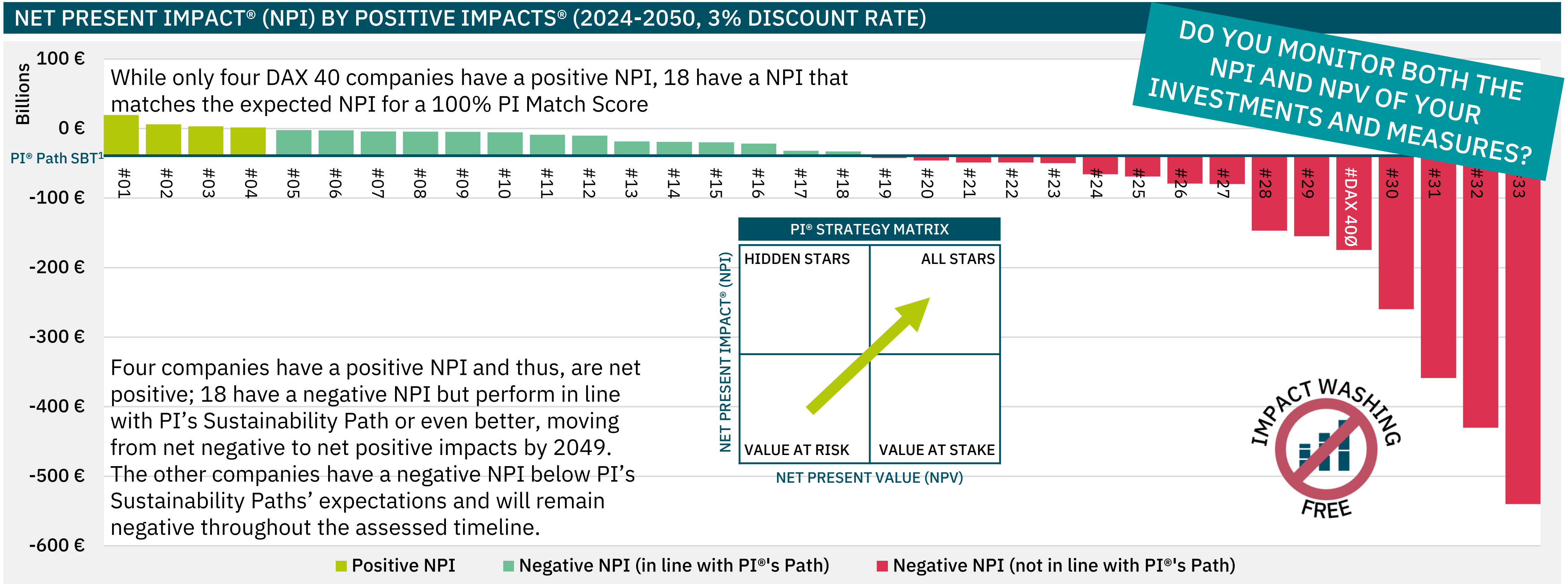
Four DAX 40 firms have positive Net Present Impact® (NPI)

NET PRESENT IMPACT® (NPI) BY POSITIVE IMPACTS® (2024-2050, 3% DISCOUNT RATE)



© Positive Impacts (PI) GmbH (2024); **1**) As you can see on previous slides, PI's Sustainability Path remains net-negative until shortly before 2050; thus, being on track means that your NPI is above the shown line. The shown path is calculated for the weighted average of the DAX 40.

Avoid misleading Net Present Impact® calculations (!)

IMPACT WASHED APPROACH

IMPACT QUANTIFICATION APPROACHES THAT SHOULD NOT BE USED FOR CALCULATING NET PRESENT IMPACT® (NPI) VS. PI®'S NPI APPROACH

TEMPTATION 1: REVENUE

- As an introduction to the topic by comparing it to NPV: An investment's Net Present Value (**NPV**) is calculated by **discounting** the **costs** and **benefits** that will occur in the future. It represents the present value in the form of a profit or loss[1]
- In performance evaluation, PI takes a pure societal perspective. Thus, PI asked: what are the **costs** and **benefits** of an activity from a **societal perspective**?[2] Some approaches also account for jobs or payments to owners as positive impacts on society. While PI partially admits it by considering them in PI's Societal Value KPI[3], they are not used as a basis for the NPI calculation since:
  - the **government** will **bear** the effects of negative **externalities** and **not** the **individuals** who **profited** from generating them[4]
  - PI considers jobs and dividends **implicitly** on the **x-axis** of the PI Strategy Matrix (using profits or NPV) as identifying profitable investments will allow the market participants to continue paying salaries and dividends
  - this would mean that **increasing** the **price** of a **product** would **make it "more sustainable"** as higher wages/dividends can be paid, leading to inflation
  - there is **no science-based target** for **jobs or dividends**, and the idea of allocating jobs to revenues is known as a centrally planned economy and not as a market economy

TEMPTATION 2: "POSITIVES"

- Companies may be attracted by methods **exaggerating "positive" impacts** if the negative impacts (externalities) are much higher than the taxes paid
- This may lead to further forms of **impact washing of externalities with "positives"**[2]:
  - **induced GDP** effect is the GDP (revenue) generated by the employees' consumption financed by the salaries they received
  - **employee training** impacts are calculated using the resulting future revenues

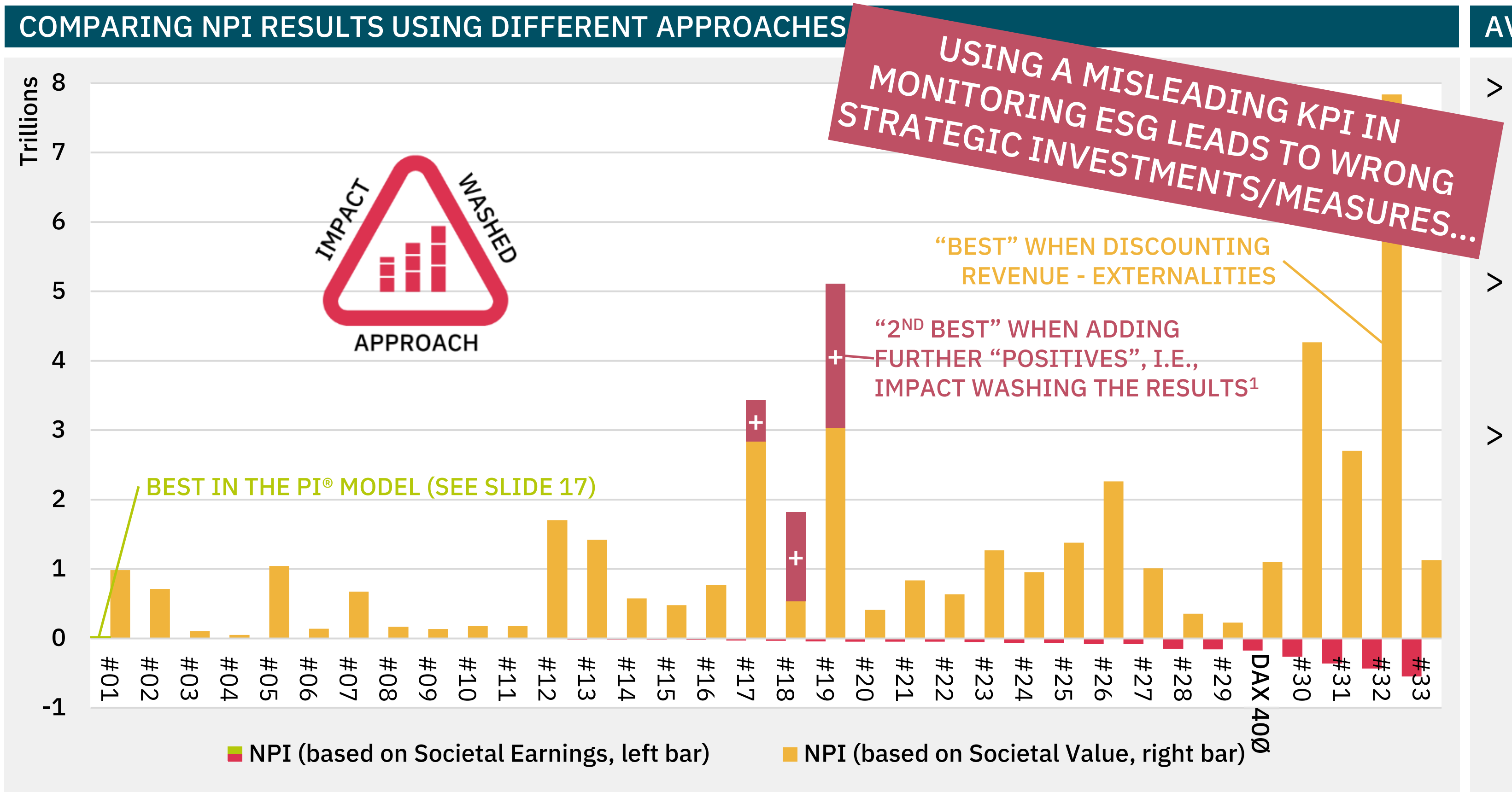
PI®'s NPI APPROACH

- **PI** only includes relevant **ESG KPIs** connected
  - to **science-based targets**,
  - to **global** performance **data**
  - and are or could be **reported by companies**
- Accordingly, and by this, PI
  - ensures that the **scope** is **consistent** with revenues,
  - **refrains** from **mixing** absolute, influenced, and marginal **impacts** and
  - **excludes KPIs** that **should not be allocated** to market players as **PI believes in competition**

1) See, e.g., Wikipedia for more information; 2) See Positive Impacts (PI) GmbH (2022) On track to net positive? Paper No. 3 for more on this topic; 3) We define Societal Value as revenue + positive - negative externalities; 4) See slide Harvard vs. VBA vs. PI and our recommendations to the IFVI/VBA for more.

Avoid misleading Net Present Impact® calculations (!)

COMPARING NPI RESULTS USING DIFFERENT APPROACHES



AVOID IMPACT WASHING RISKS(!)

> Using the wrong sustainability KPI in your strategy matrix leads to inappropriate investment decisions

> The false indications will even worsen if you fall for impact-washing approaches[1]

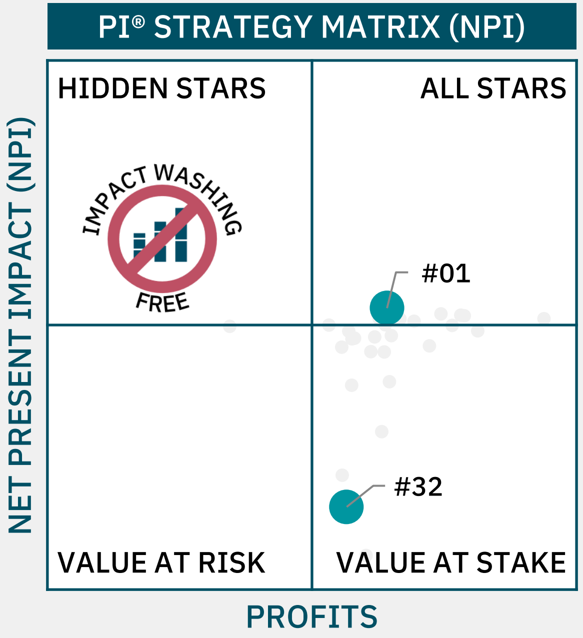
> Instead, using the right NPI approach and assessing the full value chain's NPI helps to identify your product portfolio's risks and opportunities

© Positive Impacts (PI) GmbH (2024); **1**) Do you calculate the NPV by discounting your expected revenues or your expected profits? As NPVs are calculated by discounting expected profits, we also discount Societal Earnings and not Societal Value in our NPI calculations. Societal Earnings are the sum of the net taxes paid, less the sum of externalities (cradle-to-gate). Societal Value is the sum of the revenues, less the sum of externalities (cradle-to-gate). See Paper # 3, Positive Impacts (2020) for impact washing approaches or our public recommendations to the IFVI/VBA.

Avoid misleading Impact calculations that turn results upside-down

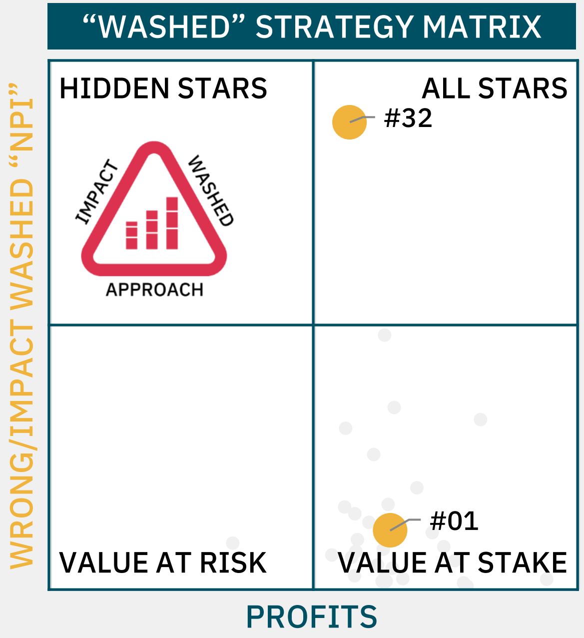
COMPARING PI's NPI RESULTS TO IMPACT WASHED RESULTS OF TWO COMPANIES: #1 AND #32[1]

PI®'s NPI APPROACH



- Recommended version to prioritize investments
- Possible KPIs for 3rd dimension: NPT, revenue, etc.

TEMPTATION 1: REVENUE



- Misleading view when prioritizing investments
- Instead, e.g., add jobs/dividends as 3rd dimension

RISKS OF IMPACT WASHING

- Main **risks** of **using impact-washed KPIs** on the y-axis of your strategy matrix:
  - **Risks** deriving from impacts on society will be **underestimated**
  - **Opportunities** deriving from low-impact portfolios may be **assessed** completely **wrong**

© Positive Impacts (PI) GmbH (2024); **1**) Ranking number of the 33 real economy companies in the DAX 40 according to NPI, with #1 being the best, #33 the worst, and #32 as a case study to show the extreme difference between the approaches.

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Appendix: Approach comparison of Positive Impacts® vs. VBA/IFVA vs. Harvard

What others say about our approach

PAPER SERIES PRESS COVERAGE (GERMAN)

Handelsblatt

> PART 1, **PART 3**

PART 3:

Börsen-Zeitung
Zeitung für die Finanzmärkte

> PART 1 , **PART 3 (SPOTIFY#30)**

TAGESSPIEGEL BACKGROUND

> PART 1, PART 2, **PART 3** (see right)

Forum Nachhaltig Wirtschaften

> PART 1, (02/2022),**PART 3** (04/2022)

TAGESSPIEGEL BACKGROUND COMPARES HARVARD, VBA AND POSITIVE IMPACTS APPROACH

The renown Tagesspiegel Background Sustainable Finance **compares** the **PI approach to** the one from **Harvard** and of the **VBA**:

“**Positive Impacts** has developed a similar concept to the one of [...] Harvard's, and the **Value Balancing Alliance**, an industry alliance, that is also working on it. They all convert emissions and other environmental impacts of corporate activities into monetary amounts and compare these with certain payments made by companies, such as taxes or salaries.

There are several ways in which companies can be made to look more positive or more negative, i.e., more beneficial or more detrimental to the common good: Which factors are considered positive or negative and what price tag is put on environmental damage, such as a ton of CO2, are such **set screws.**

Salaries or taxes as a positive effect? [...]

In the Positive Impacts methodology, there is a ‘societal value’ and a ‘societal gain/loss.’ The external effects are offset against sales in the case of the former, and against taxes paid in the case of the latter – after all, only these are used to finance services for the general public, whereas salaries flow into private accounts.

The Value Balancing Alliance [...] gives its backers a method that makes them look good: [...] its methodology [...] considers **profits, interest payments** and depreciation in addition to salaries and taxes.”[1]

Harvard Business School's approach, which is continued by the **International Foundation for Value Impacts (IFVI)**, also uses amongst others earnings and interest payments.

1) Tagesspiegel Background Sustainable Finance from 10. November 2022, own translation

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