

# Due Diligence: Social License if Positive Impact

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**Summary Statement:** Due diligence as a tool for mitigating and compensating social and environmental impacts through risk management, and the design and execution of social impact investment portfolios (participatory).

## Abstract

This paper proposes a multi-step due-diligence process that involves evaluating the social and environmental impacts, mapping impacts to stakeholders, conducting a surrounding risk analysis, designing a participatory social investment portfolio, and finally, measuring the impact to business, stakeholders, and the environment. In addition, this paper proposes a communication strategy to manage expectations and create a traceable process based in evidence, reporting accurately the impact assessment's findings and thereby encouraging confidence.

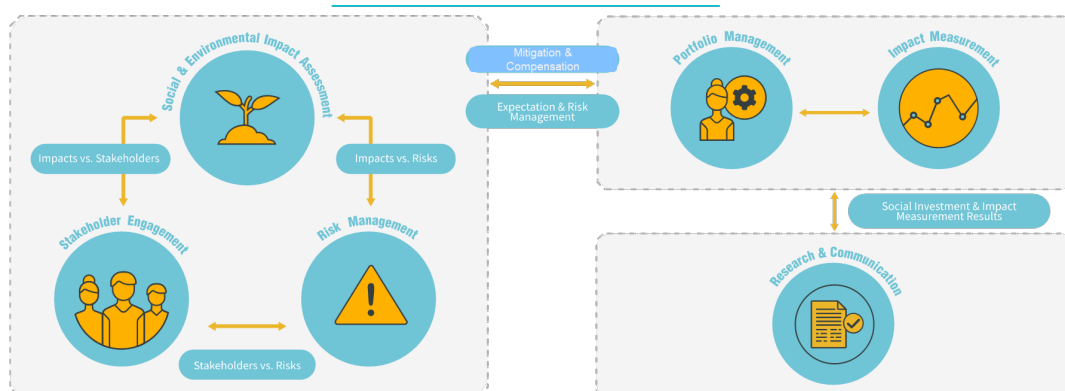
## Introduction

Due diligence is a term used in various fields: commercial, legal, financial, environmental, and the prevention of money laundering, among others (Schafrik & Kazakidis 2011). In the case of companies and particularly for the purpose of this paper, the concept will be adjusted exclusively to the ways companies must act when faced with social and environmental impacts, weighing the maturity of their processes.

This definition then corresponds to the company's responsibility for the impacts caused. For example, companies must integrate prospective impacts into their value chain so that any action taken to offset these impacts (be it social or environmental) are realistic, accurate, technical, and appropriate. In short, this process will help identify the positive or negative impacts a company's operations may have on the direct and indirect surroundings in which they operate.

## Methodology

In *Figure 1* below we present the Due Diligence methodology in relation to impact assessment.



**Figure 1: The cycle of due diligence: From the evaluation of impacts to strategic communication.** (Source: Own elaboration).

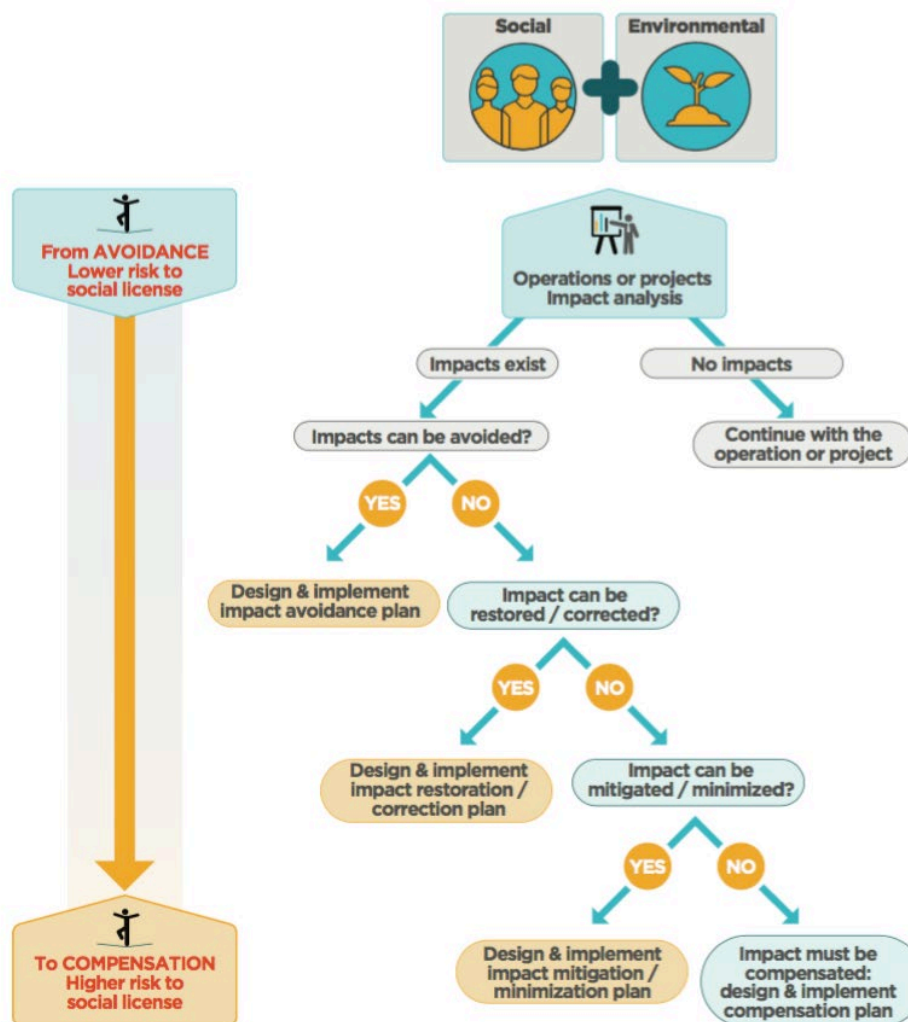
Based on this proposed model, the following sections detail every process, in order to present the main elements to be developed to implement comprehensive due diligence in organizations. These steps are detailed in the following five sections: social and environmental assessment, impact evaluation for stakeholders and knowledge of expectations, risk analysis, designing a participatory social investment portfolio, and international performance standards alignment.

### **Social and environmental assessment**

To identify associated impacts, this paper recommends the utilization of the Mitigation Hierarchy as evidenced in figure 2 below (Ekstrom, 2015). This process involves documenting and evaluating all associated impacts due to projects or operations that a company a) can avoid; b) can correct or restore; c) can mitigate or minimize or d) must compensate for when no other interventions are possible (Karami et. al., 2017). Only by performing this exercise will the residual impacts (that is, the "remnant") can be evidenced. In all cases, an action plan must be generated according to the result obtained through this method.

Following the completion of the mitigation hierarchy, a company should also generate qualitative or quantitative modeling that identifies the intensity of the impacts generated. This process involves prioritizing all associated impacts, generating action plans, and conducting preliminary risk assessment exercises for the both the business and impacted stakeholders (Esteves et. al, 2012).

*Figure 2* below depicts an adapted Mitigation Hierarchy related to Social and Environmental impact assessment.



**Figure 2: The Mitigation Hierarchy for Social & Environmental Impact Assessment.**  
 (Source: Own elaboration).

### Impact evaluation for stakeholders and knowledge of expectations

The company must also create a stakeholder map that follows rigorous methodologies that allow them to identify, characterize, and qualify the nature or type of the stakeholder relationships. This mapping process should then prioritize the type of engagement that is necessary for each stakeholder. It is important to understand that some of the actors will not appear to be a priority for the business, but the business will definitely be a priority for them. As a result, each stakeholder can be classified as either an opportunity or a threat.

By analyzing stakeholders in this way, the company will be able to map them, in order to gain a greater understanding of the various types of relationships it will be exposed to, such as a) collaborative relationships; b) social relationships; c) conflicting relationships; and d) relationships with shared value (Graetz & Franks 2013).

In addition, stakeholders that are exposed to social and environmental residual impacts should always be prioritized.

## Risk Analysis

The company will undertake a risk analysis in which it will identify the root causes that are generating such risks. This analysis is integral for the due diligence process. It is important to note that information pertaining to the risk analysis may come from internal or external sources of the business:

- a) For impacts that originate outside of the company, it is important to establish what the degree of "manageability" is and what the conditions are that generate such risks.
- b) For those causes that originate from the internal scope of the organization, it is necessary to analyze the weaknesses of the company's current controls and processes that trigger risk events in surroundings areas.

This identification process allows us to establish and measure the consequences and therefore, the intensity and priority that each risk will have in the final result of the analysis. This will then be reflected in a risk matrix, which includes various business impact dimensions, such as: a) financial impacts, b) reputational impacts, c) impacts on human rights, d) impacts on the environment, e) legal impacts, and f) impacts on the relationship between business and stakeholders, among others. All of these types of impacts must be monitored and controlled.

For the risks that are prioritized in the analysis, a response plan will need to be created, establishing clear strategies to avoid a risk materialization, and also identifying strategies to manage the contingency in case of a risk occurrence.

*Figure 3* is a representation of the risk sources that companies should manage according to a due diligence approach which is focused on maintaining a responsible social license.



**Figure 3:** Sources of risk (Source: own elaboration).

### Designing a Participatory Social Investment Portfolio

The social investment portfolio is the main tool in which all the components efforts of impact, expectation and risk management are consolidated.

One of the main difficulties organizations face when conducting a participatory social investment portfolio is their inability to successfully execute an idea into action, given the following process weaknesses: a) the portfolio is not formulated in a participatory manner with the stakeholders, b) it is not formulated following project management methodologies with impact measurement techniques, c) the teams that design and execute the portfolio are weak in their technical competencies of project management, and d) that management based on performance indicators (social, environmental or managerial) are too complex to design and run.

The success of a social investment portfolio relies on its justification from all actors, both internal and external to the organization. Moreover, it is also important to note that the design of the social investment must account for short, medium and long-term impact interventions that benefit both the business and stakeholders (Arvidson et. al, 2013).

### International performance standards alignment

In a transversal manner, a company must also ensure compliance with social and environmental international performance standards. These standards are in the supra-legal in scope and therefore, are independent of the level of regulations that exists within a country in which an organization operates.

## Conclusion

Companies are faced with significant challenges when trying to strike a balance between investing in business for innovation, growth and operation, against investing in the social and environmental surroundings. It is important to know that when facing these challenges, a social license will not be achieved with atomized (separate) actions.

It is necessary to design a strategy that encapsulates the concepts proposed in this paper, thereby demonstrating that there are clear actions to address real or perceived concerns of the various stakeholders. Only a standardized, measured and monitored process will evidence due diligence and such processes are vital in building confidence and prosperous relationships with all parties.

## References

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