THE ESG RISK RATINGS
MATERIAL ESG ISSUE — THE ENVIRONMENTAL AND SOCIAL IMPACT OF PRODUCTS AND SERVICES
SUSTAINALYTICS’ MATERIAL ESG ISSUE: 
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How companies manage the impact of their products and services can pose varying degrees of environmental and social risks to investors’ portfolios. Sustainalytics’ ESG Risk Ratings assess this risk through an analysis of the Environmental and Social (E&S) Impact of Products and Services material ESG issue. This issue shows investors which companies are most exposed to this risk and how well they are managing it. In this backgrounder, we will examine why this issue is growing in importance, analyze which industries are most exposed to this issue and highlight companies that perform well on this material ESG issue.

The Growing Importance of the E&S Impact of Products and Services
There are several factors encouraging the transition to more sustainable products and services. Regulations, which are becoming increasingly stringent, govern aspects related to the E&S impact of products, from hazardous chemicals to plastic packaging. The European Union’s Regulation on the registration, evaluation, authorization and restriction of chemicals (REACH) calls for the substitution of the most hazardous chemicals as soon as alternatives become available. There are also initiatives around the world that seek to reduce food waste, such as the Green New Deal and Circular Economy Action Plan in the EU, Interagency Agreement on Food in the U.S., and the National Food Waste Strategy in Australia. Broader trends in sustainable investing, such as the EU Sustainable Finance Action Plan, provide significant incentives for the transition toward a more resource-efficient, circular economy.

At the same time, consumers are demanding more sustainable products and services, which can present both risks and opportunities for companies. As evidence, research by NYU’s Stern Center for Sustainability into the purchasing habits of consumer-packaged goods found that 50 percent of growth between 2013 and 2018 came from sustainable products and services1. For example, Deloitte expects the market for agricultural biological pesticides, a less toxic alternative to traditional pesticides, to grow more than twofold, from USD 2.8bn in 2018 to USD 7.1bn in 2025. Similar trends have been observed for organic or natural food products, retail goods and beauty products2.

Assessing the Unmanaged Risk of the E&S Impact of Products and Services by Industry
Products may have a negative E&S impact due to inherent characteristics, like tobacco or hazardous chemicals, or because of how they are used, recycled and disposed of, as in the case of medical devices or plastic packaging. Industries that require the use of substances with known physical, environmental, or human health hazards, such as chemicals or tobacco, are particularly exposed to this issue.

The risk rating for a company’s E&S Impact of Products and Services combines the risk it cannot manage due to the nature of its products or business model combined with the risk that it is not actively managing with relevant programs and policies. Applying our consistent and comparable ESG Risk Ratings model, we see that the E&S Impact of Products and Services is material for over 1,880 companies in our comprehensive universe of more than 4,500 companies, spanning 18 industries and 43 subindustries. As indicated in Exhibit 1 below, companies in the chemicals industry have the highest unmanaged risk scores on average, followed by construction and engineering, consumer services and building products.


2 Source: Deloitte, The future of agrochemicals | Capturing value through innovation, resourcefulness, and digital alchemy, as of 2019.
The ESG Risk Rating for a company’s E&S Impact of Products and Services combines the risks it cannot manage due to the nature of its products or business model combined with the risk that it is not actively managing with relevant programs and policies in place. In contrast, incidents and controversies indicate a failure of the company’s programs and policies. As seen in Exhibit 2 below, as of September 2021, Sustainalytics has recorded a total of 367 events related to the E&S Impact of Products and Services for 367 companies for which this issue is material. Events are assessed on a scale of 1-5 based on impact on stakeholders and business risk, and are captured through our news screening of more than 700,000 news items, third party sources or company and regulator reporting. For this issue, events often involve lawsuits filed by consumers alleging negative impacts on their health or surrounding environments.
How Sustainalytics’ Evaluates Companies on the E&S Impact of Products and Services

Leveraging our ESG Risk Ratings framework, we score companies on a set of subindustry-specific exposure and management indicators. We consider whether a company sells products with known human environmental concerns as well as sustainable products. Depending on the subindustry, we assess management practices related to product stewardship and involvement in relevant industry initiatives. Moreover, we recognize that the transition to a more sustainable economy takes time, therefore we consider whether a company has in place management systems to identify, review and manage the hazardous products in its portfolio and targets to improve the management of substances of high concern and eventually phase them out.

One example of a company with strong management of this issue is AkzoNobel, a Specialty Chemicals company located in The Netherlands. AkzoNobel is one of the world’s largest producers of paint and coatings. As seen below, AkzoNobel falls within the low risk category for the E&S Impact of Products and Services, putting it within the 17th percentile for its subindustry.

AkzoNobel uses a sustainable product portfolio assessment that classifies products into five categories according to certain criteria like toxicity, energy efficiency, use of natural resources, emissions and waste, and land use. As of 2020, 21 percent of the company’s sales came from Eco-Premium solutions, which are products that outperform the market on at least one criterion and not significantly worse than the market in any other criteria, surpassing a 2020 target of achieving 20% of sales in this area.

Another example of leading practice is Evonik, a German Specialty Chemicals company within the low risk category for the E&S Impact of Products and Services, putting it within the top 9 percent of its subindustry. Evonik has an in-house chemical management system to evaluate the E&S impact of substances it places on the market in quantities of over one metric ton. As part of its commitment to improve management of hazardous substances, Evonik achieved its goal of completing a risk assessment for over 99 percent of these substances by the end of 2020.

Sustainable products and services today account for USD$125 billion and are expected to increase to USD$141 billion by 2023, according to NYU’s Stern Center for Sustainability. Given this projected growth, companies will be increasingly under pressure to demonstrate that their products and services do not have harmful environmental or social impacts. Leveraging our ESG Risk Rating framework, investors can clearly see which companies are most exposed to this important issue and how well they are managing their related risks.

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3 Source: NYU Stern Center for Sustainability, as of March, 2020. Article: Sustainable Purchasing Patterns and Consumer Responsiveness to Sustainability Marketing Messages.