Why telecom companies should focus on the 's' in ESG

Telecom companies can find additional opportunities to increase revenue and enhance their contribution to society through reinvigorating three social ESG factors: offering a great place to work, promoting digital inclusion, and growing cybersecurity services. ESG accountability and more robust methodologies can help firms as well

Creating a great workplace is imperative for telecom companies to attract and retain employees, as well as improve labour productivity

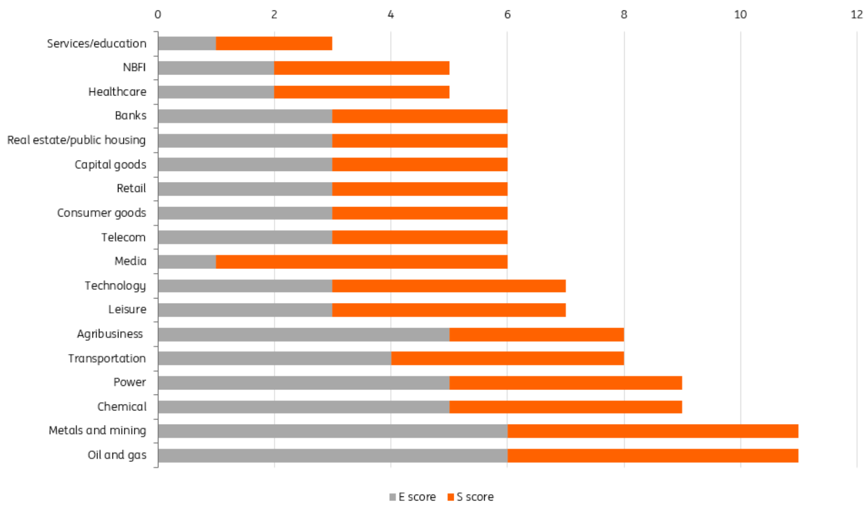
With energy prices on the rise, more telecom operators are improving energy preservation methods whilst working towards their net-zero emissions targets. This is contributing to the increased attention that environmental, social and governance (ESG) is receiving today.

In this article, we argue that for the telecom sector, increasing workplace attractiveness, enhancing digital inclusion, and promoting cybersecurity can help companies seize unique revenue opportunities while improving social performance. Although some companies are already doing this, we see room for improvement as well as better alignment. ESG analysis typically looks at both risks and opportunities, while we specifically identify three social factors that can help telecom companies take advantage of opportunities. We would like to propose a new narrative that reinforces the positive contribution of telecom companies to society through uncovering the importance of social ESG factors, separate from environmental or governance ESG factors.

Identifying material ESG factors to mitigate risks and realise opportunities

Here we look at how two expert agencies in the field of ESG – S&P and MSCI – evaluate ESG factors in the telecom sector. S&P suggests in its ESG Risk Atlas that telecom companies are subject to social risks and environmental risks in an equal manner. The environmental factors it deems relevant are energy consumption, emissions, end-of-life implications of equipment, water consumption of data centres, and exposure to extreme weather conditions. The social factors it considers are data privacy and network stability, possible excessive social media use (and misinformation), human capital management, issues arising out of the ethnically diverse customer base, safety management risks, as well as corporate citizenship. Given S&P's background as a firm providing credit ratings, its focus is very much on the risks. It evaluates important governance risks elsewhere in its credit risk framework.

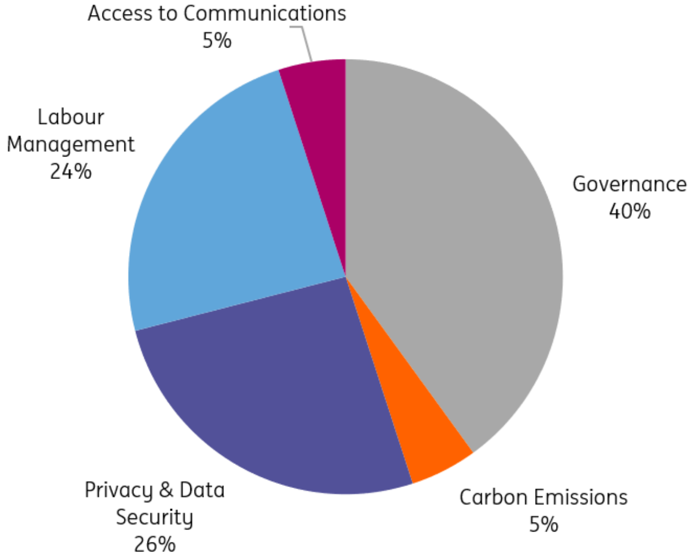
S&P sector risk atlas



Source: S&P Global Ratings

MSCI evaluates both a company's ESG risks and opportunities through its ESG Industry Materiality Map. The drivers of ESG in the telecom sector are governance (40%), carbon emissions (5%), privacy & data security (26%), labour management (24%) as well as access to communications (5%). For example, the carbon emissions category evaluates a telecom company's carbon intensity, as well as its efforts to manage climate-related risks and opportunities. MSCI does include access to communications as a social opportunity factor in its ESG rating metrics, defining it as "the extent to which companies are taking advantage of opportunities for growth in historically underserved markets," in both developing and developed countries. Yet, this factor only accounts for 5% of the total rating.

Distribution of material ESG factors for the wireless telecommunications sector - MSCI



Source: MSCI

Below are more detailed explanations of some selected traditional social ESG factors of telecom operators:

- **Data privacy**: As telecom companies are responsible for disseminating information, failing to protect basic data privacy will lower customer trust and raise reputation and regulatory risks. That said, better data privacy policies and actions can protect customers and therefore businesses.
- **Network stability and safety**: S&P also points out that factors such as personnel and infrastructure maintenance can determine the stability and safety of a telecom network. Unreliable networks may lead customers to switch to other companies; incidents happening at towers and data centres can reduce employee confidence and increase reputation risks.
- **Human capital management**: Telecom operators, which are often large companies with unionised workers and disadvantaged groups (such as minorities or people with disabilities), need to engage in a proper way with their employees. They should offer appropriate benefits to prevent good employees from leaving, but also avoid labour-related conflicts. Strikes are obviously a serious destruction of value, but poor human capital management could also lead to lower morale or worse.

Three social factors that can bring additional revenue to telecom companies

Telecom companies today are consciously addressing the abovementioned risks, which will help improve their creditworthiness. While many telecom companies are already rolling out initiatives to seize opportunities, we argue that the following three factors – workplace attractiveness, digital inclusion, and cybersecurity services – need more attention.

Being a great place to work

Creating a great workplace is imperative for companies to attract and retain employees, as well as improve labour productivity. This includes promoting diversity, employee engagement, and a sense of employee belongingness. While the first two factors have been regularly integrated into company ESG practices and ESG ratings, the last –belongingness – is not implemented as often.

- **Diversity**

Diversity is an essential means to increase the confidence of employees and customers. Consultancies, companies, and rating agencies have emphasised its importance: for instance, Deloitte wrote in an article that more diverse workforces can play a multiplier effect on a company's ESG performance and we fully subscribe to this idea. Diversity has also become an important focus for companies. ESG rating agencies are also taking it into account, for example, Sustainalytics scores on diversity programmes, gender pay disclosure and gender pay equality programmes.

- **Employee engagement**

A high level of employee engagement helps enhance labour enthusiasm as well as retention rates. It is often measured by employee Net Promoter Score (eNPS) – and several companies in the technology, media and telecom sector have used eNPS as one of the KPIs when issuing their sustainability-linked loans.

- **Belongingness**

Nurturing a sense of belongingness in the workplace is highly intertwined with diversity and engagement, but its importance to a company's culture and prosperity means that it deserves to be treated separately and more seriously. In its ESG efforts, technology firm Wolters Kluwer reports a measure for "belonging". It defines this measure as "the extent to which employees believe they can bring their authentic selves to work and be accepted for who they are". We think that a healthy score on such a factor could improve productivity, and improve innovation because people feel free to talk.

Promoting employee belongingness can also entail setting up ventures that have their own purpose and organisational culture – for telecom companies, such ventures could be around cybersecurity. This is because employees may prefer to work for a fast-growing cybersecurity company over a larger corporate. By setting up smaller ventures, large corporates can attract and retain talent, as long as there is a fit for the wider corporate organisation. Furthermore, employees often choose to work for a firm with a clear purpose in society. Developing a relevant purpose should therefore be included in the design of a great place to work.

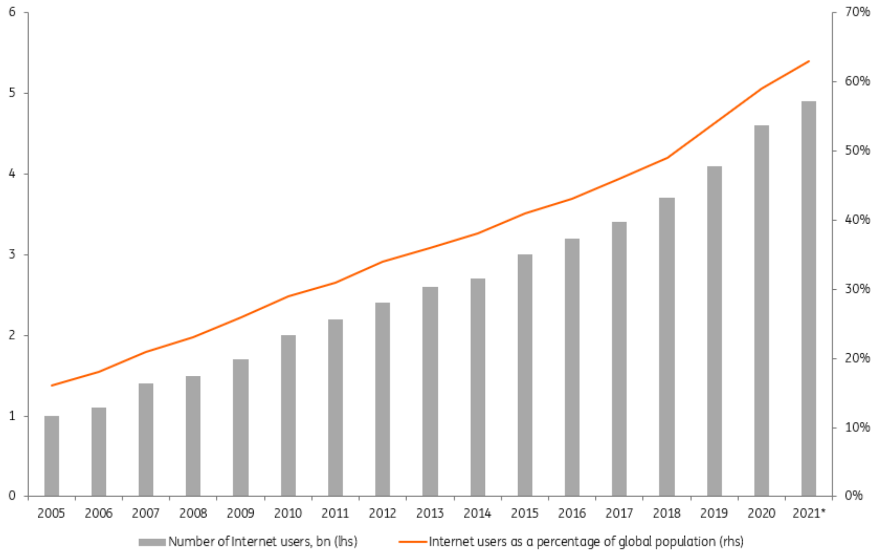
Because of its uniqueness, a sense of belongingness should be featured in ESG ratings, which could then encourage more companies to consider making efforts to improve the issue.

Digital inclusion

Telecom companies need to ensure geographic regions and minorities have access to digital networks and services. Many telecom operators today are expanding and upgrading networks. Digital inclusion is an important social factor that focuses on opportunities rather than risks. Equipping more people with proper information and communication technologies can create new jobs, accelerate economic development in innovative ways, and expand people's ways of enjoying services. The use of novel technologies such as Fixed Wireless Access is also an example of this. Web and software design technology also facilitate access in multiple languages which could aid minorities.

Digital inclusion is commonly understood as ensuring all humans – including those living in disadvantageous situations – have access to information and communication technologies (ICTs). But today, 2.9 billion people in the world (or 37% of the entire population) are still unconnected, despite more and more people gaining access to ICT networks each year. Most of the people without access to ICT networks are in poor economic conditions, in remote areas, minorities, women, the less educated, disabled, or a combination of those.

Worldwide access to the internet



Source: ITU

As the notion of equality evolves, the scope of digital inclusion is also being widened. The World Benchmark Alliance notes that in addition to universal access to digital technologies, digital inclusion also encompasses strengthening digital skills at all levels, enhancing trustworthy use of ICTs by mitigating risks, as well as innovating openly, inclusively, and ethically. This wider definition of digital inclusion is aligned with the EU's Digital Economy and Society Index (DESI), whose assessment of member countries' digital performance centres around human capital, connectivity, integration of digital technology, and digital public services. The methodology provides insight into the different subfactors that need improvement for the EU to accelerate its digital capabilities. Telecom operators are building new networks in Europe since they are very well placed to help the EU to achieve its goals.

Some may think of enhancing digital inclusion and creating social impact as a philanthropic deed or moral obligation which underpins the license to operate and enhances brand trust. However, social impact can generate economic value and positively affect a company's financial position as better connectivity, services targeted at minorities, and business model innovation can lead to higher-quality products for a larger customer base. MSCI, to some extent, does include access to communications as a social opportunity factor in its ESG rating metrics. We argue that a stronger focus on digital inclusion can be a revenue opportunity for telecom network operators, something many are already doing.

Cybersecurity services

As telecom companies are experts in data protection, they could also provide cybersecurity services to customers, in addition to maintaining basic network safety. Cybersecurity services are showing above-average growth rates, as they can provide telecom companies with additional revenue sources.

Over the years, the number and sophistication of cyberattacks have shown strong growth. More recently, cybercriminals also target mobile devices and networks. Most small and medium-sized enterprises do not have in-house cybersecurity expertise and have to rely on managed service providers to protect their data and networks. These cybersecurity threats, therefore, provide a business opportunity for telecom operators as they are ideally suited to provide data security services. Some telecom operators (eg, KPN, Telefonica, Orange and BT) already offer such security services. Telecom operators can leverage their existing customer base to sell these services, enhance average revenue per user, and improve client satisfaction scores and client retention rates. Revenues from cybersecurity make up a small part of overall telco revenues at the moment, with Telefonica and Orange generating 1-2% of total revenues from this segment. Interestingly, the growth of cybersecurity services is relatively high. For Orange, cybersecurity revenue grew by 14% in 2021.

The deployment of new products and services (5G, cloud, IoT and edge computing) contributes to further growth of demand for cybersecurity services. This segment, therefore, provides a significant opportunity for revenue growth.

What should the telecom sector do to grab opportunities through better social engagement?

We think that companies need to ramp up investment in networks, bridge the digital divide, further improve the attractiveness of workplaces, expand cybersecurity services, improve reporting on ESG issues that are both financially material and socially impactful, and enhance ESG accountability.

Investment in networks

It is estimated that narrowing the global digital divide by half in the next five years will need US$2.1tr of investment, which will need to be dedicated to education, building trust in using ICTs, and advancing digital solutions in sectors such as healthcare and financial services. This vast amount of investment means that impactful financing is needed.

Companies in the telecom sector can then be the enabler of more inclusive and affordable technologies to narrow the digital divide – and they are indeed ramping up their efforts to promote digital inclusion. Orange has offered digital literacy skills to more than 40,000 unemployed women in Africa and Europe since 2015. Telefonica’s digital inclusion programmes include enhancing inclusive access, training about digital skills, providing innovation-related services, and promoting the safe and responsible use of technology. Verizon’s Innovative Learning initiative has reached 1.5 million students and the company plans to train more than 10 million youth with digital skills by 2030.

These efforts mostly focus on expanding access to and increasing the quality of ICT networks, as well as educating more people about digital skills. But if we recognise the wider definition of digital inclusion, these efforts are not enough. For telecom companies, digital inclusion also means improving device subscription affordability with a special focus on disadvantaged people, including people with disabilities, minorities, as well as people with low literacy.

Moreover, companies should not only focus on building ICT networks but also evaluate the potential negative effects stemming from the misuse and overuse of technological devices. ICT overuse can result in health issues and contribute to addiction.

It is also worth noting that the cost of launching a full network is high, and governments have been playing a role in providing subsidies to companies that are expanding their networks. In the EU, a fifth of the €723.8bn Recovery and Resilience Facility (RRF) plans to improve digital capabilities, with a prominent role for fibre deployment. Subsidies to bolster fibre network rollouts could support the telecom sector's capital spending. In the US, the Biden administration has recently launched the $45bn “Internet for All” Initiative to bring affordable, reliable high-speed Internet to as many Americans as possible. Companies can therefore actively work with governments to bridge the social-economic divide, which is partly based on access to digital services. Government subsidies could render services profitable in remote areas where a traditional business case is not profitable. Since digital connectivity becomes increasingly important for economic productivity growth (think digital farming and online education), such subsidies are often a prerequisite for economic growth.

Financing digital inclusion

We are seeing an emerging trend of companies issuing sustainability-linked bonds and loans that are partly targeted at promoting digital inclusion while contributing to the United Nations’ Sustainable Development Goals. In 2020, French telecoms company Orange completed its first sustainability bond issuance at €500m. Of the €328m of proceeds that had been used by year-end 2020 to refinance relevant capital expenditures arising from 2019-20, 37% was dedicated to social and digital inclusion projects eligible under the company’s Sustainable Financing Framework. These projects include developing fibre-to-the-home high-speed broadband in rural France and investing (through Orange Ventures) in start-ups in Africa and the Middle East, whose impact metrics are summarised in an Allocation and Impact report.

Other companies are also active in financing their digital inclusion initiatives. In 2021, Telecom Italia issued its inaugural €1bn sustainability bond. A part of the proceeds was intended to be used to fund social projects outlined in the company’s Sustainability Financing Framework, such as developing optic fibre networks in underserved areas and advancing its digital education projects. Proximus and Vodafone have developed similar sustainable finance frameworks that cover digital inclusion topics like deploying next-generation networks and equipping the disadvantaged with digital skills. In these cases, social and sustainability-linked bonds and loans become meaningful tools to finance digital inclusion.

A renewed focus on a company’s purpose and attractiveness for employees

Companies should move away from just managing their human capital to developing places where talent wants to work. An article from the Harvard Business Review suggests that the most essential keys to nurturing an ideal workplace include letting people be themselves and unleashing the flow of information throughout the company. Organisations should also bring out the best in every employee and stand for something more than shareholder value. Employees should be able to perform tasks that they feel are meaningful. Finally, companies should set rules that employees buy into. Since human capital management is a skill in itself, we only want to highlight the need for companies to become better at it, since talent is becoming scarcer and product innovation imperative.

Develop and grow cybersecurity expertise

Telecom companies need to further develop cybersecurity expertise as this could become an integral part of their service offering. Since many services are scalable, the telecom operators need to grow to provide these services at a profit margin that is sufficient. Growing these businesses could also entail mergers and acquisitions. For example, in 2019 Orange acquired a 100% equity interest in UK-based cybersecurity solution provider SecureData, as well as 100% of European cybersecurity operator SecureLink. Similarly, in 2020 Telefonica invested in cybersecurity company Nozomi Networks through its venture capital arm Telefónica Innovation Ventures.

Alternatively, relevant services can be offered through ventures. Telecom operators such as KPN and Telefonica have set up smaller ventures that develop new technologies.

More consistent disclosure and enhanced accountability

Finally, companies need to develop robust procedures with respect to ESG target-setting and accountability. They should also report impact data in a consistent way to help foster a sector-wide drive to improve social engagement.

- **Comparable disclosure**
    - Take digital inclusion as an example, 92% of the 25 leading global mobile operators today are reporting on their digital inclusion initiatives, according to a recent report by GSMA, an industry organisation representing mobile network operators globally. But GSMA also concludes that the reporting schemes lack consistency. Moreover, only 20% disclose information on the affordability of devices or data plans, the absence of which can harm digital inclusion efforts.
    - Therefore, more consistent reporting schemes both within a company and across companies will play an essential role in increasing the comparability of digital inclusion data within the sector, as well as the comparability of wider ESG performance. A good way to do that is to adhere to popularly recognised disclosure frameworks such as SASB and GRI, and follow (sub)industry guidance such as that from the GSMA.
- **Ensuring accountability**
    - Since the social ESG factor is in general softer than the environmental ESG factor it can be harder to measure the former. It is therefore important to establish relevant mechanisms that can hold telecom operators accountable to promote social engagement. For example, companies can design KPIs measuring digital inclusion, employee belongingness, and cybersecurity service growth that are easy to quantify.

The social ESG factor is a very relevant factor for telecom operators. This article argues that for the telecom sector, promoting digital inclusion, enhancing company attractiveness, and further developing cybersecurity services are three promising strategies that bring opportunities. These opportunities will facilitate company revenue growth, improve ESG scores, and create a positive impact on society. Finally, the backbone to both mitigating ESG risks and realising ESG opportunities is to hold companies accountable through more consistent and transparent industry-wide disclosure.

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