



Doing Business Sustainably in the Context of Repressive and Violent Regimes

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It is not the first time that companies doing business with or operating under repressive regimes are put in the spotlight. But rarely has it been as accentuated as we observe it now with the war in Ukraine. The general issue with companies and repressive regimes, however, arises again and again with a multitude of states. It is therefore necessary to establish and apply universally valid principles when valuating companies' sustainability impact. This article shows which principles and concepts Inrate applies in the context of repressive and violent regimes in its ESG Impact Ratings.

How is sustainable business associated with repression and violence of states?

Repressive regimes are governments that systematically restrict or violate the fundamental and/or human rights of their inhabitants. Violent regimes go one step further and use violence against their own population or against other states¹ to enforce their own power interests.

Companies can be associated with such repressive or violent regimes in a number of ways. If we want to assess the sustainability impact of companies, it is therefore necessary to answer the following two questions: **How does the company or its products enable or contribute² to violations by repressive regimes?** And following from this: **How should this contribution be reflected in the company's sustainability impact assessment?**

However, the extent to which a company or its products contribute to violations of human rights or international law is very difficult to determine. The connection between companies and fundamental rights infringements by regimes is usually very indirect.

The following categorisation – described in more detail in the following chapters - helps to make this differentiation of the various possible links between a company and repressive regimes:

1. the company's **products contribute relatively directly** to the infringements by the regime (e.g. in the security sectors);
2. the company is **state-owned** and thus under control of the regime;
3. the first two categories do not apply, but the company **generates turnover in the given state**.

To assess whether companies or their products are in some way connected to repressive or violent regimes, one can also use information on **political sanctions** or **boycotting companies**. However, this raises further conceptual issues and challenges, described below.

In the following, the above-outlined categorisation and the issues with sanctions and boycotts are briefly described from the conceptual perspective of Inrate.

1. A company's products contribute to the rights infringements by the regime

A relatively evident and direct connection between a company and the rights infringements of a regime arises when a company's products or services themselves are used for these infringements or enable them in the first place. Examples include companies that produce and supply weapons, software for censorship or that provide security services to repressive regimes.

In most cases, however, the contribution is not as clear as in the examples given above. For instance, how would an IT company be assessed if its software had (possibly deliberate) loopholes that allowed the regime to use them as surveillance tools for its citizens? Or a company that supplies parts to arms manufacturers, which in turn supply repressive regimes? - And following from that, how much further along the value chain can a contribution still be identified?

The assessment of the contribution of a company to the violations of a regime has to be made very carefully. Inrate evaluates these contributions on a case-by-case basis. Deductions on a company's sustainability rating are then made in proportion to the severity of the regime's infringements and the company's contribution to them

¹ In this case, they additionally violate international law, besides human rights.

² At this point, a contribution should be understood in a broader context, that is, including indirect contributions along the entire value chain of companies.

2. State-owned enterprises

State-owned enterprises are, as the name tells, controlled by the state. Therefore, they are connected to the regime, even if their products are in no way connected to any human or international rights infringements.

However, irrespective of the products offered, the regime in general profits from state-owned enterprises: It controls them and can use them for its own purposes and political agenda. It can dispose of its share of their profits. Or it can, as in the case of energy companies in Russia, use them as political leverage against other states to strengthen its own position. Ultimately, by controlling a company - irrespective of the direct financial benefit through the companies' profits - the state apparatus can also further enrich and stabilise itself financially or politically through such companies. It can do this by distributing high-paying posts to regime supporters or by misappropriating company assets, etc.

In this respect, Inrate argues that state-owned enterprises under a repressive regime are in principle to be considered less sustainable than privately controlled companies providing the same product or service. Accordingly, Inrate makes a deduction on the sustainability rating of state-owned enterprises under repressive regimes.

3. Companies generating revenues in a state with a repressive regime

Companies operating in states with a repressive regime do not necessarily exhibit an identifiable connection to the infringements of regimes. Most companies will naturally mainly benefit the civilian population and/or other companies with their products. Examples include companies providing food, pharmaceuticals or clothes.

Here, the connection of the company to the infringements of the regime is much more indirect than in the two cases discussed above. It evolves from the benefits accruing to the regime through taxes, licences, potentially even bribes (in the case of corruption being common in the given state), etc. Doing business in a state with poor governance and potentially a high level of corruption can also mean a much higher risk of conducting business with own poor corporate governance (including corruption, exposure of employees to repression, etc.).

From a sustainability perspective, a balance has to be struck between the positive impact of the products and services on the civilian population and the financial and political benefits for the regime. In this specific case (where connection 1. or 2. are not fulfilled, see above), the positive impact would likely prevail.

From an Inrate perspective, it would be wrong to per se assess companies that provide basic needs to the civilian population as having a negative sustainability impact, even if they operate in a repressive regime. Inrate does, however, apply a small deduction to the sustainability rating, if the respective regime gravely violates international law, to reflect the arguments outlined above

Political Sanctions

Political sanctions can also highlight certain connections between people or companies and repressive regimes. The problem here is that political sanctions are, as the name already implies, primarily political instruments of states (or state unions) and are imposed on the basis of their political and economic interests or their value systems. However, the extent to which these interests and value systems are in harmony with sustainable development is not easy to specify.

The most objective political entity in this regard would be the United Nations (UN) and in that regard the UN Security Council, which can impose sanctions. However, by their very nature, UN Security Council sanctions only cover states that do not have a veto right in the Security Council or are not protected by one. In this respect, the meaningfulness and reach of these sanctions is limited. Additionally, the extent to which sanctions can have any effect at all on the behaviour of the sanctioned states and the sustainable development in these states is highly unclear³.

In simplified terms, companies can be related to sanctions in two ways:

- a. Sanctions are imposed on the companies themselves, for instance Russian banks being excluded from the international financial transaction system SWIFT.

³ Allen, S. 2022: The uncertain impact of sanctions on Russia, Nature Human Behaviour, <https://doi.org/10.1038/s41562-022-01378-8>.

- b. Companies contribute to the circumvention of sanctions imposed on repressive regimes (i.e. not on companies), for instance banks deliberately not freezing sanctioned assets of regime members.

Case b. can generally be classified under category 1. (i.e. business activity contributes to the infringements of the regime), since the business activity evidently curbs the fight against or the weakening of the repressive regime.

Case a., however, is much more difficult to answer from a sustainability impact perspective. On the one hand, this is due to the problems of the political character of sanctions discussed above. On the other hand, companies are not necessarily sanctioned because they in fact contribute to the infringements of the regime. For example, in the case of Russian banks, sanctioning is intended to weaken the economy, as well as the solvency of the state as a whole. However, this does not mean that each of the sanctioned banks does for instance finance or support government actions.

In the case of sanctions as an indicator of the involvement of companies with repressive regimes, caution is therefore advisable. In this context, Inrate assesses the sustainability impact of sanctioned companies on a case-by-case basis and using the conceptual categorisation described above

Boycotts

Many Western companies have withdrawn from Russia some days or weeks after the invasion. However, the reasons are in most cases not actual political sanctions. Rather, the companies are concerned with economic and reputational risk considerations and, at least in part, the implementation of their own value principles.

Due to the multitude of reasons for withdrawing from a repressive state, caution is also required when assessing boycotts (or also deliberately remaining in the state). The extent to which the products and services primarily benefit the civilian population should also here be taken into account. Denying the civilian population in a repressive regime access to basic services is problematic from a sustainability perspective, even if the reason for doing so is to weaken the regime.

How the withdrawal from a repressive regime affects a company's sustainability rating (albeit always positive) thus depends crucially on the categorization of its connection to the regime before the withdrawal. For example, an arms supplier would benefit greatly from withdrawing from business with a repressive regime, as large deductions on the rating would be removed⁴. On the other hand, a company that supplies the population with basic products such as clothing will not benefit much from a boycott, as only small deductions were made in the previous assessment – if at all.

Conclusion

The sustainability impact of companies depends on the extent to which they support, contribute to or enable infringements of the regime in which they operate. This extent in turn depends on how they are connected to the regime and its infringements. A connection can be established either through the products and services, through being state-owned or through the taxes and other levies paid by companies. In any case, a contribution to any repressive and violent regime should be assessed with caution, especially as it is (very) indirect in most cases.

Inrate follows the framework outlined in this article when assessing companies under repressive regimes and the assessment is reflected accordingly in our ESG Impact Rating.

⁴ Please note, however, that arms suppliers are in general never rated as sustainable by Inrate.



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