

# **MSCI ESG Ratings Methodology: Raw Material Sourcing Key Issue**

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October 2023

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## Introduction

This document provides essential information on the components of the Raw Material Sourcing Key Issue to enable users of ESG Ratings to understand how our outputs are determined. Raw Material Sourcing is a Key Issue in the Environmental Pillar of the MSCI ESG Ratings model. Companies are evaluated on the environmental impacts of the raw materials used in their products and their efforts around supply-chain traceability and certification.

For additional details on the MSCI ESG Ratings Model, refer to Section 2, Data, ratings and scores, of "ESG Ratings Methodology."

**Exhibit 1: MSCI ESG Key Issue hierarchy**

3 Pillars	10 Themes	33 ESG Key Issues
Environmental	Climate Change	Carbon Emissions
		Climate Change Vulnerability
		Financing Environmental Impact
		Product Carbon Footprint
	Natural Capital	Biodiversity & Land Use
		<b>Raw Material Sourcing</b>
	Pollution & Waste	Water Stress
		Electronic Waste
		Packaging Material & Waste
	Environmental Opportunities	Toxic Emissions & Waste
Opportunities in Clean Tech		
Opportunities in Green Building		
Opportunities in Renewable Energy		
Social	Human Capital	Health & Safety
		Human Capital Development
		Labor Management
		Supply Chain Labor Standards
	Product Liability	Chemical Safety
		Consumer Financial Protection
		Privacy & Data Security
		Product Safety & Quality
		Responsible Investment
	Stakeholder Opposition	Community Relations
		Controversial Sourcing
	Social Opportunities	Access to Finance
		Access to Health Care
Opportunities in Nutrition & Health		
Governance	Corporate Governance	Board
		Pay

3 Pillars	10 Themes	33 ESG Key Issues
		Ownership & Control
		Accounting
	Corporate Behavior	Business Ethics
		Tax Transparency

## Risks associated with this Key Issue

- Damage to brand value.
- Failure to meet consumer demand for more environmentally sound products.

## Raw Material Sourcing Key Issue Score

The Raw Material Sourcing Key Issue Score evaluates the company’s level of exposure to, and management of, risks on this Key Issue. The Key Issue Score is based on the Exposure Score and the Management Score using the formula below. The Exposure Score and the Management Score are combined such that a higher level of exposure requires a higher level of demonstrated management capability in order to achieve the same overall Key Issue Score.

$$KI_i = 7 - (\max (EXP_i, 2) - MGMT_i)$$

Where:

- $KI_i$  is the Key Issue Score for company  $i$ .
- $EXP_i$  is the Exposure Score for company  $i$ .
- $MGMT_i$  is the Management Score for company  $i$ .

## Raw Material Sourcing Management Score

The Raw Material Sourcing Management Score evaluates the company’s ability to manage its exposure to risks on this Key Issue. It is based on the Management Score category listed below, modified by Controversies. These scores are derived from data points that are scored on a 0-10 scale, with 10 corresponding to best practice and 0 corresponding to lack of management. Refer to Section 3.3, Analyzing risk management, of “ESG Ratings Methodology” for additional details. Sources are

company disclosures except where otherwise indicated. The following formula is used to calculate the Raw Material Sourcing Management Score - Excluding Controversies:

$$MGMT_{RMS,i} = SPC_{RMS,i}$$

Where:

- $MGMT_{RMS,i}$  is the Raw Material Sourcing Management Score - Excluding Controversies for company  $i$ .
- $SPC_{RMS,i}$  is the Sourcing Policy & Commitments Score for company  $i$ .

The following data points, without constituting an exhaustive list, are representative of the inputs to the Management Score. The data points listed below are used in the Management Score calculation:

## Management Score category: Sourcing Policy & Commitments Score

For indicators related to certification and traceability, we use company-disclosed values where available. Where company disclosures are not sufficiently granular, we extrapolate from company disclosures to derive more granular values.

- **Extent of supply chain initiatives to address impacts of beef and/or dairy production.**  
**Definition:** The extent of the company’s initiatives to develop sustainable practices within its beef and/or dairy supply chain, e.g., sustainable land management program, methane reduction program, implementation of specific sustainable requirements for suppliers and verification of compliance.
- **Extent of supply chain initiatives to address impacts of cotton production.**  
**Definition:** The extent of the company’s initiatives to develop sustainable practices within its cotton supply chain, e.g., water and pesticide reduction programs, technical assistance to obtain sustainable certification.
- **Extent of supply chain initiatives to address impacts of leather production.**

**Definition:** The extent of the company’s initiatives to develop sustainable practices within its leather supply chain, e.g., technical assistance to obtain sustainable certification, reduction of chemical use in the dyeing and tanning process.

- **Extent of supply chain initiatives to address impacts of palm oil production.**

**Definition:** The extent of the company’s initiatives to develop sustainable practices within its palm oil supply chain, e.g., technical assistance to obtain sustainable certification, implementation of specific sustainable requirements for suppliers and verification of compliance.

- **Extent of supply chain initiatives to address impacts of seafood production.**

**Definition:** The extent of the company’s initiatives to develop sustainable practices within its seafood supply chain, e.g., technical assistance to obtain sustainable certification, involvement in Fisheries Improvement Projects.

- **Extent of supply chain initiatives to address impacts of timber and/or paper production.**

**Definition:** The extent of the company’s initiatives to develop sustainable practices within its timber and/or paper supply chain, e.g., technical assistance to obtain sustainable certification, implementation of specific sustainable requirements for suppliers and verification of compliance.

- **Future targets for beef and/or dairy sourcing.**

**Definition:** The extent to which the company has clear, measurable targets for certifying or tracing its sources of beef and/or dairy.

- **Future targets for cotton sourcing.**

**Definition:** The extent to which the company has clear, measurable targets for certifying or tracing its sources of cotton.

- **Future targets for leather sourcing.**

**Definition:** The extent to which the company has clear, measurable targets for certifying or tracing its sources of leather.

- **Future targets for palm oil sourcing.**

**Definition:** The extent to which the company has clear, measurable targets for certifying or tracing its sources of palm oil.

- **Future targets for seafood sourcing.**

**Definition:** The extent to which the company has clear, measurable targets for certifying or tracing its sources of seafood.

- **Future targets for timber and/or paper sourcing.**

**Definition:** The extent to which the company has clear, measurable targets for certifying or tracing its sources of timber and/or paper.

- **Percentage of beef and/or dairy third-party certified to an environmental sustainability standard.**

**Definition:** The estimated share of beef and/or dairy externally certified to sustainable standards (e.g., organic certification).

- **Percentage of cotton third-party certified to an environmental standard.**

**Definition:** The estimated share of cotton externally certified to sustainable standards (e.g., Better Cotton Initiative).

- **Percentage of leather third-party certified to an environmental sustainability standard.**

**Definition:** The estimated share of leather externally certified to sustainable standards (e.g., Leather Working Group Silver and Bronze).

- **Percentage of palm oil third-party certified to an environmental sustainability standard.**

**Definition:** The estimated share of palm oil externally certified to sustainable standards (e.g., Roundtable on Sustainable Palm Oil).

- **Percentage of seafood third-party certified to an environmental sustainability standard.**

**Definition:** The estimated share of seafood externally certified to sustainable standards (e.g., Global Aquaculture Alliance’s Best Aquaculture Practices).

- **Percentage of timber or paper third-party certified to an environmental sustainability standard.**

**Definition:** The estimated share of timber or paper externally certified to sustainable standards (e.g., Programme for the Endorsement of Forest Certification).

- **Extent of beef and/or dairy certification against the most stringent sustainable criteria.**

**Definition:** The estimated share of the company’s supply of beef and/or dairy externally certified to the most stringent sustainable standards (e.g., Rainforest Alliance).

- **Extent of leather certification against the most stringent sustainable criteria.**

**Definition:** The estimated share of the company’s supply of leather externally certified to the most stringent sustainable standards (e.g., Leather Working Group Gold).

- **Extent of palm oil certification against the most stringent sustainable criteria.**

**Definition:** The estimated share of the company’s supply of palm oil externally certified to the most stringent sustainable standards (e.g., Segregated or Identity Preserved Roundtable on Sustainable Palm Oil).



- **Extent of seafood certification against the most stringent sustainable criteria.**

**Definition:** The estimated share of the company’s supply of seafood externally certified to the most stringent sustainable standards (e.g., Marine Stewardship Council, Aquaculture Stewardship Council).

- **Extent of timber certification against the most stringent sustainable criteria.**

**Definition:** The estimated share of the company’s supply of timber externally certified to the most stringent sustainable standards (e.g., Forest Stewardship Council).

- **Extent of beef and/or dairy traceability to place of origin.**

**Definition:** The estimated level of traceability of beef and/or dairy up to the plantation/farm level. Best practice is for all products to be traceable.

- **Extent of cotton traceability to place of origin.**

**Definition:** The estimated level of traceability of cotton up to the plantation/farm level. Best practice is for all products to be traceable.

- **Extent of leather traceability to place of origin.**

**Definition:** The estimated level of traceability of leather up to the plantation/farm level. Best practice is for all products to be traceable.

- **Extent of palm oil traceability to place of origin.**

**Definition:** The estimated level of traceability of palm oil up to the plantation/farm level. Best practice is for all products to be traceable.

- **Extent of seafood traceability to place of origin.**

**Definition:** The estimated level of traceability of seafood up to the fishing location/farm level. Best practice is for all products to be traceable.

- **Extent of timber and/or paper traceability to place of origin.**

**Definition:** The estimated level of traceability of timber and/or paper up to the plantation or forest level. Best practice is for all products to be traceable.
  
- **Commitments towards responsible beef and/or dairy sourcing.**

**Definition:** Indicates whether the company has an explicit policy to sustainably source beef and/or dairy (e.g., zero-deforestation beef policy) or whether it belongs to an industry group with such a policy (e.g., the Global Roundtable on Responsible Beef).
  
- **Commitments towards responsible cotton sourcing.**

**Definition:** Indicates whether the company has an explicit policy to sustainably source cotton or whether it belongs to an industry group with such a policy (e.g., Textile Exchange or Better Cotton Initiative).
  
- **Commitments towards responsible leather sourcing.**

**Definition:** Indicates whether the company has an explicit policy to sustainably source leather (e.g., addressing deforestation) or whether it belongs to an industry group with such a policy (e.g., Leather Working Group).
  
- **Commitments towards responsible palm oil sourcing.**

**Definition:** Indicates whether the company has an explicit policy to sustainably source palm oil (e.g., no deforestation, no peat, no exploitation policy) or whether it belongs to an industry group with such a policy (e.g., the Roundtable on Sustainable Palm Oil).
  
- **Commitments towards responsible seafood sourcing.**

**Definition:** Indicates whether the company has an explicit policy to sustainably source seafood (e.g., banning the sale of endangered species, specifying acceptable fishing methods) or whether it belongs to an industry group with such a policy (e.g., Marine Stewardship Council).

- **Commitments towards responsible timber and/or paper sourcing.**

**Definition:** Indicates whether the company has an explicit policy to sustainably source timber or whether it belongs to an industry group with such a policy (e.g., Forest Stewardship Council).

Sources: company disclosures; Roundtable on Sustainable Palm Oil; other stakeholder working groups, for example, Rainforest Alliance, Better Cotton, Textile Exchange, Leather Working Group.

## Controversies

A controversy deduction ranging from 0 to 5 points is subtracted from the overall Management Score, based on the severity and type of controversies facing the company on this Key Issue. The following categories of controversies are used in the assessment:

- Environmental issues in the supply chain controversies.

For more details on how controversies are included in the MSCI ESG Ratings model, refer to Section 3.3.2, Controversies cases, of "ESG Ratings Methodology."

## Raw Material Sourcing Exposure Score

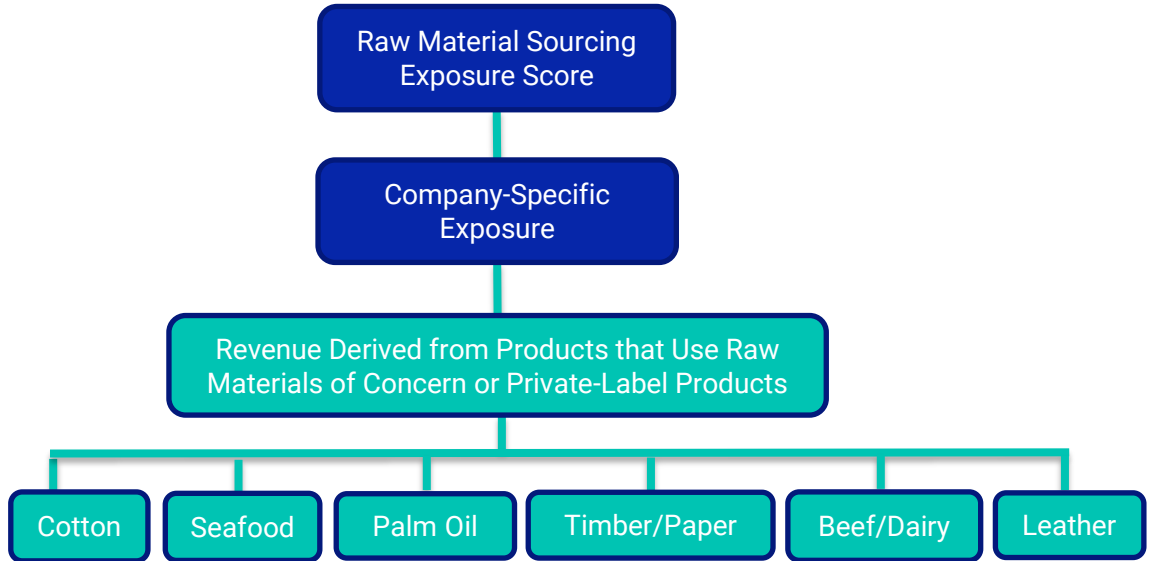
The Raw Material Sourcing Exposure Score evaluates the company's exposure to risks on this Key Issue. It is based on the Company-Specific Exposure Score only. The Company-Specific Exposure Score is scored on a 0-10 scale, with 10 corresponding to the highest risk and 0 corresponding to the lowest risk. Refer to Section 3.2, Analyzing risk exposure, of "ESG Ratings Methodology" for additional details. The following formula is used in the Exposure Score calculation:

$$EXP_{RMS,i} = COM_{RMS,i}$$

Where:

- $EXP_{RMS,i}$  is the Raw Material Sourcing Exposure Score of company  $i$ .
- $COM_{RMS,i}$  is the Company-Specific Exposure Score of company  $i$ .

**Exhibit 2: Exposure Score components**



**Company-Specific Exposure Score**

The Company-Specific Exposure Score is a simple average of the Company-Specific Exposure Scores of the raw materials of concern sourced by that company:

$$COM_{RMS,i} = \frac{1}{n} \sum_{k=1}^n (COM_{RMS,i,k})$$

Where:

- *n* represents the number of materials of concern that are sourced by company *i*. This may be different for each company depending on the raw materials sourced by them. Raw materials of concern include:
  1. cotton,
  2. seafood,
  3. palm oil,
  4. timber/paper,
  5. beef/dairy, and
  6. leather.

- $COM_{RMS,i,k}$  is the Company-Specific Exposure Score for raw material of concern  $k$  sourced by company  $i$ .

The Company-Specific Exposure Score for each raw material of concern is a simple average of the Dependency Score and the Footprint Score for each raw material of concern  $k$  sourced by company  $i$ .

$$COM_{RMS,i,k} = \frac{DS_{RMS,i,k} + FS_{RMS,i,k}}{2}$$

Where:

- $DS_{RMS,i,k}$  is the Dependency Score for raw material  $k$  sourced by company  $i$ .
- $FS_{RMS,i,k}$  is the Footprint Score for raw material  $k$  sourced by company  $i$ .

For each raw material of concern sourced by the company, the Dependency Score is derived from the estimated percentage of the company’s revenues that rely on the specific raw material of concern.<sup>1</sup>

For each raw material of concern sourced by the company, the Footprint Score is derived from the total estimated revenues (three-year average, in USD million)<sup>1</sup> that rely on the raw material of concern. To derive revenue and revenue percentage estimates, we generally extrapolate from company disclosures to derive more granular values.

## Data Sources

The following sources are used to determine the Raw Material Sourcing Exposure Score:

Refinitiv, MSCI ESG Research, company disclosures.

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<sup>1</sup> Companies are assessed on revenues from their private-label products where applicable.

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