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ESG in India: It's Time To Take Notice

Commitment to change and sustainability is imperative for any organisation to evolve into a future-proof business. Organisations should be mindful that in order to build resilience and boost stakeholder buy-in, it is key to focus on embedding and establishing environmental, social and governance ("ESG") frameworks that comprise of a strong corporate governance structure, sustainable procurement, diversity & inclusion, supporting local businesses and being conscious of future resource consumption.

New-age investment theses prioritise commitment to sustainable investments, with actively managed funds including ESG criteria in their collaterals. This has been mirrored by the significant increase in ESG funds in India, that have witnessed exponential growth in the last four years, with their assets under management ("AUM") of increasing from USD$283.5 million[1] (INR 2,268 crore) in March 2019 to USD$1.5 billion (INR 12,447 crore) in March 2022.[2]

After the Prime Minister of India announced that the country will achieve net zero emissions by 2070[3] as well as India's updated climate pledge[4] as part of the Paris agreement - a global treaty where 196 countries agreed to cooperate to reduce greenhouse gas ("GHG") emissions - that will lay out India's clean energy transition pathway from now through 2030, organisations have been preparing for future regulations that would require them to declare net zero emission targets. Such companies are committing to timelines that are determined through science-based targets, which enable them to track, monitor and report their commitments on a periodic basis. Indian subsidiaries of such multinational companies have similarly declared aggressive carbon emission goals, with some as early as 2030[5] to comply with the commitments made by their parent companies.

ESG has been a trending topic for some time now, and lately it has also come onto the radar of U.S. Securities and Exchange Commission ("SEC"), which has been investigating potential greenwashing by financial institutions and associated investment funds.[6]

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[1] All USD/INR figures are converted at the rate of USD 1 = INR 80

[2] https://rg.link/P1uF-xd

[3] https://www.bbc.com/news/world-asia-india-59125143

[4] https://www.downtoearth.org.in/news/climate-change/

[5] https://in.pg.com/environmental-sustainability/

[6] https://qz.com/2176870/the-esg-crackdown-is-coming-for-goldman-sachs/

Recently, the SEC investigated one of the world's largest banks on ESG claims and levied fines on another large financial institution for alleged fraudulent ESG credentials.[7] With fast-paced adoption of ESG and the setting of aggressive timelines, companies are often only focusing on the low-hanging fruits. Organisations need to innovate and re-evaluate reducing emissions and adopting future-proof sustainable business operations across their whole value chain in order to avoid being perceived as greenwashing.

Organisations can benefit greatly by implementing actionable ESG initiatives, setting realistic sustainability goals and regularly assessing and monitoring their progress. Such assessments and tracking mechanisms prove to be beneficial to institutions in identifying successful long-term investments, saving costs, optimising risks, seeking capital inflow and achieving their short-term sustainability commitments.

How can companies yield results by implementing robust ESG program and conducting periodic ESG assessments?

— **Reduction in costs:** investors and promoters of companies are shifting from a mindset that considered ESG implementation as a cost, to ESG as a long-term investment. Companies that are using their research and development departments to innovate sustainable products and designs are finding these innovations to also be cost-effective. Savings resulting from efficient energy sources and water consumption can be immense, especially now when the cost of solar and other renewables is down trending.[8] Re-designing processes in order to achieve minimal waste can further reduce costs and ensure the efficient use of resources, while also being planet conscious.

— **Aids in price negotiations:** for investors, performing ESG due diligence prior to making an investment can be crucial in determining the cost implications and risks involved, as this not only has an impact on the reputation of the investor but can also be advantageous during negotiations. Through this exercise, investors gain a clear action plan for the short and the long-term in order to fix the issues identified during the review, based on a set risk prioritisation.
While on the flip side, investors during divestment can avoid price chips through ESG reviews, which can detect red flags and provide actionable solutions, turning the company into a better prospect for potential new investors.

— **Impacts valuation and future proofs growth:** according to the Morgan Stanley Institute for Sustainable Investing,[9] sustainable funds outperformed traditional peer funds and reduced investment risk during COVID-19 in 2020. As investment firms are offsetting their prior investments into organisations with heavy carbon footprints with greener investments, ESG performance has gained further relevance in fundamental analysis, and it is now considered as a decision-making factor for investors. Furthermore, the sustainability tag acts as a unique selling point as consumers become more planet conscious. This helps organisations in adapting to the change in consumer behaviour early on, thus safeguarding future revenue. Small and medium enterprises have more potential to win business from larger corporations, which focus on sustainable sourcing, as ESG assessments for vendors has been a key trend for companies trying to further improve their frameworks.

— **Better interest rates:** sustainability-linked loans have gained prominence in the West since 2017 and are at a relatively nascent stage in the Asia Pacific region but are steadily gaining traction. According to Bloomberg,[10] sustainability-linked loans worth around USD$22 billion were completed in the Asia Pacific region in the first five months of 2022, which is more than double the amount in the same period for the previous year. Companies can now have a unique arrangement with their financiers where the company can link its ESG rating to interest rates, and be penalised if the set goals are not achieved. Such an arrangement can work as a motivator for companies to incorporate ESG compliance into their corporate strategy and leaves no place for greenwashing as companies must report the set metrics at regular intervals to the financial institutions.

The biggest challenge that ESG acceptance faces today is accountability. Internationally accepted reporting frameworks such as the Task Force on Climate-Related Financial Disclosures ("TCFD"), which was created by the Basel-based Financial Stability Board ("FSB"), provides

[7] https://www.nytimes.com/2022/06/12/business/sec-goldman-sachs-esg-funds.html
[8] https://www.weforum.org/agenda/2020/12/
[9] https://www.morganstanley.com/ideas/esg-funds-outperform-peers-coronavirus
[10] https://asia.nikkei.com/Opinion/No-place-for-greenwashing-in-Asia-s-loan-markets

a framework that helps companies report on climate-related disclosures with transparency and consistency to investors, lenders and insurance underwriters.[11] The TCFD reporting framework continues to gain traction since its inception, as countries incorporate it into their regulatory frameworks. Similarly, the United Nations Sustainability Development Goals ("UN SDGs") adopted by all 193 member states[12] place responsibility on businesses to achieve sustainable development by incorporating the 17 outlined goals into their corporate strategy. Companies that are proactively compliant with such global frameworks distinguish themselves from companies that do not contribute to helping to protect the planet from climate change and thus become more attractive investments.

How can ESG reviews make an impact on the most crucial components of any ESG framework?

— **Efficient energy and water consumption**

The 17 UN SDGs put a focus on affordable and clean energy as well as clean water and sanitation. Companies should track their energy and water consumption on a regular basis and create an action plan to reduce consumption through the use of:

— energy efficient technology and equipment;

— assigning capital expenditure budgets towards transitioning to renewable energy sources; and

— recycling and reusing water.

While some ESG mature companies may have already initiated these measures, it is equally critical to track these consumption savings ethically and have a continuous improvement process in place. ESG quality reviews can help companies to ensure if metrics such as consumption from renewable energy sources, reduction in energy and water consumption, claims of efficient initiatives undertaken are accurate and evident at site.

— **Sustainable procurement**

Sustainable procurement similarly connects to the UN SDGs of Responsible Consumption and Production. Our experience with procurement units of companies has revealed that sustainability is often neglected as a selection criterion. Companies that already have a procurement process in place may want to revaluate the weight given to vendors during selection by considering:

— micro, small and medium enterprises;

— women-owned businesses;

— vendors providing environmentally friendly products and services;

— ESG profile of vendor; and

— vendors enabling waste reduction in supply chain.

— **Employee well-being**

A 2021 global ESG survey conducted by BNP Paribas[13] revealed that 51% of surveyed investors found it difficult to analyse and embed social elements in investment strategies, as there is a lack of standardisation. "Social" covers a wide range of issues from pay gap to labour unions, thus making it imperative for companies to conduct quality review and account for measurable metrics such as the number of women in the workforce, along with safeguarding interests of all employees. Diversity and inclusion can no longer be limited to a policy but needs to be a continuous improvement platform so that the societal gaps that currently exist are reduced. Implementing policies on areas that are often neglected – including paternity leave, workplace relationships, and gender reporting – can be a good place to start for companies embracing the "S" in ESG.

— **Effective policies and their awareness**

Governance metrics strongly factor in the level of execution of the set out policies and procedures of a company. Well defined and detailed policies set the tone from the top. For instance, a strict no gift giving policy in a company with high exposure to government touchpoints may essentially eliminate a significant risk concerning compliance to anti-bribery anti-corruption laws and policies such as the Prevention of Corruption Act, 1988, Foreign Corrupt Practices Act,[14] United Kingdom Bribery Act,[15] etc.

Since many of the policies that form a part of governance metrics are also standalone laws in India, it is important that effective controls are created and implemented for each business function to ensure compliance. Stakeholders such as suppliers and

[11] https://www.unepfi.org/climate-change/tcfd/

[12] https://www.unglobalcompact.org/sdgs/about

[13] https://securities.cib.bnpparibas/esg-global-survey-2021/

[14] https://www.justice.gov/criminal-fraud/foreign-corrupt-practices-act

[15] https://www.legislation.gov.uk/ukpga/2010/23/contents

employees need to be given the necessary training towards policies including anti-bribery/ anti-corruption, whistle-blower mechanisms and guidelines on gifting, which will ensure compliance and reduce fraud related risks.

— **Monitoring ESG risks and metrics**

Risk management with a focus on ESG ensures that risk areas of a business that may have been overlooked by traditional risk mitigation controls are being addressed. Stakeholders from all business functions need to pitch in to the ESG perspective and highlight areas that have not been addressed where risk mitigation would be supplemented through measurable targets. While established companies with mature counterparts, or parent companies, may have already adapted to such ESG-centric risk management frameworks, Indian companies are still finding the right balance in aligning sustainable goals with their long-term business objectives. Companies that want to better understand their ESG risks need to collect, record and track datapoints that enable formulating comprehensive risk matrices with ratings, prioritisation and associated controls. Such mechanisms can assist organisations in pre-emptively addressing threats that may detract them from meeting their sustainability goals.

Organisations that have advanced ESG frameworks in place but lack recording of measurable data points and continuous monitoring of key ESG metrics often lead to inefficient implementation of otherwise impressive ESG initiatives.

In India, the key tenets of ESG are covered under various standalone laws such as the Environment (Protection) Act, 1986,[16] Minimum Wages Act, 1948,[17] and the Companies Act, 2013.[18] While there is no single regulation that guides registered companies towards being ESG compliant, the Securities and Exchange Board of India ("SEBI") has mandated the top 1000 listed companies by market capitalisation, previously limited to the top 100, to include a Business Responsibility and Sustainability Reporting ("BRSR") section in their annual reports starting from financial year 2022-2023.[19]

In a country with over 1.43 million[20] registered companies, the SEBI requirement does not even cover 0.1% of the total companies to be ESG compliant.

ESG frameworks and reviews provide resilience against any potential regulation that may very likely be imposed on Indian companies in the near future as the urgency to address issues concerning climate change becomes more real every day. As long as businesses incorporate ESG frameworks, which assess the risks involved, track metrics and adopt a reporting framework, the ability to adapt to potentially upcoming changes strengthens. A robust ESG programme can open up access to large pools of capital, increase employee productivity, minimise regulatory and legal interventions, build a stronger corporate brand and promote sustainable long-term growth.

[16] https://www.indiacode.nic.in/bitstream/123456789/4316/1/ep_act_1986.pdf
[17] https://clc.gov.in/clc/sites/default/files/MinimumWagesact.pdf
[18] https://www.mca.gov.in/Ministry/pdf/CompaniesAct2013.pdf
[19] https://www.sebi.gov.in/legal/circulars/may-2021/
[20] https://www.statista.com/statistics/1008330/

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