ESG: A New Horizon towards Sustainable Growth

Dr. Shyam Kishor Yadav
Guest Teacher
Department of Commerce
R. K. College, Madhubani

Abstract

Environmental, Social and Governance (ESG) are three key factors company's sustainability and social responsibility performance. ESG is more than good intentions. It's about creating a tangible, practical plan that achieves real results. Success is not about climate change, diversity and disclosures alone. It's about embedding these principles- and more across your business from investment to sustainable innovation. Bringing together your best people and smartest technology so you can see more, go deeper and act swiftly. Enabling you to tackle the biggest challenges of today and capture the best opportunities of tomorrow. Investing responsibly, or considering environmental, social and corporate governance (ESG) criteria in investment valuations and assessment, can generate long-term competitive financial returns and positive societal impact.

Hence, organizations worldwide are developing and embedding environmental, social and governance strategies to build sustainable businesses. Both global and Indian business operations have been undergoing significant changes amidst externalities such as climate change, finite resource availability, deteriorating ecosystems and evolving stakeholder expectations. The COVID-19 pandemic and associated business disruptions have only heightened and reinforced the need for action, making ESG a critical agenda for companies as they are focusing on long-term sustainable growth.

***Key words**: Corporate Social Responsibility, Environmental, Social and Governance, People and Planet, Sustainability Reporting Practices, Sustainable Development Goals.*

Introduction

The current developments underline the imperatives for countries to make this planet a better place to live. The harsh truth for all countries, whether rich or poor, is that as long as society is economically unbalanced as well as unstable, fuelling sustainable economic and social growth addressing all sections of the society and the environmental concerns is a pipe dream.

The requirement is a sincere, open and inclusive mind set as well as gigantic effort, calling for a new model of development that will simultaneously give a push to positive economic advancement, provide a framework for sustainability in decent living for all in an inclusive manner and reverse the damage already caused to the environment at the least, failing which any endeavour towards SDG's are bound to be piecemeal and / or exclusive and / or inadequate. In this context, ESG through crystal clear policy measures is suggested as the route to be pursued for marching towards attaining Sustainable Development Goals (SDG's).

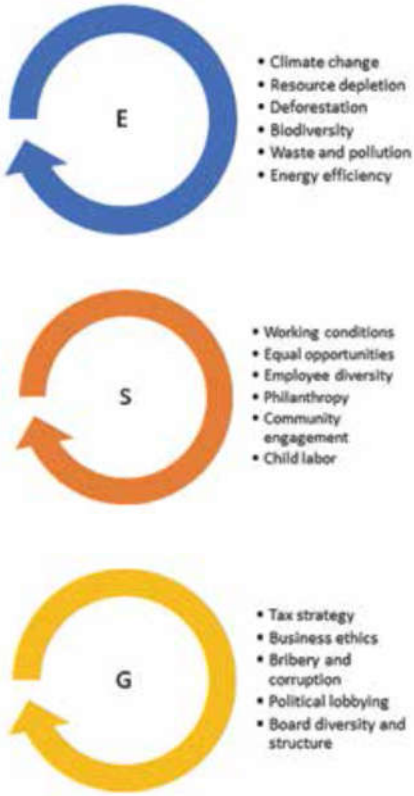
The SDGs 2030 is a global initiative by 193 Member Nations of the United Nations (UN) calling for bold initiatives towards sustainable development focusing on people, planet, peace and prosperity and they offer a globally accepted framework with uniform metrics for all countries against which to measure and compare progress. The SDGs identify 17 fields across 163 inter-connected indicators and push for alignment and collaborative as well as co-ordinated action among the stakeholders. It can be seen that the SDGs are ambitious goals targeting elimination, rather than reduction of malnutrition, poverty and the like. From an Indian perspective, there is a need to review and re-work the its development narrative so that no one is left behind as the country seeks to truly grow into a leadership position as an emerging world power.

ESG: An Initiative Considering People and Planet

ESG refers to the environmental, social and corporate governance issues that stakeholders consider in the context of corporate behaviour. Environmental, social and governance factors cover issues which traditionally are not part of financial or economic analysis but are extremely important and relevant to financial decisions. These may include steps taken by corporations on climate change, managing resources like water, wind etc. and, how they manage their supply chains. These may also cover health and safety policies of organizations and other steps taken to build trust and foster innovation.

The term 'ESG' was predominantly used in an initiative titled "Who Cares Wins" by UN Global compact and the Government of Switzerland (International Finance Corporation, 2004). ESG investing is a type of 'sustainable can protect brand name, improve talent acquisition and retention, promote customer loyalty and reduce the risk of lawsuits against companies.

During and after Pandemic days CEOs and all stakeholders are forced to think about environmental well-being. Thus it is making a change in the view of stakeholders' expectations from the way of doing businesses. The societal issues are no longer to be ignored and will have to be positively addressed by all those who are integral part of the society. After this consciousness towards the issues, companies can consider embracing the ESG as one of the ways to overtake the competitors. The components of 'E' "S' and 'G' could be described as under:



Global Scenario of ESG

The 2015 Paris Climate Agreement has perhaps been the starting point for this serious pursuit in the direction of ESG. The landmark agreement featured a commitment from the signatory countries to achieve reduction in the quantum of carbon emissions by 55 gigatons by 2030. Given the enormity of the effort required, this requires collective effort by all countries.

An estimate of the extent of sustainable investments in 2020 according to the Global Sustainable Investment Review Report is around US$35.3 trillion, which covers the financial markets in the regions of United States, Canada, Japan, Europe and Australia. Across these regions these sustainable investments represent 36 per cent of the assets under management.4 Compared to the position two years before, investments in sustainable assets was estimated at US$30.7 trillion, indicating a growth of 15 per cent in this period. Going forward, this increasing trend is expected to continue as both institutional as well as individual demand is expected to increase.

In this context, it is praiseworthy to note that quite a few less prominent countries have made a silent yet significant impact with respect to ESG initiatives, some of which are briefly covered in the ensuing paragraphs.

The noted trend in **Japan** is that investors are attaching great importance to ESG criteria when assessing investment proposals. This has driven the listed entities in Japan to disclose more ESG-related information and activities. Following this trend, especially overseas entities have published frameworks, standards, as well as guidance on ESG disclosure, but listed companies are struggling in the process.

Norway has ushered in a new ESG code this year which is expected to enhance the already significant impact it has made. The ESG code contains certain regulations that are applicable to all industries and some are applicable to specific industries. For instance, regulations such as Company Act, Human Rights Act, Working Environment Act, Gender Equality and discrimination Act, Biodiversity Act, Pollution Control Act, Penal Code and the National regulation incorporating the international commitments of Norway are generally applicable irrespective of the industry. The highlight of the new regulation is that Norway is probably the only Government which has considered COVID-19 pandemic not as a threat for ESG, but an opportunity to pursue ESG more vigorously.

Botswana Stock Exchange (BSE), which happens to be one of the partner exchanges of the United Nations Sustainable Stock Exchanges initiative (SSE) since 2016, has taken initiative early on by issuing concrete guidance to the listed companies on ESG reporting to stakeholders. The BSE has recognised the importance of SSE’s intention to bridge the gaps in the disclosures relating to ESG. As per the BSE’s website, “it is the 28th exchange to publish such guidance since the beginning of the campaign.

In total there are now 42 stock exchanges with guidance on ESG reporting, with a further 7 having made commitments to do so in the future. Whilst ESG reporting remains voluntary for BSE issuers, the availability of guidance will make transparency on ESG issues easier to achieve and should increase the incidence of companies choosing to disclose such information."

The country **Trinidad and Tobago** is committed to the 2030 SDG's as is evident from the 2030 vision which incorporates the SDG's. The Voluntary National Review (VNR)7 is the Government's commitment to inclusive growth and development which engages stakeholders for concrete measures leading to sustainable development. The commitment of the Government has been seen to be evident during the pandemic period, as borne out by the number of online consultations.

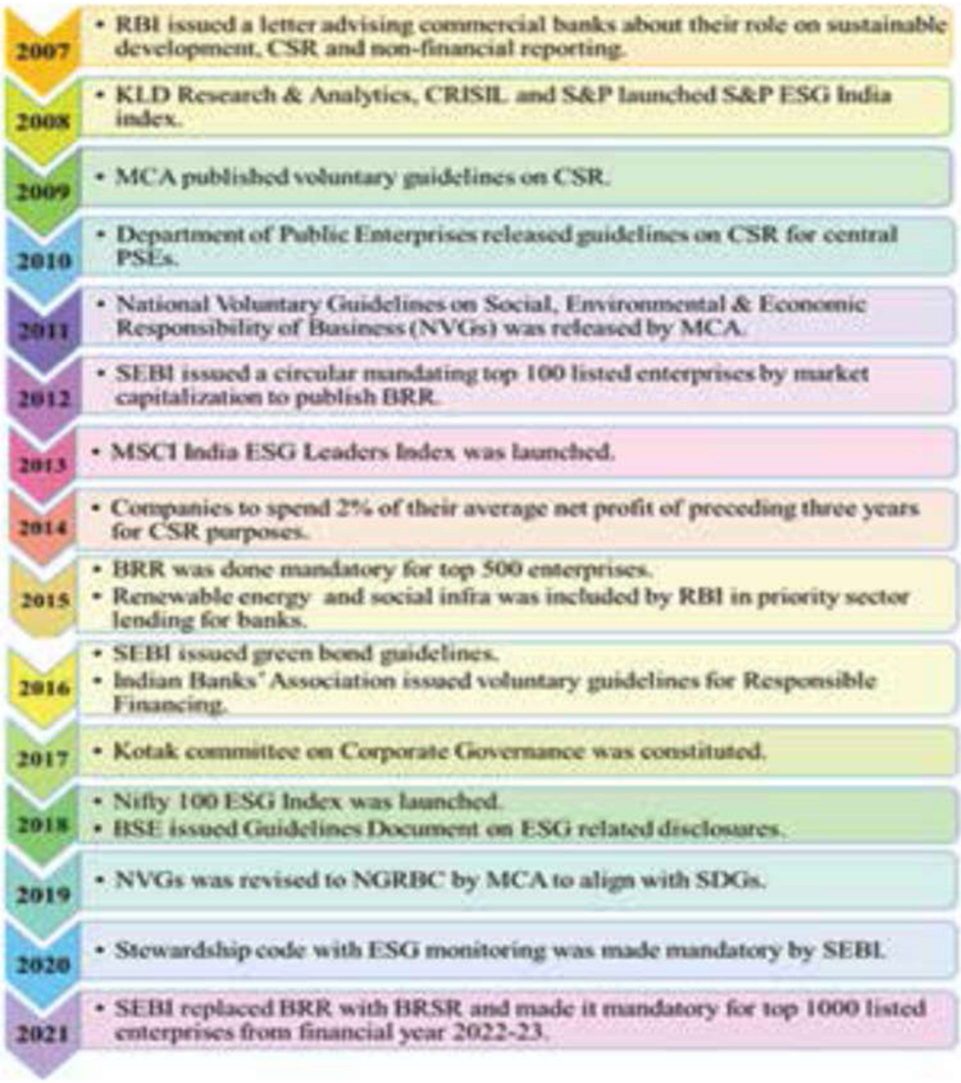
Like Trinidad and Tobago, most of the Governments of the other about 20 nations constituting the **Carribean islands** have clearly communicated to the stakeholders the importance of ESG highlighting that investors may find those businesses without track record not worthy for being considered for investments.

Evolution of ESG in India

The emphasis on ESG factors embarked in India in 2007 with the issuance of a letter by the Reserve Bank of India (RBI) advising all scheduled commercial banks regarding their role and responsibility on sustainable development, corporate social responsibility (CSR), and non-financial disclosure. This was the initial move towards integrating the notion of business responsibility and sustainability into business activities. Subsequently, in 2009, the Ministry of Corporate Affairs (MCA) pioneered ESG reporting in India by issuing voluntary guidelines on CSR. Henceforth, the ESG reporting scenario in India has come a long way with the release of several other guidelines, including Business Responsibility Report (BRR), Integrated Reporting (IR), National Guidelines on Responsible Business Conduct (NGRBC), and recently, the Securities and Exchange Board of India (SEBI) introduced Business Responsibility and Sustainability Report (BRSR) in May 2021. Top 1000 listed enterprises (by market capitalization) shall file BRSR mandatorily from the financial year 2022- 23 and voluntarily for the financial year 2021-22.

This BRSR will replace BRR. BRSR is the communication and disclosure of a company's ESG goals and the progress made towards achieving them. The evolution of ESG in India is summarized in Figure-1 below.

Figure 1: Tracking the Growth of ESG in India



Source: MCA, SEBI, Companies Act, 2013 and CRISIL ESG Report, 2021

Role of Stakeholders in ESG

ESG has now become an important indicator for most investment decisions and involves almost every component of the economy from the Regulator to the civil society. All these acts as stakeholders have some specific contributions to make in the fulfilment of the cause. The category wise roles of such stakeholders may be summarised as follows to understand how important they are in ensuring the success of this concept of "Green Governance".

Companies: Companies are at the core of the ESG movement as they create the significant wealth for any economy. However, their participation in ESG has to be made part of their business principles and governance policies. They are also required to present their reports on ESG related performance in a standard format and to provide information and reports on related performance in a more consistent and standardised format in the annual report or any communication with investors.

Investors: At the institutional level, asset managers could integrate research on ESG aspects while taking investment decisions.

Regulators: They shape the legal frameworks mandating the minimum degree of disclosure on ESG so that it could facilitate financial analysis by investors. The standards of the disclosure have also taken into consideration the existing initiatives in this direction like the Global Reporting Initiative or Standards set by Sustainability Accounting Standards Board. Further Stock exchanges can also be going forward by including ESG criteria for listing.

Analysts: They are expected to evaluate ESG factors and create tools and models based on existing know-how to include new industry sectors and asset classes. Academia and other research organisations also need to support the efforts of ESG analysts by providing high-level research and thought leadership.

Civil society: Non-Governmental organisations have been a very powerful driver of social reforms and could play an immense role in the enforcement of ESG standards. Many such agencies have been fighting for survivors of Industrial disasters across the world and could become instrumental in sharing their experience with both companies and regulators for strengthening the ESG regime.

The Way Forward

ESG reporting has been in existence since 2000 as Global Reporting Initiative (GRI). Global Sustainability Standards Board (GSSB) are responsible for setting globally accepted standards for sustainability reporting known as GRI Standards.

ESG reporting evolved over the years to keep pace with changing regulatory requirements and saw a major shift in focus after United Nations adopted the Sustainable Development Goals (SDGs) in 2015.

Investors worldwide are echoing the sentiment and investor interest in ESG data has grown manifold since 2006 when signatories to the United Nations Principles of Responsible Investing committed to use ESG parameters for investment analysis.

Total ESG assets worldwide were at $37.8 trillion at the end of March 2021. These are expected to cross $100 trillion by 2030 as per a forecast of Barclays Bank in 2018 (**CRISIL, 2021**).

Investors have evinced interest in subscribing to Green Bonds too. These are fixed income instruments used to raise funds for environmental and climate related projects like sustainable agriculture, energy efficiency and pollution control. $1.44 trillion worth of Green Bonds have been issued till October 2021 (**Climate Bonds Initiative , 2021**).

Investment professionals find ESG information to be financially material to investment performance because it assesses the firm's reputational, legal and regulatory risk. Investors use it as a proxy for assessing management quality.

Enterprises with integrated and proactive ESG practices are better able to adapt to changing environmental and socio-economic conditions preparing for the adverse effects of emerging issues and are better capable of identifying strategic opportunities, developing resiliency, and taking on competitive challenges, thus helping to control and manage risk and maintain robust governance structure. Institutional and other investors are mainly inclined towards putting their massive pools of funds in businesses that proactively govern themselves and function in a responsible, sustainable, and ethical manner. The rising evidence that a firm's ESG activities are closely linked to performance is drawing the attention of not only investors but also acquirers on ESG scores. ESG factors are playing a growing role in firms' decisions regarding acquisitions, mergers, demergers, and divestitures (**McKinsey Report, May 2020**). Also, regulatory authorities have determined that the growing level of disclosures regarding sustainability and ESG practices can attract foreign investment (**Deloitte Report, 2020**).

The advent of compulsory CSR in India and the substantial population of our country has opened up avenues for investments in sectors like healthcare, housing, sanitation, education to name a few which are great facilitators of ESG. Further the securities market regulator SEBI also recognised social ventures with social performance criteria as an alternative investment. Such social venture is aligned towards environmental and socially relevant sectors which have an immediate impact on the area of operation of the portfolio companies.

The possibility of the phenomenal growth of such social venture funds or ESG oriented investing has unfortunately attracted negative intent with misleading information for investors through “Greenwashing”. Investors are conveyed misleading information or given a false impression that a company’s products are environmentally sound or a technology, service is actually environment friendly. Greenwashing could also be an outcome of not having a standard framework for transparency and disclosures.

The awareness about the need for sustainable growth across the world has been felt for decades. But, the traction it has received in terms of initiatives from all stakeholders, be it Governments, corporations, international policy making bodies, financers and investors in the last few years has been unparalleled. As these initiatives percolate across all levels, sustainability will be as much in focus as financial performance.

Currently, sustainability reporting is considered as a negative screener to filter out prospective investment options. But as data becomes more consistent and reliable, there will be a shift in using sustainability reports as positive screeners with sector specific parameters for evaluating a firms’ performance. Currently, not enough data is available and what is available lacks good quality. Thus, further deliberation and action is required on the following fronts:

- ✓ **Availability of data –** More companies need to start disclosing information to facilitate analysis and evaluation
- ✓ **Consistency of data –**There are multiple reporting formats (e.g., PRI, GRI, SASB, Integrated reporting and so on). Moreover, these reporting formats are evolving over time and firms need to adapt to different versions. Data needs to be consistent for comparability.
- ✓ **Reliability of information –** The current focus is on reporting and disclosure. There is also a requirement for a robust audit mechanism to confirm the reliability of information. Third party indices/ scores to measure sustainability will also help in ascertaining the certainty of disclosed information. In India, CRISIL’s initiative to score Indian firms on their ESG performance is a welcome step.

Conclusion

In recent times, world economies are facing numerous social and environmental challenges, ranging from global warming, climate change and pollution to poverty and unemployment, which demand immediate attention. Now, the time has come when the conventional economic growth models are at a crossroads and require a new perspective where economic growth can be reconciled with the overall well-being of society. Such paradigm shift in the economic process can only be brought into fruition with the collective and cooperative action of all stakeholders so that every aspect of the decision-making process and investment analysis can better integrate with ESG factors. Moreover, during the past few years, ESG parameters have cut through from the periphery and have made inroads into the crux of the investment decision-making process throughout the world. Therefore, the interest of investors and other stakeholders in ESG issues has surged over the last few years. Consequently, the ESG landscape has evolved considerably in recent times.

We may conclude that the concept of ESG has gained prominence and will dominate the global agenda for the near future. As we take new vows of being carbon neutral, carbon zero or fulfilling SDGs one thing is eminent countries like India need to embrace such changes on a war footing. The mandatory compliance for the top 1000 listed companies by market capitalization to Business Responsibility and Sustainability Reporting (BRSR) from the financial year 2022 -2023 or the launch of NSE Prime by the National Stock Exchange where companies can report standards of corporate governance that exceed current regulations or recent SEBI consultation paper on ESG reporting and ESG rating providers (ERPs) are constructive efforts towards meeting the ESG demands. However, it cannot be ignored that as time elapses for the SDGs or carbon zero commitments, India needs work on creating a more robust and prominent framework for ESG wherein the setting up of the SSE will open new avenues for ESG compliance and change the way how people look at ESG in India.

References:

1. *Bhalla, Rajni and Bansal, Sanjeev K (2014), Corporate Sustainability Reporting: A Study of Economic Sustainability Aspect by Selected Indian Corporations, International Journal of Current Research and Academic Review, Vol.2, No.5, May, pp. 37-46.*
2. *Boffo, R and Patalano, R (2020), ESG Investing: Practices, Progress and Challenges- www.oecd.org*

3. *Friede, G, Busch, T and Bassen, A (2015), ESG and Financial Performance: Aggregated Evidence from more than 2000 Empirical Studies, Journal of Sustainable Finance and Investment, Vol.5, No.4, pp. 210-233.*
4. *Hensz, W, Kotler, T and Nuttall, R (2019), Five Ways that ESG Create Value, McKinsey Quarterly.-www.mckinsey.com*
5. *Sarkar, Subhrangshu S and Banerjee, Amitava (2022), Financing ESG Initiative-An Insight into Social Stock Exchange, The Management Accountant, Vo.57, No.3, March, pp.27-30.*
6. *United Nation (2015), What Are the Sustainable Development Goals?-www.undp.org*
7. *www.crisil.com*
8. *www.esgenterprise.com*
9. *www.globalreporting.org*
10. *www.mca.gov.in*
11. *www.sebi.gov.in*