Achieving ESG Compliance

This editorial is based on [“Taking ESG Reporting to the Next Level”] which was published in The Hindu BusinessLine on 25/05/2022. It talks about the significance of ESG compliance by companies and the measures that can be taken to ensure compliance.

For Prelims: ESG Funds, Corporate Social Responsibility, SEBI, Business Responsibility and Sustainability Report (BRSR)

For Mains: Growth of ESG Funds in India - its significance and concerns associated with it.

Traditionally, investment decisions have mainly been driven by financial parameters. However, with growing concerns around climate change, adapting to and mitigating its consequences by transitioning to sustainable models of development (and therefore, investment) have emerged as major concerns on an international scale.

There is an **increasing investor focus on sustainability investing**, shifting from finance-centric investment models to more socially and environmentally responsible long-term investing trends. As a result, the demand for Environmental, Social and Governance (ESG) investing has gained significant traction globally.

The **asset size of ESG Funds has grown nearly five times to Rs 12,300 crore** over the last couple of years.

What are ESG Goals?

- Environmental, Social, and Governance (ESG) goals are a **set of standards for a company’s operations** that force companies to follow **better governance**, ethical practices, **environment-friendly measures and social responsibility.**
    - Environmental criteria consider how a company performs **as a steward of nature.**
    - Social criteria examine how it manages **relationships with employees, suppliers, customers,** and the communities where it operates.
    - Governance deals with a company’s **leadership, executive pay, audits, internal controls,** and shareholder rights.
- It **focuses on non-financial factors** as a **metric for guiding investment decisions** wherein increased financial returns is no longer the sole objective of investors.
- Ever since the introduction of the **United Nations Principles for Responsible Investing (UNPRI)** in 2006, the ESG framework has been recognised as an inextricable link of modern day businesses.

What do we Know about ESG Funds?

- ESG Fund is a kind of Mutual Fund. Its investing is used synonymously with sustainable investing or socially responsible investing.
- Therefore, the key difference between the ESG funds and other funds is **'conscience'**.
  - The ESG fund focuses on companies with environment-friendly practices, ethical business practices and an employee-friendly record.
- The fund is regulated by Securities and Exchange Board of India (SEBI).

How does ESG Create Value for Corporates and their Stakeholders?

- **Growth in Revenue:** Aligning with the ESG principles **helps companies to expand existing markets** and provide new avenues for growth as part of their blue ocean strategy.
- **Enhanced Public Image**: ESG-compliant companies have **ease of access to resources — natural, financial, human talent**, etc — at a lower cost.
  - ESG is critical to fund raising and free access to other resources is equally important in countries like India wherein companies face stiff resistance from local communities while taking up new projects in their reserved areas.
- **Long-Term Sustainability:** Adherence to ESG framework **encourages companies to look for more sustainable investment opportunities** that creates competitive advantage in the long run.
  - The companies with lower carbon emissions, waste reduction, optimum water-usage, higher employment generation and relatively better disclosures will score high on ESG index.
- **Increasing Employee Productivity:** Integration of ESG with the company's ecosystem instils a **'purpose-driven-life' among the employees s**o as to excel in their jobs.
- **Reducing Costs/Risks:** Fulfilment of ESG norms such as redress of shareholder grievance, human rights and gender diversity of the companies will **result in fewer penalties and enforcement actions.**

What Initiatives have been taken to Ensure ESG Compliance?

- One of the initial milestones towards identifying ESG disclosure requirements for companies was the release of the **National Voluntary Guidelines** on Social, Environmental and Economic Responsibilities of Business (NVGs) in 2011 by the **Ministry of Corporate Affairs (MCA).**
- In 2012, the SEBI formulated the **Business Responsibility Reports (BRR)** which mandated top 100 listed entities (which was extended to top 500 listed entities in 2015) by market capitalization to file BRR as part of their annual report.
- In 2021, SEBI replaced the existing BRR reporting requirement with a more comprehensive integrated mechanism, the Business Responsibility and Sustainability Report (BRSR).
  - It will be **mandatorily applicable** to the top **1,000 listed entities** (by market capitalization) from FY 2022-23 onwards.
- The BRSR seeks disclosures from listed entities on their performance against the nine principles of the **'National Guidelines on Responsible Business Conduct' (NGBRCs).**

How are the Stakeholders Responding to It?

- Indian **investors are showing increased interest in ESG compliant companies** and investment products and **companies are proactively taking steps** towards inculcating ESG in their corporate governance strategies.
  - For instance, Tata Consultancy Services revealed plans to reduce its absolute GHG emissions to achieve net zero emissions by 2030.
- In a first of a kind move, the **Ghaziabad Municipal Corporation** became the **first ever civic body in India** to issue **green bonds** listed on the Bombay Stock Exchange (BSE) for an **environmentally sustainable project for wastewater reuse.**

What can be the Way Forward?

- **Role of Policy Makers:** The Policymakers shall aim to gradually build a **more comprehensive and extensive ESG reporting regime**, with the aim of **encompassing all listed as well as**

unlisted entities and bringing them within the purview of the ESG reporting framework.
    - An increasing demand for ESG investing means a **growing need for adequate disclosure and reporting mechanisms** to be put in place to keep pace with the changing investing trends leaning towards goals of long-term sustainable returns, by **incorporating risk assessment and mitigating measures** of environmental, social and governance challenges.
- **Standardised ESG Parameters:** The **quantitative and standardised disclosures** on ESG parameters would ensure a more holistic approach, providing stakeholders with **both financial and non-financial information** and concise communication about how an organisation's strategy, governance, performance and prospects will create value over time, in line with the objective of seeking greater transparency on sustainability issues.
- **Role of Investors and Companies:** Investors should not only be oriented towards securing increased financial returns but also **look forward to align their portfolios with sustainable development**.
    - **Integrating ESG disclosures with corporate governance practices** of companies is becoming extremely consequential from an investment standpoint as it plays a significant role in assessing the valuation of companies.
    - Implications of not taking ESG factors into consideration in business strategy/policies **may result in business processes becoming redundant** in future, due to legal and regulatory changes which might forbid particular ways of doing business, thereby reducing its viability in the eyes of investors.

What other Challenges need to be Addressed?

- The **lack of standardisation of reporting requirements** across borders may pose difficulties in harmonising ESG principles, frameworks and considerations.
- The other **challenges relating to transparency, consistency, materiality and comparability** of ESG standards may also pose roadblocks in the seamless implementation of ESG reporting framework ahead.
- Although ESG is making its way into mid-sized and small companies, these smaller businesses may be constrained from doing more than the minimum on ESG because of **high capital costs and/or lack of expertise in implementing such measures.**
- These concerns must be addressed in order to formulate an effective and efficient mechanism of ESG reporting in future.

Drishti Mains Question

Discuss the measures that can be taken to ensure the compliance of Environmental, Social, and Governance (ESG) standards in India.