THEME

Emerging Landscape of ESG Investments in India

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A buoyant stock exchange is the barometer of a country's growth sentiments. As a part of the capital market, the stock exchange caters to all kinds of investors who apart from their motivation for financial returns are also looking at long term sustainability. This is where non-financial aspects of the investments become important and these days the theme of ESG investing is fast catching the attention of not just institutional investors but also the average retail investor who is also looking at investing for long term sustainability. The article gives a basic overview of the subject including the recent regulatory changes in the disclosure regime prescribed by SEBI for listed entities with respect to ESG parameters and looks at the potential opportunity for the Chartered Accountants.

"The greatest threat to our planet is the belief that someone else will save it" – Robert Swan

ESG – An Overview

Three powerful words make up ESG namely "Environment (E)", "Social (S)" and "Governance (G)". The concept of ESG globally is a natural result arising out of the shift of emphasis from "shareholders" to "stakeholders". It has changed the way investors and fund managers globally as well as in India evaluate and decide upon investments focussing more on long term sustainability, which is the essence of ESG. Nowadays, non-financial metrics in the form of ESG are also given due weightage by the investors in addition to the financial metrics. Thus, ESG has evolved into a proactive framework integrating the three pillars (ESG) with the objective of maximising stakeholder well-being instead of just the shareholder well-being which the financial metrics considers. It is when the financial and non-financial metrics of ESG are connected as well as integrated and embedded with focus on Strategy and Sustainability, they become even more powerful.

Analysing the three pillars of ESG individually[1]

Environmental pillar refers to the environmental impacts that an entity creates through its functions, operations and activities along with the risk management practices followed by it. Examples are the direct as well as indirect Greenhouse Gas (GHG) emissions, the way the natural resources are utilised by the entity and the ability of the entity to absorb the various environmental risks such as Climate Change, fires, flooding, pollution etc.

Social pillar refers to the relationship of the entity with stakeholders including interactions with the communities, value chain partners, respecting supremacy of human rights, well-being of its employees etc.

Governance pillar refers to how an entity is led, managed, and controlled, including their alignment to stakeholder expectations and the effectiveness of internal controls that promote transparency and accountability at the highest level of management.

[1] *https://corporatefinanceinstitute.com/resources/esg/esg-environmental-social-governance/*

The following table gives a snapshot of the scope and concerns of ESG: -

Environmental	Social	Governance
Greenhouse Gas (GHG) Emissions, Air/Water Pollution	Social Well-Being, Health, Security and Safety	Business Ethics and Ethical Standards
Climate Change	Working Conditions	Composition of Board, Board Process, Diversity and Governance
Water Management	Employee benefits	Structures of Board Committees
Recycling Process	Gender Diversity and Inclusion	Risk Management Systems
Deforestation	Respect for Human Rights	Stakeholder engagement
Emergency Preparedness and Disaster Management	Impact on Local communities	Anti-Corruption and Anti Bribery policies

Source: Compiled by the authors

ESG Landscape and concepts

ESG Maturity

Every business entity interested in travelling the path of excellence with focus on sustainability will have to carry out a self-assessment as to where they stand regarding ESG Maturity. This calls for steps towards better integration of ESG parameters and Key Performance Indicators (KPIs) with the strategic management process, risk management systems, corporate culture and governance systems to lead the entity towards long-term sustainability. Based on such a self-assessment, with external help from ESG professionals wherever required, a business entity would be in a better position to determine the stage of its maturity level with respect to ESG.

The following table may be used to roughly determine the stage of ESG maturity which an entity has achieved or is currently in and then decide what needs to be done to reach the desired levels of maturity with respect to ESG.

Stages	Maturity Levels	Brief Description
1	Entry level maturity	ESG is regarded as an inevitable responsibility and merely a compliance requirement. Most large organisations are expected to have crossed this stage.
2	Slightly more sustained and shared process	Some importance is given to ESG metrics wherever considered useful but not a great deal important strategically. Due importance is given to sustainability risk to the extent that impacts the "Going Concern", but not all key ESG metrics.
3	Strategic Agenda	Management starts appreciating the strategic importance of proper mapping of the primary ESG-related interests and priorities of the entity's stakeholders against those of the business and the related stakeholders. Due emphasis is given for analysing those ESG metrics, which if not well managed, will negatively impact the enterprise value of the entity.
4	Brand Building	The entity has established appropriate documentation demonstrating a good understanding of where they need to strategize with respect to leading in addressing the ESG perspectives of all stakeholders. These are followed rigorously with the conscious objective of brand building.
5	Leadership Position	The business leads the ESG agenda in the industry or even across industries. They set trends and have established processes that integrate the financial and non-financial reporting using ESG related KPIs that are also updated from time to time.

Source: Conceptualised by the authors

Each stage above represents a progression from one level of maturity to the next higher level of maturity. The level of maturity with respect to ESG directly as well as positively influences the ESG ratings, which in turn enhances the reputation of the business to be perceived as more sustainable than it would have been otherwise.

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ESG Investing

Typically, every rational investor be it Institutional Investor, HNI Investor or Retail Investor carries out a comprehensive analysis of a company's performance across various parameters and seeks to achieve a diversified and balanced portfolio. In doing so, the current tendency of the investors is to give due weightage to long term sustainability of their investments as they seek to pursue their goal of maximising financial returns. However, over the last two decades, the concept of "Sustainability" has evolved with increasing importance being given to environmental and social aspects. And this is where "ESG Investing" bringing into a single umbrella concepts like "Sustainable Investing", "Responsible Investing", "Impact Investing" or "Socially Responsible Investing" (SRI) comes in, wherein investors prefer investments which duly addresses the concerns of Society and Environment in addition to financial returns.

According to a report entitled "5 sustainable Investing Trends for Companies and Investors"[2], there is going to be a transformation of the global economy that will entail an average investment in ESG related physical assets which alone is estimated at more than $9 trillion for achieving Net Zero carbon emission by 2050. While on one hand, there is requirement for investments in ESG related assets, on the other hand companies which are having gaps in their sustainable performance would be seeking to prioritise and improve their efforts so that they can integrate the environmental and social issues into their strategic decision-making process. Further, investors seeking to invest in ESG related assets would be dependent upon a reliable rating system for ESG investments.

Indian Companies, according to a published report by Carbon Disclosure Project (CDP) in 2022, is expected to lose over Rs. 7.14 lakh crore if there are no actions taken to mitigate climate risk related issues over the next few years and conversely there could be opportunity in the form of potential gain of Rs. 2.9 lakh crore if prompt action is taken.[3] A very recent eye opener is the fire at Brahmapuram in Kochi in the State of Kerala on March 02, 2023 as a result of which a large part of the city got gutted by toxic waste. Though reportedly, the fire has been contained, the environmental experts have opined that the environmental and social consequences of this fire incident may remain for many years to follow. These and similar catastrophes are a constant reminder to us that due attention and highest priority must be accorded for environmental and social issues with zero-tolerance.

ESG Ratings

According to "CRISIL Sustainability Year Book 2022"[4], ESG Ratings is a relative evaluation and assessment of an entity's exposure and capacity to manage, mitigate or absorb risks related to ESG as well as convert such exposures to opportunities. Globally, the requirements for ESG ratings are driven by the need of investors looking to make ESG related investments. These investors are guided by models that have the capacity to pin-point areas in the management of the entity that can have an adverse impact on its performance arising out of its ESG exposure[5]. ESG Ratings help the investors to make decisions regarding allocation of funds focussing on long term sustainability after factoring ESG aspects. However, it should be noted and remembered that the credit rating of an entity cannot necessarily be correlated with ESG ratings. This is obvious because in credit rating, it is the creditworthiness of a debt or the relative debt instrument is being rated whereas in ESG rating it is the exposure to ESG risks of an entity that is being rated.

From the foregoing, it follows that a high ESG rating need not necessarily result into a high credit rating and vice versa, though some of the factors that go into the rating exercise for both these ratings may be common.

Globally, the ESG rating industry is largely unregulated.

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2 *https://www.morganstanley.com/ideas/sustainable-investing-trends-outlook-2023*

3 *https://www.crisil.com/en/home/what-we-do/financial-products/crisils-sustainability-solutions/download-crisil-sustainability-yearbook-2022.html*

4 *Ibid….3*

5 *https://esgrisk.ai/esg-india/esg-ratings-for-india/*

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Considering the rapid growth in ESG investments, there are moves to evolve a suitable framework to regulate the ESG ratings. Japan's Financial Service Agency released a draft code of conduct in 2022 for ESG Rating and Data Providers, while UK has set up a voluntary group for best practices code for ESG Rating providers with a view to cover them within the scope of Financial Conduct Authority.[6] In India, the Securities Exchange Board of India (SEBI) has issued a public consultation paper on regulation of ESG Rating Providers in February 2023 calling for comments from the stakeholders and the public.

ESG Reporting

There are quite a few ESG reporting framework used globally, popular among them are: -

a) the Integrated Reporting framework developed by the International Integrated Reporting Council (IIRC) which merged with the Sustainable Accounting Standards Board (SASB) in 2021 to be called "Value Reporting Foundation". The SASB has evolved 77 industry - specific standards that assist in identifying the material ESG parameters applicable to the industry and

b) the Global Reporting Initiative (GRI), whose guidelines are used by about 100 countries to report about impacts on issues such as climate change, human rights, diversity and corruption.

There are other reporting formats and disclosure frameworks with defined boundaries such as Task Force on Climate-Related Financial Disclosures (TCFD), Carbon Disclosure Standards Board (CDSB), Global Real Estate Industry Benchmark (GRESB) and Dow Jones Sustainability Indices.

The global trends have influenced the Indian corporate reporting on ESG parameters and large corporates are vying to achieve excellence in ESG reporting. These companies have been publishing annual sustainability reports highlighting the material sustainability risks and how they address the concerns of the stakeholders with respect to the environment and the society. The sustainability reporting by these companies are largely based on either the GRI standards or the Integrated Reporting Framework.

SEBI introduced Business Responsibility Report (BRR) for the first time for top 100 listed entities by market capitalisation effective from the financial years ending on 31st December, 2012. Gradually the coverage was extended and the BRR framework was mandatorily applicable to the top 1000 listed companies till FY 2021-22. SEBI, vide its circular dated 10th May 2021, came out with a new format of Business Responsibility & Sustainability Report(BRSR). The new format was voluntary for the financial year 2021-22 while it is mandatory from the financial year 2022-23. The regulations require the top 1000 listed companies by market capitalization to disclose information in a prescribed format to the stock exchanges and the shareholders, as part of their annual reports.

One of the governing principles of BRSR is that it will serve as "a single comprehensive source of non-financial sustainability information relevant to all business stakeholders – investors, shareholders, regulators, and the public at large." BRSR contains more than 100 data points calling for information on various ESG parameters. Reporting on these parameters require companies to have in place a robust internal MIS and reporting system as well as Board level involvement with amendments to various policies followed at the highest level.

As per SEBI's estimates, more than 175 listed companies[7] have voluntarily adopted BRSR format of disclosure which is evidence of the drive and motivation of these corporate houses in India to work towards leadership initiatives on the ESG front.

The BRSR framework draws upon the NGRBC (National Guidelines on Responsible Business Conduct)[8], which

[6] *https://www.bsr.org/en/blog/upcoming-regulations-in-esg-ratings-three-implications-for-business#:~:text=Similarly%2C%20the%20European%20Commission%20expects,reality%20for%20ESG%20rating%20agencies.*

[7] *SEBI consultation paper on ESG Disclosures, Ratings and Investing*

[8] *National Guidelines on Responsible Business Conduct (NGRBC) issued by the Ministry of Corporate Affairs*

in turn is linked with the 17 Sustainable Development Goals (SDGs) mandated by the United Nations, which have been agreed to by India and 192 other countries all of whom have committed to achieving targets on their respective part in a time bound manner.

G-20 Presidentship in 2023 – A great opportunity

As India has assumed the G-20 presidency for the year 2023, India gets an opportunity to demonstrate its unique strengths in providing leadership in a strategic multilateral platform connecting the world's major developed and emerging economies. As per published estimates G-20 members together represent 85% of global GDP, 75% of international trade and two-thirds of the world's population. The size and strategic importance of the G-20 makes it imperative that it plays an important role in showing the way for inclusive economic prosperity.

India's significant influence is visible in the approach of the government on various international matters, which has been widely appreciated. India's presidency brings to focus the approach to be taken on various international issues that are not only relevant to the further advancement of its capital market but also to global as well as its domestic inclusive development strategies.

Indian Corporates by virtue of their imposing presence in the Indian sub-continent as also quite a few of them being global players have a vital opportunity to shoulder a crucial responsibility while it takes part in India's leadership initiatives arising out of India's G20 Presidentship.

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Role of Chartered Accountants

It is worth noting that Section 166(2) of the Companies Act, 2013 imposes a duty on the directors to act in good faith to promote the objects of the company for the benefit of and in the best interests of the company, its employees, the shareholders, the community and for the protection of the environment. It follows that directors have a fiduciary responsibility towards the stakeholders on ESG aspects and failure to monitor ESG issues impacting the company comprehensively and adequately could well be considered as negligent in the performance of duties. This is one of the reasons why there is today a huge demand for ESG and Sustainability professionals, whether as in-house professionals working in large organisations or as practitioners coming from different disciplines such as CA, CMA, CS, Engineers, Medical Professionals, Doctors etc. This demand is only expected to grow keeping in mind that there are many functions centred around ESG / Sustainability such as ESG Investing, ESG Due Diligence, ESG Ratings, ESG Reporting and possibility of ESG Assurance (Internally as well as Externally). Though in the PPP model of stakeholders, Profit is the third priority in order, with People and Planet coming first and second respectively, business entities are hesitant to take up new investments unless there are profits or economic returns in the short or at least the medium term.

It is here that the Chartered Accountants backed by their intensive training, experience and expertise have demonstrated prowess in their field and they are better equipped to contribute using their lens in financial as well as management accounting to provide the appropriate perspective both in financial as well as non-financial parameters. The scenario provides an opportunity to CAs to shift their focus from conventional practice to areas of Strategic Management, where there is already a huge demand supply gap for professional services. Those CAs who intend to make a career in this field in the long run, are sure to find this shift of focus as an extra-ordinary opportunity to showcase their professional (generalist as well as specialist) skills as well as the ability to work in multi-disciplinary teams and / or lead / co-ordinate the efforts of such teams. Where there is a will there is a way. And it is up to the profession to take up and show the sustainable way. ■■■

Note: The views expressed are the personal views of the authors and do not reflect the views of the organisations they work for or are associated with.