ADVENT OF ESG ECOSYSTEM IN INDIA

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Abstract

In India, there is a growing recognition for ESG factors and their material impact on corporate sustainability. This recognition is coming from all the stakeholders of financial markets. The ESG ecosystem is rapidly getting evolved by institutional investors, firms, policy makers and regulators. This article gives an insight about India's ESG ecosystem and recent developments around it.

INTRODUCTION

The Environmental, Social, Governance (ESG) ecosystem consists of several important stakeholders which can be broadly categorized into companies, institutional investors, policy makers, regulators, ESG rating agencies, and index providers. This article explores all these key players, and their role towards ESG growth in India.

COMPANY

The whole ESG ecosystem pivots around a company. Companies are the issuers of equity or debt instruments in the financial market. They demand capital from the investors in return for the securities. Issuers might be private or public companies. If the company is good at ESG performance IT has a high probability to attract ESG conscious investors with low cost of capital (*Cantino, et.al. 2017*). During the FY 2020-21, Indian companies spent averagely Rs 12,000 Cr and 527 listed companies and 1092 unlisted companies disclosed CSR related variables[1]. Although ESG is a broader concept and different from CSR (Corporate Social Responsibility) approach, still ESG growth is rooted in CSR which marked the starting point for business not only taking ownership of their impact on society but also disclosures of it. The CSR experience has created fertile ground for Indian companies to embrace ESG practices. Currently top 1000 listed companies make disclosures related to E&S through BRSR (Business Responsibility Sustainability Reporting) and governance through corporate governance disclosures under listing obligations. Some multinational Indian listed companies already have been following various international ESG norms of disclosures and reporting voluntarily even before introduction of BRR. But quality of data disclosed, standardisation of data, magnitude and transparency of ESG disclosures are still cause of concern, which could be resolved through regulatory push in coming times.

It is time for businesses to get adjusted to this tectonic shift. *Gunnar et.al* did literature reviews of 2000 research findings related to ESG and concluded, that there was positive impact of ESG performance of companies on corporate financial performance *(Fried, et.al, 2015*). Hence companies should not look ESG as mere disclosure or cost but opportunity to nurture new value creation and long term sustainability. Companies should inculcate the ESG related best practices right from the board agenda, resources mobilisation, operations till product/service delivery.

[1] National CSR Portal

INSTITUTIONAL INVESTORS

Institutional investors are holding collectively the largest stake in public companies around the world and have the potential to impact corporate behaviour (*Clark, 2005*). Mutual funds, hedge funds, banks, private equity, or insurance companies have significant investment in firms and their activism towards ESG are important.

There are USD 121 Trillion worth assets under the management of 3404 investors who pledge to be responsible investors and will incorporate ESG factors while taking investment decisions[2].As per UNPRI (United Nations Principle of Responsible Investing) data, most of the large foreign institutional investors pledge to be responsible investors by incorporating ESG variables while investing in Indian companies. Institutional investors can demand higher ESG disclosures from potential investee companies pushing corporates for more engagement to enhance ESG impact.

Post Covid pandemic asset under management of ESG theme is reported to have grown four times (*ET, 2022*). As on September 2021, there were eight ESG thematic funds, one ESG ETF and one ESG ETF fund of fund. SEBI Consultation Paper[3] on Disclosure Norms for ESG Mutual Funds suggested that ESG mutual funds should disclose the type of ESG investment strategy which are mainly four namely exclusion, best in class, integration and impact investing. Due to increased institutional investor activism in recent times, mutual funds are showing interest in ESG related matters. As the investors are demanding more investment products sensitive towards people, planet and corporate governance which are creating the opportunity for institutional investor's business to grow. The increase in demand for ESG products also demands increased responsibility on the part of institutional investors to choose better ESG performer investee company. Institutional investors can play a significant role in influencing the ESG related behaviour of companies, due to their large money resources and long investment standing.

[2] As on 31st March 2021, UNPRI.org,

[3] Consultation Paper on introducing disclosure norms for ESG Mutual Fund Schemes. 26 October 2021.

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POLICY MAKERS

The United Nations Global Compact first used the term ESG in its report "Who Cares Wins- Connecting financial markets to changing world" in 2006 (*Eccles,et.al, 2020*). In the year 2016, more than 190 countries agreed on climate change measures in Paris. The Paris Agreement bolstered the corporate role to improve environmental, social and governance parameters for better sustainable futures. Governments' policy makers across the world are improving the regulations to achieve the Paris agreement goal. In 2009, the National Voluntary Guidelines (NVGs) were issued by the MCA (Ministry of Corporate Affairs) evidencing India's early adoption and commitment towards corporate responsibility.

Interest of Governments and policy makers in sustainable finance have increased exponentially. Many developed economies revised their laws or introduced new laws to facilitate sustainable finance ecosystem. The new laws support, penalise, or encourage investors and investee to consider ESG seriously. Various forum like G7[4], G20[5], IOSCO[6](International Organization of Securities Commissions), World Economic Forum[7], COP26[8] in the year 2021, emphasise on governments' role to inculcate sustainable practices by corporates for sustainable future.

REGULATORS

Regulatory environment will be biggest driver for sustainable growth. In India, SEBI has introduced timely regulations related to ESG disclosures. Starting from Business Responsibility Reporting (BRR) in 2012 for top 100 companies the drive extended to mandated CSR in 2014, extension of BRR to 500 top listed companies in 2015, integrated reporting in 2017, adoption of new corporate governance disclosures norms at par with international standards as per Kotak Committee recommendation in 2018, further extension of BRR to top 1000 listed companies in 2019 and replacement of BRR with new Business Responsibility And Sustainability Reporting (BRSR)

[4] 47th G7 summit in Cornwall, UK. June 2021

[5] 16th G20 summit in Rome. October 2021

[6] 46th IOSCO virtual summit l, December 2021

[7] 55th WEF summit, January 2020

[8] 26th COP26 at UK, October-November 2021.

mandatory for 1000 listed companies from financial year 2022-23. The European Union regulator recently issued ESG disclosures regulation called Sustainable Finance Disclosure Regulation (SFDR). China, UK, Japan, and Hong Kong recently updated their ESG disclosure codes as per international standards. IOSCO (International Organization of Securities Commissions) stated in its April 2020 report thus: "broad acknowledgment among regulators, industry participants and other parties that climate-related risks can be material to firms' business operations and investors' decisions". Recently SEBI also proposed various norms related to disclosures and regulation for ESG mutual funds schemes[9] and ESG rating providers[10]. Indian ESG reporting and disclosure is now rapidly moving towards global international standards and timely regulatory push by SEBI can trigger the chain reaction to further strengthens the ESG ecosystem.

ESG RATING AGENCIES

ESG rating providers include those firms which provide assessment on the companies of the issuers based on their disclosures that offers sustainability metrics and information which help them determine ESG scores. Different firms use different methods to provide ratings. ESG data is getting generated and disclosed by firms or provided by data providers. There is serious challenge of consistency, transparency, standardisation and comparison of ESG data; if they have are bias then it may lead to greenwashing[11] (*Yang, 2019).* The unregulated ESG ratings provider with lack of transparency is a concern for whole ESG ecosystem. On 24th Jan 2022, SEBI published a consultation paper related to ESG rating agencies. The paper pointed out several issues related to ESG rating like lack of standard ESG terminology, ambiguity lack of transparency related to ESG methodology and lack of standardisation of ESG data. The major cause of concern is third party ESG data provider. There is thus a need to regulate the ESG rating agencies. IOSCO report on ESG rating suggested the principle based regulation where more focus should be on transparency, governance, prevention of conflict of interest and due diligence instead checking correctness of ESG methodology. SEBI in its consultation paper suggested the accreditation of ESG rating agencies. It is further proposed that the net worth of entity which wants to be SEBI accredited ESG rating agency should have net worth of rupees 10 crores. The rating is highly knowledge based and hence the SEBI proposes that the rating agency should have one specialist related to data analytics, finance, IT, Law and sustainability.

[9] 26th October 2021, SEBI
[10] 24th January 2022, SEBI
[11] "Greenwashing is the process of conveying a false impression or providing misleading information about how a company's products are more environmentally sound" by Jay Westerveld 1983.

ESG INDEX PROVIDERS

ESG indices track various ESG titled market portfolios. It acts as a benchmark to judge the performance of the portfolios based on the indices. Indices are also used by mutual funds and ETF for their investments. There are hundreds of ESG indices which track ESG performance under different methodology. The quality and transparency of data related ESG index construction need to be improve d further.

INTERNATIONAL ORGANISATIONS

There are international organisations which are working towards corporate sustainability disclosures including Sustainability Accounting Standards Board (SASB), Global Reporting Initiative (GRI), International Integrated Reporting Council (IIRC) etc. Taskforce on Climate-related Financial Disclosures (TCFD), and Climate Disclosures Standards Board (CDSB) provide the framework for climate risks exclusively. At the end of COP 26 (Conference of Parties) climate summit in Dec, 2021, IFRS also come out with an important announcement to establish the International Sustainability Standard Board (ISSB). There are growing number of ESG related disclosure standards internationally and hence there is need to consolidate them so that the ESG disclosures could be consistent, comprehensive and comparable.

ACADEMIC INSTITUTIONS

Academic institutions are ancillary but important to ESG ecosystem by providing research insights and trained human resources. As the ESG screening methodologies are just decade old, there is ample scope of research to evaluate different dimensions of corporate sustainability, ESG integrations, impact assessment, new research methodology, and performance evaluation. Recent research conferences held by premier institutes of India shows a keen interest in ESG research by researchers. There is need to engage corporates with academia to do more material research.

On 22nd January 2022, SEBI proposed that ESG credit rating providers shall have at least one specialist related to data analysist, finance, law, IT and sustainability. ESG is providing new opportunities for academic institutions to launch new ESG courses or training programme as per the requirements of ESG ecosystem stakeholders. MA

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I, Dr. Ketharaju Siva Venkata Sesha Giri Rao hereby declare that the particulars given above are true to the best of my knowledge and belief.

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Dr. Ketharaju Siva Venkata Sesha Giri Rao

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