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THE ESG AGENDA AND IMPLICATIONS FOR C-SUITE AND CORPORATE INDIA

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INTRODUCTION

The topic of Environmental, Social and Governance ('ESG') aspects of a business has been extensively covered across the global media in the past couple of years. The focus on ESG has been particularly expedited by the Covid-19 pandemic. There is mounting pressure on businesses from all stakeholders – shareholders, investors, regulators, suppliers, customers and communities – to start thinking about their sustainability and wider ESG journey.

ESG - DEVELOPMENTS IN INDIA

The business landscape in India is catching up on the ESG agenda. There is a significant growth in ESG-linked capital markets in India, with assets under management of the top 10 ESG mutual funds growing to INR 12,000 crore during 2019-2021 - representing almost a 5x increase in just two years[1]. From F.Y. 2022-23, SEBI has mandated the top 1,000 listed companies by market capitalisation to disclose ESG data through Business Responsibility and Sustainability Report (BRSR). At the COP26 summit in November 2021, India announced its goal to be net-zero by 2070. It will be businesses – large and small – which will eventually have to work towards achieving the net-zero goal and key targets around the country's energy mix and carbon emissions intensity.

In addition to this business and regulatory imperative, environmental factors are also at play. According to Germanwatch, India is one of the top countries which will be impacted by climate change[2]. Chennai almost ran out of water in 2019. The year 2021 saw droughts, floods, and landslides in various states in India. The start of the year 2022 was one of the coldest winters in India. The frequency and scale of such events are predicted to only increase in the future. Combining the impacts of such natural disasters with India's goal to be net-zero by 2070 means that businesses across industry sectors will have to start considering sustainability and ESG parameters to make their operations more resilient for a climate-informed landscape of the future.

So, what does this ESG agenda mean for Indian companies?

I have identified three key themes and focus areas for the C-suite to consider while trying to embed ESG parameters into business operations: **a) Sustainable/ESG financing, b) Operating model, and c) Stakeholder engagement.**

SUSTAINABLE/ESG FINANCING

Sustainability is not an overnight success. Embarking on a sustainability journey involves potential changes to how businesses have operated historically. This requires long-term planning and resources, with capital often being the most important. Organisations that lack enough capital or need additional funds can look at Sustainable/ESG financing. There are growing sustainability-focused capital markets – in India and overseas – that Indian companies can tap into to finance their sustainable business transformations. Depending on the business needs, the funding can take the form of either of the following two mechanisms: 1) 'Use of proceeds' instruments (e.g., Green/sustainability bonds/loans), where funds are used to finance specific projects/initiatives with environmental or social benefits. The 2022 Finance Budget has laid out various policies, including launching Sovereign Green Bonds and other initiatives on a private-public partnership model, in order to boost the climate finance ecosystem in India. In September 2021, Adani Green Energy Limited issued green bonds worth $750 million to fund the Capex of its ongoing renewable projects[3]. 2) 'ESG-linked' instruments (e.g., ESG/sustainability-linked loans), where repayment terms are pegged to certain environmental or social performance indicators. Ultratech Cement is

1 https://economictimes.indiatimes.com/mf/mf-news/esg-fund-assets-jump-4-7-times-in-2-years-may-grow-further/articleshow/88380627.cms
2 https://www.business-standard.com/article/current-affairs/india-among-top-10-countries-most-affected-by-climate-change-germanwatch-121012500313_1.html
3 https://www.adanigreenenergy.com/newsroom/media-releases/Adani-Green-Energy-Continues-to-Ramp-Up-Focus-On-ESG

already linking its financial commitments with sustainable targets[4].

Financial institutions are increasingly moving away from funding traditional environmentally damaging assets and industry sectors. Sustainable/ESG financing can help CFOs access necessary capital as well as a greater capital pool. Additionally, such funding can potentially be at a lower cost, in turn positively impacting the bottom line. ESG/sustainability-linked loans usually involve a reduced interest rate when underlying ESG goals are met. Similarly, organisations can issue Green/sustainability bonds at lower coupon rates to investors who are willing to accept lower returns alongside achieving positive environmental and social outcomes. For organisations, sourcing cheaper Sustainable/ESG financing can help reduce the cost of capital and improve margins whilst advancing their sustainability/ESG agenda. Additionally, through embedding ESG metrics within their strategic decision-making process, an organisation can ensure that funds are utilised in activities/initiatives which can generate maximum environmental and social impact.

OPERATING MODEL – VALUE CREATION FROM ESG

Secondly, from an operating model perspective, there are opportunities for value creation as well as risk mitigation from incorporating ESG parameters into business operations. Organisations can look at value creation by assessing their product/service mix. Companies can consider launching new sustainable products to take advantage of shifting consumer trends and preferences. E.g., the plant-based protein market in India is expected to grow to $650-700 million by 2025[5]. Similarly, the market for vegan food, recycled raw materials, electric vehicles, alternative raw materials to single-use plastics, etc., is on the rise. A global BCG research suggests that within the consumer goods sector, 70% of consumers are willing to pay a 5% price premium for more sustainably manufactured products[6]. India's net-zero goals and transition to zero-carbon economy present multiple business opportunities in the areas of green hydrogen, biofuels, electric vehicles and related infrastructure, waste management, etc. Organisations can therefore achieve top-line growth through a combination of ESG/sustainability-focused new product and service launches, entering into new markets, and premium pricing. For SMEs and start-ups, it is a great opportunity to be disruptors in the sustainability domain. Through sustainable products and services, SMEs/start-ups can achieve a competitive advantage vis-à-vis large corporates which lack ESG credentials.

A strong focus on environmental parameters can help organisations achieve significant resource efficiencies. Through embedding circular economy principles, companies can look at reducing the usage of raw materials and resources, including reusing and recycling them, in turn driving cost savings. A global paper company managed to achieve a 10% increase in EBITDA margins through a combination of emissions costs reductions, resource efficiencies and revenue growth[7]. By 2030, Ambuja Cement is targeting to save 77 litres of water/tonne of cement produced[8]. While these ESG-focused efforts require initial investments and often involve a longer payback period, it is not always the case. A private Indian mining company that invested in a water treatment facility on their site was able to recover the investment in just under three years. Reducing greenhouse gas emissions by shifting to renewable sources of energy and less carbon-intensive methods can also drive energy savings. Ultimately, such cost savings translate to higher business valuations. The BCG research cited earlier[9] also suggests that by being leaders in the ESG domain, companies across industry sectors are able to achieve significant valuation premiums (between 11-14% across consumer goods, steel and chemical sectors) over peers. Businesses can therefore look at significant value creation through a combination of multiple ESG-focused initiatives across their end-to-end value chains.

OPERATING MODEL – RISK MITIGATION BY FOCUSING ON ESG

From a risk mitigation perspective, companies need to start assessing and adapting their supply chains to account for negative impacts from climate change. Almost 5 million hectares of crop in India was affected in 2021 due to climate crisis[10]. A negative impact on the agricultural sector can have a knock-on implication on multiple other industry sectors that directly or indirectly rely on agricultural produce for their raw material needs. WWF research predicts that almost 30 cities in India will

4 https://www.business-standard.com/article/current-affairs/glasgow-cop26-how-india-inc-plans-to-meet-net-zero-targets-by-2070-121110300058_1.html
5 https://www.cnbctv18.com/environment/global-surge-in-plant-based-cultivated-meat-indian-market-sees-substantial-growth-11012762.htm
6 https://www.bcg.com/publications/2020/supply-chain-needs-sustainability-strategy
7 https://www.bain.com/client-results/a-paper-company-takes-bold-steps-to-become-a-sustainability-leader/
8 https://www.business-standard.com/article/current-affairs/glasgow-cop26-how-india-inc-plans-to-meet-net-zero-targets-by-2070-121110300058_1.html
9 https://www.bcg.com/publications/2020/supply-chain-needs-sustainability-strategy
10 https://www.downtoearth.org.in/news/climate-change/climate-crisis-has-cost-india-5-million-hectares-of-crop-in-2021-80809

face acute water crises by 2050[11]. In addition to traditional industry sectors like agriculture, manufacturing, mining, chemicals, this can be a cause of concern for the growing technology sector in India, whose demand for water to cool their data centres will continue to rise. There is a growing sense of urgency for businesses across industry sectors to look at sustainable options and plan for raw material shortages (in India and globally) to avoid potential supply chain disruptions.

Indian companies might also face risks from regulatory changes and/or increased scrutiny. While an earlier blanket ban imposed in 2019 on single-use plastics was held off by the central government, it is now going to come into force from 1st July, 2022. **New EPR rules in relation to plastic recycling and use are also coming into effect from 1st July, 2022[12]. Corporates will have to reassess their supply chains to comply with these upcoming regulations.** In November 2021, a local municipal corporation in western India, imposed a crackdown on major textile companies discharging trade effluents into the city sewage network citing environmental concerns, leading to factory closures. Proactively implementing sustainable supply chain measures can help organisations mitigate any potential disruptions (and consequential financial loss) from such regulatory changes and/or scrutiny.

Focusing on social aspects like health and safety, employee wellbeing, impact on communities and indigenous populations is also becoming increasing important. Any instances of corruption, bribery, child-labour, human rights abuses, etc. can lead to a negative impact on brand reputation. This might also entail financial risk in the form of a decline in stock prices or reduced valuations, regulatory penalties and fines. Ensuring the right social and governance policies for increased transparency and accountability is becoming critical.

Leading Indian multinationals have already committed to various climate change and sustainability and ESG goals. The likes of the Tata group have put compliance with ESG standards as a top business priority, and more business will follow. For SMEs as well, it will be a business imperative to consider the ESG agenda – particularly where they are suppliers or customers of large Indian and global multinationals which have their own sustainability goals and targets to achieve.

ESG AND STAKEHOLDER ENGAGEMENT

Lastly, from a stakeholder engagement perspective, the C-suite can place high importance on ESG reporting and sustainability-related disclosures. For listed companies not within the remit of the current SEBI mandate, as well as for private companies, a voluntary disclosure can help achieve a competitive advantage through improved brand credentials. Such a voluntary disclosure can be based on existing domestic requirements in India (SEBI's BRSR) or any global frameworks (like GRI, UN SDGs, etc.) or a customised basis depending on the commercial priorities. Voluntary disclosures can also help C-suite pre-empt any potential disclosure requests and/or pressure from customers, communities, activists and investors and build more transparent and better working relationship with these stakeholders. Mandatory or voluntary disclosures that show improved performance and results on ESG metrics can help enhance ESG ratings for organisations, which can in-turn enable them to access a larger capital pool and at more favourable terms. The government of India is also looking at obtaining an ESG ranking for the upcoming Initial Public Offering of the Life Insurance Corporation of India, with the aim of attracting a larger and responsible pool of capital[13].

Impact investment has gained a lot of traction in India in the past couple of years. According to data from Impact Investors Council, almost $1.2 billion were invested just in the first five months of 2021[14]. Private equity and venture capital groups in India are also increasingly focusing on ESG parameters as part of their investments as well as launching dedicated ESG funds[15]. Consequently, for SMEs and start-ups, focusing on ESG can be a great catalyst for raising funds to fuel their expansion and growth journey.

CONCLUSION

All of the above three themes - Sustainable/ESG financing, Value Creation and Risk Mitigation from ESG from an Operating Model perspective and Stakeholder Engagement – are in a way interrelated. In practice,

11 https://www.downtoearth.org.in/news/water/wwf-identifies-100-cities-including-30-in-india-facing-severe-water-risk-by-2050-74058
12 https://indianexpress.com/article/india/centre-notifies-epr-norms-for-plastic-packaging-waste-7780632/
13 https://economictimes.indiatimes.com/markets/ipos/fpos/govt-working-on-esg-ranking-for-lic-ahead-of-public-offer/articleshow/88744950.cms
14 https://www.freepressjournal.in/business/impact-investors-infused-around-12-bn-in-india-amid-the-second-wave-of-covid
15 https://www.livemint.com/companies/news/aavishkaar-capital-launches-250-mn-esg-first-fund-11643022266115.html

it will be difficult to isolate one theme from the other. Progress in one aspect will have a compounding impact on others. Similarly, a negative outcome in one will also mean potential revisions across other ESG initiatives. Therefore, organisations will have to undertake a robust scenario-planning analysis in choosing ESG initiatives to be implemented and engage in continuous monitoring to maximise their ESG impact.

Irrespective of the industry sector, ownership status (public vs. private), the scale of operations (start-up vs. large multinational), it is becoming clear that there are multiple business reasons for organisations to look at ESG.

Climate change is already here (the latest evidence is the unseasonal rain on 6th January, 2022 in my home city of Ahmedabad – for a minute not considering its unintended consequences for the agricultural sector). **The time for the C-suite of Indian organisations to act is now.** The more proactive they are, the bigger will be the benefits and opportunities for future generations in India. ■

A clear mind leads to better judgment and better outcomes. A happy, calm, and peaceful person will make better decisions... So if you want to operate at peak performance, you have to learn how to tame your mind.
— Naval Ravikant

You might think you want a fancy car or a nice watch.
But what you probably want is respect and admiration.
— The Psychology Of Money