ESG-conscious investment is the future

Nitin Potdar
Partner
J.Sagar Associates

Did you know that Blackrock, the world's biggest asset manager, has committed that by the end of 2020, all its active portfolios will be fully ESG integrated? Another top asset manager, State Street has gone so far as to plan voting action against board members if companies underperform when it comes to ESG parameters.

Make no mistake, ESG (Environment Social and Governance) investing is the next big opportunity globally. While India is still in the nascent stages when it comes to ESG investment, the West has whole-heartedly embraced ESG compliance, which basically measures how sensitive an entity is about its social, environmental and governance responsibilities.

Close to $12 trillion are currently focussed on ESG compliant investment globally and going forward it is estimated that there will be more than $20 trillion of asset growth in ESG funds over the next two decades. What is encouraging is that in India we are already seeing many domestic asset management companies, thematic funds and large private equity players getting into ESG investing.

To put it bluntly, corporates or entities who do not care for their environment or are lacking in the above values will be on the backburner for investors in the future. A study conducted by Wells Fargo Wealth and Investment Management revealed that since the beginning of the pandemic more than 50 per cent of investors were interested in ESG investment. More interestingly, a very promising 59 per cent of women and 64 per cent of millennials were interested in the same - clearly pointing to a phenomenal scope for ESG related investment in the long term.

A case in point being ITC. Over the past three years, foreign Institutional investors' holding in ITC has been on a steady decline for reasons which are obvious. In fact, the first ESG fund in India, Avendus India ESG Fund, does not invest in fossil fuels whether it is oil, gas or thermal coal, and is very selective even when it comes to the automobile sector because of the carbon emissions. And the ESG bandwagon is only increasing with Aditya Birla Sun Life Mutual Fund planning an ESG fund, and Axis Mutual Fund already launching its ESG Fund recently.

The coronavirus pandemic has been a catalyst for bringing ESG investing to nearly every portfolio worldwide, since it has accelerated investor focus on such sustainable investing. A McKinsey Survey on valuing ESG programs points to the unanimity among investors and executives to enhance ESG approaches and create user-friendly, effective metrics and data standards. ESG issues can affect company performance, and the financial impact of ESG programs will likely shoot up in the light of growing expectations and scrutiny from stakeholders in the times to come.

What is ESG? Broadly speaking, Environmental concerns imply the company's efforts to protect and conserve the natural environment of its operations, and Social objectives include the quality of relationships with different stakeholders – whether they are employees, suppliers, customers, or the community at large.

While evaluating ESG, corporate policies and practices of energy usage, waste emission and management, pollution control, and treatment of animals are measured for their appropriateness and effectiveness, besides being used in evaluating any environmental risks a company might face and how the company is managing those risks.

Governance would evaluate the quality and transparency of the company's vision, values and leadership, compensation structures, management styles, and protection of shareholder interests, and also includes the evaluation of the company's accounting methods for their accuracy and fairness. It is also the study of other practices to detect or rule out the possibility of conflicts of interest, political influence, and illegal transactions.

What can India do to attract Global Investors?

If India needs to be a hotspot for global investors in the future, we will need to strive to institutionalize a strong ESG culture if we are to strengthen and sustain our global competitiveness. It is a no-brainer that we need a wholesome ecosystem that thinks radically and acts rapidly, and moves dutifully away from the mistakes of the past.

The current rigid system which is full of cross-functional regulations and complications leads to an aversion to interface with regulators, and this is exactly what needs to change to further improve the already inspiring levels of Ease of Doing Business

But the shift in mindset needs to be delicate, carefully monitored and guided in the right direction. Regulators like the Ministry of Corporate Affairs & SEBI need to stop their 'punitive regime' of reprimands, reversals, penalties and punishments, and be more positive, inclusive and encouraging in these matters. The approach needs to be more corrective, and non-rebuking which will definitely encourage managements across companies to show a long-term, earnest and sincere commitment to the ESG agenda and they will consequently strive to build robust and ethical business practices.

Government regulators, audit agencies, corporate players, investment firms, industry experts and academic scholars all need to pitch in when it comes to dispelling the myths, as well as propagating the benefits of ESG. Fervour and regulation in equal measure should prompt companies to achieve a mindset change in favour of ESG compliance and for this, we need a more considerate environment where interactions will be driven more by the pull of faith, rather than the revolting push of fear.

If we take ESG investment seriously, it is only a matter of time before all stakeholders will realise that complying with environmental, social, and governance criteria is not just an ethical concern, and that the risk factors are more lethal and even fatal. In fact, 15 out of 17 (90 per cent) bankruptcies in the S&P 500 between 2005 and 2015 were companies with poor Environmental and Social scores five years prior to their bankruptcies, clearly pointing to the fact that an ESG rating can also be a criteria to evaluate the future of a business.

The icing on the cake is that the ESG Primer Report of Bank of America Merrill Lynch reveals that the strategy of buying stocks that rank well on ESG metrics would have outperformed the market by up to a full three percentage points per year over the last five years. Do we need more incentive?

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nitin@jsalaw.com
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