ESG in India - regulatory approach and imperatives for businesses

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ESG in India

1. ESG n India in it's present form has a history since ancient times in the form of charity, donation, philanthropic initiatives in the areas of education, health, women empowerment and human welfare- practiced as a caring and sharing between haves and haves not. After independence,the developmental policies and programmes of the Government in themselves were not enough for social welfare and upliftment of poor. These needed to be supported by the businesses by adopting socially responsible business practices for the well-being of the communities ,in which the business operates ,and for sustainable development.

The Ministry of Corporate Affairs , Government of India, in 2009 introduced Voluntary Guidelines for Corporate Social Responsibility in the nature of a prescriptive road-map (and not as a legal or regulatory requirement).

2.The Guidelines was a first step and were subsequently revised in 2011 and named as 'National Voluntary Guidelines on Social, Environmental and Economic Responsibilities of Business (NVGS).Later ,the Companies Act 2013 which reformed the erstwhile Company Act , 1956 cast fiduciary duties on the directors requiring them to promote the objects of the company not only for the interest of the company but also for the benefit of its its employees, the shareholders, the community and for the protection of environment. The Act further mandated the select categories of companies based size of their net worth or turnover,to spend at least 2% of their average net profits for preceding three years on CSR initiatives.

3.Since the introduction of mandatory CSR, the corporate landscape in India ,both in size and profile ,witnessed a significant shift in their approach towards their role in societal well being. The companies, both large and small, strived to make CSR as board room agenda and integrate the concept in their business strategies. CSR initiatives did expand beyond mere philanthropy and charity to include sustainable development, environmental conservation, and skill development.CSR was also seen by few companies as a tool to enhance their brand reputation, build stakeholder trust, and create long-term sustainable value.

Introduced in 2021 , the BRSR was more comprehensive with changes in the format, areas and depth of questions covered , specificity in the key performance indicators (KPI)with greater clarity and transparency in reporting.The BRSR laid greater focus on non-financial performance on sustainability and business responsibility.

4.In June/July 2023, the SEBI introduced new Business Responsibility and Sustainability Reporting (BRSR) guidelines primarily focusing on ESG metrics and value chain disclosures for the top 1,000 listed entities and required "reasonable assurance" on these metrics gradually for for the top 1000 listed companies, from FY 2026-27. While the ESG law and practice in India was getting momentum, albeit slowly ,in December 2024 , on the industry pursuance citing practical difficulties , cost and complexities involved as alibi ,Sebi relaxed the BRSR requirements ,deferring ESG disclosures for value chain and making these voluntary.

ESG Regulations in India - a step up approach hindered by industry's complacency

5.India has followed a highly practical and pragmatic approach towards sensitising and nudging the businesses, step by step, in coverage, scope and complexities , towards their role in well-being of the society and in increasing their own enterprise value. The Voluntary guidelines 2009 was followed by SEBI requiring top 100 listed companies for ESG reporting in 2012. In 2013 ,the Companies Act mandated ESG reporting for certain categories of companies. In 2021 The format for reporting was revised to additionally lay focus on non-financial performance on sustainability and business responsibility. The requirements were made more stringent by introducing KPI matrices , reasonable assurance and credit rating though following a glided path. The recent pronouncement by SEBI relaxing some of the requirements as stated earlier is a retrograde step loosening the impetus that it sought to give in a progressive manner over last 15 years.The industry's response , over the period has been less than encouraging despite global commitments being made toward net - zero , development in ESG requirements and imperatives as were unfolding in different countries . These were clear indications of the direction that companies should follow not only for regulatory compliance but also for their own viability, growth and sustainability.

Progress on ESG compliance

6.Over the years , regulatory framework has increased awareness of ESG imperatives and industry preparedness but not at the desired level.

As per Deloitee ESG preparedness survey report only 27%of businesses in India are well prepared to meet ESG requirements.Amongst the suppliers(in the value chain) only 15% are ready. Of the businesses surveyed only 49% were aware of ESG reporting mechanisms and regulations. Compliance with BRSR has been more in letter than spirit and lack clarity, reliability and transparency, for example ,same emissions are reported multiple times . Disclosures including those for value chain partners are not supported by underlying assumptions.Financial reporting is without consideration of impact of emerging ESG physical, legal, transitional and compliance risks on financial results and business continuity. Widespread phenomenon commonly noticed is having a label on the product or advertisement with false claim or assertions made which are not truthful or are truthful but irrelevant . As regards reasonable assurance auditors in general have relied on the assertions made by the management in BRSR report or inputs provided by them without independent assessment there of .Greenwashing in BRSR reporting is also not uncommon.Regulatory mechanism for enforcing compliance is virtually non existing for fixing accountability of the board, directors and officers of the companies.

ESG reporting internationally

7.Internationally, mandatory carbon reporting is the law in 40 countries across the World, including UK, many EU member states, North America, Australia, Japan.In terms of ESG 38 countries had mandatory ESG regulations in 2022.The EU's Corporate Sustainability Reporting Directive (CSRD) mandates that select companies, including those based elsewhere with operations in the EU, report on their Scope 3 emissions including across the value chain . Disclosure of Scope 3 emissions poses complexities and entail significant cost. Yet 30 % of the global companies with or without being mandated disclose meaningfully disaggregated Scope 3 emissions data according to ISS Corporate Solutions data.

ESG reporting- a business necessity

8.Investors, employees , lenders, consumers and regulators are increasingly on the lookout for ESG initiatives , projects , and progress.Consequences of greenwashing are rising - in terms of reputation, and business performance , share prices and legal penalties as well. Expectations are growing for reporting and reducing scope 1, scope 2 and scope 3 emissions and ESG compliance upstream and downstream the value chain.ESG has become a necessity for companies in their own interest . The Deloitte survey suggested that 88% organisations believed sustainability regulations will directly impact their businesses.Further nearly 90% organisations believed that ESG reporting will improve brand reputation and 75% stated that their investors rate their ESG performance.The US Securities and Exchange Commission (SEC) has proactively taken action on greenwashing matters. ESG litigation is a growing area of legal challenges, encompassing a wide range of cases, from greenwashing lawsuits to shareholder activism and climate change litigation. In USA , recent years, many companies adopted more ambitious DEI (Diversity, Equity, Inclusion) seeking to improve racial and gender diversity in senior executive and board roles. Nearly 40 suits have been filed including against Delta Airlines and Wells Fargo, for failing to live up to their net-zero commitments. In March 2023, attorneys general from 21 states in USA sent an open letter to 51 asset managers alleging that their actions to influence climate-related and diversity-related policies at companies in which they hold investments were a breach of their fiduciary duties and otherwise violated laws. Similar instances are noticed in other countries including Germany, Australia, Netherlands,other countries in US.

9.In India instances of litigations for alleged greenwashing are not yet noticed . SEBI has however taken action against companies for misrepresentation in various forms, including overstated sustainability initiatives. Additionally, a few public interest litigations (PILs) have been filed by environmental groups targeting greenwashing, and non compliance of sustainability norms. Recently Central Consumer Protection Authority ("CCPA") promulgated Guidelines for Prevention and Regulation of Greenwashing or Misleading Environmental Claims under the Consumer Protection Act, 2019, inviting legal implications in case of non compliance.Lenders, investors, and insurers are demanding more transparency and reliability in ESG measurement and reporting from their clients .Increasingly, they will not only monitor the companies but will also assess the implications of ESG risks on quality of the their portfolio. Lenders are giving due weight to ESG parameters in due diligence and carry out third party assessment to monitor achievement of agreed targets. Nine of ten asset managers as per a recent survey believe that integrating ESG into their investment strategy will improve overall returns.The potential financial implications arising from climate-related and other emerging risks may arise due to changes in the useful life of assets;changes in the fair valuation of assets; changes in provisions for onerous contracts or contingent liabilities arising from fines and penalties;changes in expected credit losses for loans and other financial assets.Indian consumers are also becoming increasingly concerned about environmental issues.A survey by the Federation of Indian Chambers of Commerce and Industry (FICCI) found that 79% of Indian consumers are willing to pay more for green products.

Impact of ESG on companies performance- an indicator of it's relevance

10.Despite global acceptance and a legal and regulatory backing , ESG concept,policies and practices have been receiving criticism in particular from some quarters in industry. The concerns for climate change and for a sustainable governance of companies is as important as its bottom line.The need is to strike a balance- for example thrust on clean energy at the cost of thermal, had led to shortage of power in India ,apart from loss of employment and other socio- economic consequences arising from closure of large number of coal based power projects.Cost and complexities involved in computing ESG indices and ESG score makes the exercise less meaningful.Political and industry lobbying in US , India and other countries have been able to dilute or delay ESG regulations particularly emissions and value chain related disclosure. Effectiveness of the compliance by companies has also been questionable. Green washing in reporting is wide and unchecked. Applying a single ESG score which is not only broad and complex but also is meaningful in many situations because of interdependencies and relations between and amongst environmental, social and governance aspects.

11.Amidst the contrarian view , various studies carried on impact of ESG measures on performance of compliance are not unanimous . A study conducted by researchers at the University of Chicago found that high sustainability funds hadn't outperformed any of the lowest rated funds.

Another study by the European Corporate Institute found that businesses with investment from ‘responsible investors’ didn’t observe an improvement in ESG scores and actually experienced reduced financial returns.On the other hand, according to a news report by the Institute for Energy Economics and Financial Analysis (IEEFA), ESG investments, despite facing perception challenges and regional differences, have outperformed traditional funds and exchange-traded funds (ETFs). Sustainable funds generated better returns than traditional funds in 2023, with a median return of 12.6% versus 8.6% for traditional funds. This outperformance was extended across both equity and fixed-income fund asset classes. Studies reports based on findings of different research papers generally suggest that ESG measures have positive outcomes for most of the companies whose data have been analysed. A Harvard Business Review study found that companies with high ESG ratings outperform their peers in stock market performance and exhibit lower risks during economic downturns.

12.It is also important to understand how ignoring ESG risks and threat can negatively affect the business model and the share prices. For instance ,Bharat Heavy Electrical Limited(BHEL)’s - a navratna PSU ,in manufacturing thermal power plant,- business model was tied to the thermal power sector. the global trend towards renewable energy and the decreasing interest in fossil fuel projects led to existential threat to BHEL.The share price of the company reduced to ₹76 in October 2018 down from high of ₹335 in 2015. Changed focus in the business model led to revival of growth and capital market sentiments of BHEL

13.ESG has strong bearing on business viability and continuity as a going concern. Rising heatwaves affecting productivity of labour up to 15%,water scarcity is affecting the cost of procurement of water (from alternative sources) ,cyclone, floods , wars and earthquakes are causing physical threats .Similar is the situation for social aspects like gender gap, sex or cast or ethnic discrimination. Lack of trust ,transparency and accountability or ethical compromise have cost the companies dearly.As per a recent study of ASSOCHAM disruptions due to climate have cost indian companies whopping ₹22000 crores in 2023. Consumers increasingly prefer eco- friendly products.Global clients ask for ESG compliance and for disclosure of related risks not only in the company but also for the entire value chain.EU has imposed Carbon Border Adjustment Mechanism (CBAM). Supply chain audits,stress testing, remaining alert for warning signals and scenario planning along with a communication strategy internally and externally becomes imminent.

In summary ESG consideration by businesses are no more driven solely on regulations and their enforcement .Sooner they realise better for their enterprise value.