The New Sustainability Challenge for Directors: Perils and Prospects in Greenwashing

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Preamble

One of the biggest recent ESG greenwashing fiasco that was uncovered by the Wall Street Journal in August 2021 was related to Deutsche Bank's asset management arm DWS Group. It was claimed that out of the total ESG holdings of around USD 1 trillion, almost half of the funds were falsely claimed to be green. Investigations were being carried out by regulators in the US and Germany, which led to sharp decline in the share price of DWS. The incident shows that even the big players can resort to greenwashing, making false claims about the green initiatives. Another example is from UK based company Oxo biodegradable which claimed its bags to be biodegradable but tests proved otherwise. Similar example from Singapore where a company announced a petrol guzzling car as grand prize for bringing down plastic use shows that companies resort to paying lip service to sustainability efforts. However, there have been some sincere efforts by some companies; for e.g McDonald's has made some serious efforts to bring down its carbon footprint in specific areas.

Prevalence and Incidence

Greenwashing is deceiving consumers about positive environmental benefits. It Involves selective disclosure or a positive spin on communication of firm's corporate social actions.[2] Competition and Market Authority, UK found that 40% of the firms' green claims could be false or greenwashing.[3] The global prevalence of green washing has been captured by Terra Choice, a Canadian environmental consultancy, in their popular seven sins of greenwashing; i. sin of hidden trade-off, where sustainable looking products may need more energy and resources to produce ii. sin of vagueness; where green claims made by products cannot be verified iii. Sin of feebing; lying about the green claims iv. Sin of no proof v. Sin of lesser of two evils; driving a fuel efficient SUV does not negate the fact that the vehicle still require more fuel than other models. vi. Sin of irrelevance; making green claims that are not relevant any more vii. Sin of worshiping false labels; fake certifications or endorsement.

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[2] de Freitas Netto, S.V., Sobral, M.F.F., Ribeiro, A.R.B. *et al.* Concepts and forms of greenwashing: a systematic review. *Environ Sci Eur* **32,** 19 (2020)

[3] https://www.gov.uk/government/news/global-sweep-finds-40-of-firms-green-claims-could-be-misleading

The research findings on sustainability reporting by Singapore companies shows that all (100%) of companies report on their 'favourable aspects' of their operations whereas only two-third (around 67%) report on 'unfavoruable aspects' which might be material in many cases. Independent external assurance on such reporting, which can improve such disclosures, is still very low at around 2.8%.There are also cases from India where companies made false claims about their green initiatives which might not be verifiable and sometimes backed by the government as well[4].

Consumer Perspectives

Consumers' awareness on sustainability has increased around the world and more than 50% are willing to pay more for sustainable products[5]. However, greenwashing can be harmful for any business as findings show that there is negative perception among the consumers when companies focus only on positives and ignore negatives while reporting on environmental impact[6]. Greenwashing is global problem, including in India; for e.g. more than two-third of the print ads claims were either shallow or moderate, which means their green claims about the products or services are vague or not backed by any substantiate evidence[7]. Expertise and physical attractiveness of celebrities are capitalized in making fake green claims appear convincing[8]. Evidences from India shows that consumer with better knowledge of greenwashing are likely to scrutinise products for their green claims and make green purchases. Also, consumers with higher income are more likely to have higher environmental consciousness and willingness to pay higher price for green products[9]

Investor Perspectives

Greenwashing is also a huge problem in the financial sector around the globe. For e.g. recently it was found that 85% of ESG funds such as the iShares ESG Aware MSCI USA ETF were guilty of misleading markets about their sustainability allocations[10]. Another study claims that more than 50% of financial institutions in Asia-pacific expressed greenwashing as a hurdle in sustainable investments[11]. Similarly, it was found that only 60% green bonds, which aims at

[4] For e.g. more evidences must be provided for claims like biodegradable eyewear campaign by Eye my Eye or zero emission electric buses by a state government
[5] Nielsen (2014), Doing well by doing good
[6] Marquis et al. (2016), Marquis, C., Toffel, M. W., & Zhou, Y. (2016). Scrutiny, norms, and selective disclosure: A global study of greenwashing. *Organization Science*, *27*(2), 483–504.
[7] Mousami Prasad, Trupti Mishra, Arti D. Kalro, Varadraj Bapat, (2017) "Environmental claims in Indian print advertising: an empirical study and policy recommendation", *Social Responsibility Journal*, Vol. 13 Issue: 3,
[8] Bhatnagar, A., & Verma, S. (2019). Celebrity footprint in greenwashing. *International Journal of Research in Engineering, IT and Social Sciences*, *9*, 22-37
[9] Jog, D., & Singhal, D. (2020). Greenwashing Understanding Among Indian Consumers and Its Impact on Their Green Consumption. *Global Business Review*.
[10] Endowus. (2021). *Avoiding greenwashing in sustainable investing*.
[11] Acosta, F. N. (2020). *Greenwashing a concern for Asia's institutions*.

financing green projects, were externally audited[12]. To achieve India's clean energy and climate goals, financial instruments such as green bonds need to be scaled up. It has become the second-largest market globally for green bonds with $10.3 billion of transaction in the first half of 2019. However, the Reserve Bank of India acknowledged challenges such as "greenwashing", false claims of environmental compliance, and plurality of definitions in this sector.[13]

Regulations and Safeguards

Apart from the consumers and investors, the third important stakeholder in the greenwashing debate are the regulators. Greenwashing is an important issue because many countries and companies are now moving into next era of sustainability to combat the impact of climate change and looking into climate change mitigation and adaption strategies. Continuation of greenwashing can lead to weakening of such efforts. To check this and strengthen the sustainability movement, regulators around the globe are taking initiatives; UK – Green Taxonomy framework to eradicate greenwashing, US – Federal Trade Commission released green guides to help avoid greenwashing in marketing claims, Netherlands – businesses fined up to 1% of their gross turnover for misleading claims, Australia – ESG investments are reviewed, ascertaining they are green as claimed.

In May 2021, UK's Competition and Markets Authority (CMA) has issued, for consultation, draft consumer protection law guidance for all businesses making environmental claims. In addition to draft guidance and consultation document, CMA is publishing literature review, which summarizes surveys, articles and research reports that were considered while developing draft guidance. CMA plans to publish final version of consumer protection law guidance in August / September 2021. CMA will also issue short guide for consumers to help them to understand the sort of questions they should be asking themselves when deciding whether or not they should trust environmental claims being made by businesses.[14]

In Singapore it is considered dishonest to make false or misleading claims under the Consumer Protection (Fair Trading) Act and Singapore Code of Advertising Practice and consumers can sue merchants for damages under Misrepresentation Act.

In India, Advertising Standards Council of India (ASCI) ensures that representations and claims are truthful and not misleading. The public can bring up complaints about advertisements with the Consumer Complaints Council (CCC). SEBI has issued a disclosure requirements for the issuance of green bonds. Definition of green bonds will be adapted from large development finance institutions such as the World Bank, asset specific standards such as Forest Stewardship

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[12] Bachelet, M. J., Becchetti, L., & Manfredonia, S. (2019). The green bonds premium puzzle: The role of issuer characteristics and third-party verification. *Sustainability*, *11*(4), 1098

[13] The Economic Times (2021). *Inflows of sustainable funds surge 76% to Rs 3,686 cr in FY21*.
SEBI (2021), *"Business Responsibility and Sustainability Reporting by listed entities"*.

[14] Competition and Markets Authority (2020). *Misleading environmental claims*.

Council (FSC), and standards for green bonds market such as Climate Bonds Initiative (CBI). Environmental objectives of the green financing instrument shall also be outlined clearly, providing for measurable benefits. In 2021, SEBI announced the format of Business Responsibility and Sustainability Report (BRSR) which will be applicable to the top 1,000 listed entities by market capitalisation (voluntary for FY21-22 and mandatory from FY22-23). This is a first of its kind structure and will make companies to disclose ESG risks and opportunities, approach to mitigate or adapt, and financial implications of various ESG issues and also set standards and benchmarks that helps in meaningful comparison across companies, sectors, peers etc.

Emerging issue: Greenwashing in Carbon Management

Carbon management is highly vulnerable to greenwashing. Accounting for carbon credit is still at its nascent stage resulting in various issues like; double counting where both buyer and seller counts the credit which can defeat the entire purpose of this mechanism. Also, there can be difficulty tracking carbon offset and holding firms accountable or companies claim of carbon offset to appear environmentally friendly contrary to their business model [15]. This can be attributed to absence of standards for carbon offsets or carbon associated claims, ambiguity surrounding what is being covered in a carbon offset[16]. This will be an important issue for India as well which is the third-largest emitter of greenhouse gases, and has a huge potential in the carbon credit market. earned a lot of money by selling its carbon credits in the international market. Private sector has invested in low-carbon technology and renewable energy with the assurance that they would get to sell their carbon credits in the international market.

Going Forward – What's the Role of Directors?

Directors will have the important role of oversight to ensure their companies are not getting into greenwashing which cans seriously hit the reputation of the company. They must delve into the following questions and prepare themselves for steering their companies away from greenwashing and towards real sustainable business practices.

- How do directors ensure that their companies are not greenwashing to the detriments of consumers and investors?
- How can directors advance and prepare for existing and emerging regulations in greenwashing?
- In the escalating quest for net-zero, how can directors put their companies on the right path of decarbonization without greenwashing?

[15] Al Ghussain, A. (2020). *The biggest problem with carbon offsetting is that it doesn't really work*.
[16] Polonsky, M. J., Grau, S. L., & Garma, R. (2010). *The new greenwash? Potential marketing problems with carbon offsets*. *18*(1), 49–54

- How can directors develop capabilities in sustainability and in particular climate change actions, with specific sensitivities to greenwashing?

The role of independent directors becomes more important in this context as they serve a more objective and prominent role in an organisation and see things without any color of bias.

You can watch the video of the talk using the link: https://youtu.be/4veEguEZ4nI