

## **Independent Directors for a better world**

*ESG with Materiality muscles and SDG soul*

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### **The World and the Business – MDGs, SDGs and ESG**

The 7<sup>th</sup> goal of the eight global goals adopted by 189 countries at the United Nations in September 2000 as the MDGs articulated the need to Ensure environmental sustainability and Integrate principles of sustainable development into country policies and programmes for reversing the loss of environmental resources.

The 17 Sustainable Development Goals (SDGs) contained in the “Agenda 2030” adopted by all 193 Member States of the United Nations in September 2015 contain most of the MDGs with the aim to provide a global framework for addressing some of the world's most pressing challenges, including poverty, inequality, climate change, and environmental degradation. The 17 SDGs are interconnected and cover a wide range of issues including promoting sustainable economic growth.

ESG is a set of guidelines and principles for evaluating a company's performance on environmental, social, and governance issues. The inter-relation between ESG and SDG 2030 lies in the fact that ESG initiatives can play a critical role in achieving the SDGs. By promoting responsible business practices and long-term value creation, ESG can help to drive the transition to a more sustainable and equitable economy, which is essential for achieving the SDGs.

The United Nations' SDGs for 2030 are closely related and complemented by the Environmental, Social, and Governance (ESG) initiatives as both are aimed at promoting sustainable development and creating a better future for all.

A quick recall of some SDGs like Goal 7 (sustainable energy), Goal 9 (inclusive and sustainable industrialization), Goal 13 (combat climate change and its impacts), Goal 14 (conserve and sustainably use marine resources for sustainable development), Goal 8 (inclusive and sustainable economic growth, decent work for all), Goal 5 (gender equality) and SDG 10 (reduced inequalities) would establish that many of these goals have direct linkage with the concept of ESG for businesses. And by ensuring good governance and transparency, companies can help to promote SDG 16 (peace, justice and strong institutions).

It is evident that while fulfilment of the SDGs demands concerted efforts by all sectors in the society, the business has a very important role to play. ESG in business is thus very crucial for the world that the world wants to build by 2030.

## **ESG and its Materiality**

Given this understanding, and the compulsions of regulatory frameworks made by nations, many businesses started considering ESG as an emoticon for exhibition or even as the coating to protect from heat of regulators. Clearly, such considerations create a crack impacting the strength of commitment toward ESG. However, with time, the business has started acknowledging the materiality of ESG in terms of economics involving Risk related costs and Investor confidence.

The scope of ESG typically encompasses the entire life cycle of the company or investment, including the supply chain and other external factors. Materiality refers to the significance and relevance of ESG factors in relation to a particular company or investment. Materiality consideration helps to assess relative importance of different ESG issues, their potential to impact financial performance or risk to the specific company. Determining the materiality of ESG factors is crucial for making informed investment decisions, as it helps to prioritize and focus on the most relevant ESG issues.

As ESG factors include a company's impact on the environment, its treatment of employees and customers, and its approach to corporate governance and ethics; apparently the term ESG refers to the “non-financial” aspects of a company, but it can impact its long-term financial performance and success.

## **Investment and ESG**

The investment landscape now has significantly increased focus on ESG factors. Awareness of ESG issues has grown among investors leading to increase in demand for ESG-focused investment products. This is driven by a number of factors, including increasing concern about the impact of business on the environment, a desire to align personal values with investment decisions, and a growing body of evidence suggesting that companies with strong ESG profiles may be better positioned for long-term success.

The rise of ESG investing has been accompanied by a proliferation of ESG ratings and rankings, which are used by investors to assess the ESG performance of individual companies and industries. These ratings and rankings take into account a wide range of ESG factors, including greenhouse gas emissions, labour practices and compensation, among others.

Despite the growing popularity of ESG investing, there is ongoing debate about the financial performance of ESG-focused investments. Some studies have suggested that companies with strong ESG profiles outperform their peers, while others have found little or no financial advantage.

One of the challenges in analysing the financial performance of ESG investments is that ESG factors can be difficult to quantify and compare. In addition, ESG performance is often influenced by a range of other factors, including company size, industry, and geographic location, making it difficult to draw firm conclusions about the financial benefits of ESG investing.

However, despite these challenges, there is growing evidence to suggest that ESG-focused investments can offer financial benefits. A number of studies have found that companies with strong ESG profiles tend to have lower costs of capital and lower volatility, which can contribute to better financial performance over the long term.

The growing interest in ESG investing reflects a broader shift in the investment landscape, as investors increasingly consider the non-financial aspects of companies and industries in addition to financial performance. While there is ongoing debate about the financial performance of ESG investments, the evidence suggests that companies with strong ESG profiles may be better positioned for long-term success.

As ESG investing continues to evolve, it is likely that we will see further development of ESG ratings and rankings, as well as new investment products and strategies focused on ESG factors. Investors who are interested in incorporating ESG considerations into their investment decisions should carefully consider their investment goals and risk tolerance, and seek professional advice as needed.

### **ESG implementation and expectations**

ESG implementation and expectations are becoming increasingly important in India as investors and stakeholders alike seek to promote sustainable business practices and long-term value creation. In recent years, ESG has gained traction as a key consideration in investment decision-making, as it can provide insights into a company's performance and future prospects, beyond traditional financial metrics.

In India, the ESG landscape is evolving, with a growing number of companies and investors recognizing the importance of ESG factors. The Indian government has also taken steps to promote ESG by establishing regulations and guidelines for companies to report on their ESG performance. Additionally, a growing number of investment products and funds are being launched that focus on ESG considerations, providing investors with a range of options to align their investments with their values.

However, despite the progress that has been made, there is still much work to be done in terms of ESG implementation and expectations in India. One of the main challenges facing the ESG community in India is the lack of consistent and reliable ESG data, which makes it difficult for

investors to make informed investment decisions. This lack of data is due in part to the limited reporting requirements for ESG information and the absence of an established ESG reporting framework in India.

To address this challenge, it is essential for companies in India to be transparent and consistent in their ESG reporting, and for investors to have access to accurate and reliable ESG data. This can be achieved by implementing mandatory ESG reporting requirements, as well as by promoting best practices for ESG reporting, such as using established ESG reporting frameworks like GRI or SASB.

In addition to the challenges posed by a lack of ESG data, there are also challenges associated with the integration of ESG considerations into investment decision-making in India. For example, some investors may be hesitant to incorporate ESG considerations into their investment decisions due to a lack of understanding of ESG and its impact on financial performance, while others may face constraints in terms of the availability of ESG-focused investment products.

To address these challenges, it is important for investors to educate themselves on the benefits of ESG investing and to have access to a range of investment products that align with their ESG values. This can be achieved through the development of ESG-focused investment products, such as ESG-focused exchange-traded funds (ETFs) and mutual funds, as well as through the education and outreach efforts of the investment community.

ESG implementation is becoming increasingly important in India, as stakeholders seek to promote sustainable business practices and long-term value creation. While there are still challenges to be addressed, the ESG landscape in India is evolving, and there are a number of steps that can be taken to promote ESG implementation in the country.

### **Role of management and potential contribution from Independent Directors**

The role of management in implementing ESG in companies is crucial. Management is responsible for setting the tone and direction for the company's ESG initiatives, as well as for developing and implementing strategies to address ESG risks and opportunities. This can include setting sustainability targets, engaging with stakeholders, and integrating ESG considerations into decision-making processes.

Independent directors have to play an important role in ensuring that the company's ESG initiatives are aligned with the long-term interests of the company and its shareholders. They have to ensure that there is wholehearted commitment and integrity within the company for implementation and reporting. The Hub February 2023 article on “Greenwashing” the reports is a case in point here. Independent directors need to provide an additional layer of oversight

and accountability. They are also well-positioned to provide constructive challenge to management and to raise any ESG-related concerns that may arise.

Potential contributions from independent directors in the implementation of ESG in companies can include:

- Providing guidance and recommendations on ESG strategies and goals, and helping to integrate ESG considerations into the company's overall business strategy.
- Overseeing the implementation of the company's ESG initiatives, and ensuring that they are consistent with the company's overall goals and objectives.
- Monitoring the effectiveness of the company's ESG initiatives, and providing feedback to management on areas for improvement.
- Engaging with stakeholders, including investors and customers, to understand their ESG expectations and to ensure that the company is meeting their needs.
- Representing the interests of shareholders and other stakeholders, and ensuring that the company's ESG initiatives are aligned with their long-term interests.

Overall, the role of independent directors in the implementation of ESG in companies is to provide a balance of perspectives and to help ensure that the company's ESG initiatives are effective, sustainable, and aligned with the long-term interests of the company and its stakeholders.

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