The Case for embedding ESG into corporate strategies

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With climate and sustainability slowly taking center stage, increasing attention is being paid to environmental, social and governance, or ESG, by all manner of stakeholders — investors, policymakers, regulators, corporates, and customers.

Yet, few organisations in India have been able to align their business strategies with it.

A comprehensive ESG vision, when plugged into a corporate strategy has the potential to deliver immense financial and non-financial value to an organisation over the long term.
The financial value would be in the form of cost reduction, increased productivity, ramping up of sustainable products, and better access to finance.
Several academic studies have shown that companies with higher ESG scores reduce their cost of capital by up to 10%.

Further, ESG-focused companies tend to have better operational efficiency, lower employee turnover rate, increased innovation, strong governance, reduced compliance costs, and better risk management — all of which bode well for shareholder value.
Businesses focusing on ESG initiatives have started attracting investments as the demand for sustainable investing has grown exponentially. For instance, according to data from Climate Bonds Initiative, annual green bond issuance topped the half-trillion mark for the first time, ending 2021 at $522.7 billion, a 75% increase on the prior year sum. India is also witnessing a number of ESG-focused funds, including both private equity and venture capital funds, wherein investors are looking towards organisations integrating ESG right from the inception stage.

Challenges linger

Despite growing awareness, there are roadblocks to ESG adoption in India.

As on date, only 121 organisations in India have committed to near- or long-term science-based emission reduction targets, as per Science Based Target initiative (SBTi) database. Of these, only 38% have got their targets validated from Science Based Target Initiative. Given the size and ecosystem of India Inc., these numbers are minuscule.

The first and main challenge faced by organisations in India is lack of understanding on the benefits ESG offers. This is even more pertinent in case of small and mid-size businesses. Most perceive ESG practices as a cost rather than an opportunity, which means the default move is to backseat ESG centric investments.

Second, given the breadth and scope of ESG, it involves collaboration of multiple stakeholders, some of whom have very limited understanding and clarity about their role in the organisation’s sustainability journey.

Third, unavailability of data and associated quality-related issues continue to be an obstacle in integrating ESG within an organisation’s strategy.

Fourth is the absence of skilled ESG professionals capable of working within the confines of sustainability from an operational perspective. This is further complicated by frameworks and regulations, which are evolving at a pace never experienced before.

Ways to bring ESG to the mainstream

Still, the shift in management thinking with regard to the benefits of ESG is gaining ground. There are several ways to integrate ESG into corporate decisions that lead to sustainable development:

- Foremost is to have clear accountability and oversight at the Board level. This can be achieved through Board-level ESG committees or individual positions such as Chief Sustainability Officer (CSO). Some organisations have even gone a step further and formulated Board-level climate risk committees

- At the management level, senior executives must take responsibility and ensure that the future investments are ESG-centric and a sustainability culture is percolated and embedded at the bottom of the pyramid. This will eventually change a company’s business model radically

- Organisations need to make ambitious ESG targets material to their business and prepare implementation roadmaps to achieve these targets. While conducting the materiality analysis, it is important that organisations consider double materiality i.e., the inward impact (of environment/climate on organisation) as well as outward impact (of organisation on environment and society). This would help in making their operations resilient to ESG-related risks

- Supply chain is a critical component to any business' success. It is essential that organisations identify emission hot spots and address risks within the supply chain, specially from a climate risk perspective
- Take stewardship responsibilities for products manufactured by instilling eco-design principles that consider product sustainability from start to finish
- It is also imperative to report and communicate assured data at least on an annual basis. This would boost investor and stakeholder confidence, and thwart green washing .
- Lastly, the journey toward sustainability involves multiple stakeholders within the organisation. Therefore, it is important to upskill employees with ESG skills to enable them to appreciate their role and contribute towards the organisation's sustainability journey

Mainstreaming ESG-led investing can have several benefits at the national level, too. According to a report by the World Economic Forum in 2021, India's green economy transition is expected to create over 50 million jobs and have an economic impact of over $1 trillion by 2030 and $15 trillion by 2070. The energy transition would require an accelerated approach to green technology innovation, a comprehensive framework to catalyse green finance, and a plan for climate adaptation.

While adopting ESG is an active challenge, regulators can play an important role in promoting ESG investing among corporates through mandatory regulatory frameworks on sustainability. This would ensure organisations are held accountable for their impact on the environment as well as the society, and that investors have access to the information they need to make informed investment decisions. Policymakers should promote formation of a sustainable products market by encouraging green labelling of products, levying taxes on brown or grey products, and offering incentives to green products.

With increasing focus on ESG investing and ESG reporting, businesses that ignore ESG risks could become more susceptible to reputational harm, decrease in revenue, supply chain-related issues and reduced stakeholder trust.

(***Views mentioned in the article are of the Author and do not represent IICA's stand/view***)