Jus Corpus Law Journal

Open Access Law Journal – Copyright © 2022 – ISSN 2582-7820

Editor-in-Chief – Prof. (Dr.) Rhishikesh Dave; Publisher – Ayush Pandey

Establishing Long-Term Value and Performance through ESG

Shreya Puranik[a]

[a]ILS Law College, Pune, India

Received 12 April 2022; *Accepted* 02 May 2022; *Published* 07 May 2022

When we look at all the various developments happening in this dynamic world, it is increasingly becoming more and more important to pay heed to ESG factors. The Covid-19 pandemic has made considerable changes in the world order and has propelled the discussion around the integration of ESG practices by organizations across the globe. This article talks about the need for ESG, the advancements made, and the awareness created in this regard. This article also explores the reason behind the need for these practices and the parameters through which ESG can produce results and sustain them for an extended period. Further, it discusses the various problems and challenges that crop up in the business environment and how solutions can be arrived at by employing ESG methodologies and effective compliance. Lastly, the article explains how and why the incorporation of ESG results in the creation of value and performance that is sustainable.

Keywords: *ESG, CSR, BRSR, long-term value, performance, sustainability, stakeholder capitalism.*

INTRODUCTION

Environment, Social, and Governance (ESG) as a concept, is based on a certain set of actionable parameters or ratings that show the commitment of a company towards implementing sustainable business practices in measurable terms. The environmental component(E) consists of examining how efficiently the companies can reduce their carbon footprint, institute best practices for pollution and waste management, and embrace the concept of a circular economy. The social component (S) deals with creating fair value propositions for society, health and safety of employees, gender diversity and inclusion, executive compensation, gender equality at work, social and economic inclusion, and mainstreaming of disadvantaged communities and interacting with customers fairly and transparently. The governance aspect (G) deals with the overall structure of the corporate governance system of an organization, actions and efforts taken by the Board, regular audits of the financials, maintaining business ethics, and firm opposition to any kind of business malpractices.[1] This term is used synonymously with sustainable, responsible, and impact investing. This idea has been formulated to apply the ethos of sustainability to the corporate realm.ESG is the philosophy of change. It is a continuous process that affects every aspect of everything we do. ESG practices are not just limited to a select few factors. They are concerned with the overall well-being of all the stakeholders of the companies.

WHY IS ESG NEEDED?

In addition to making a profit, one of the core goals of any business is to ensure its longevity. To survive and subsequently flourish over a long period, these organizations have to realize that gaining and maintaining the trust of the investors and stakeholders is paramount. The notion that the only purpose of business organizations is to increase and safeguard value for shareholders (shareholder capitalism) is undergoing a considerable change. This very idea is being looked at from a different perspective. It is observed that organizations can produce long-term value to shareholders when they can comprehend and deal with the needs of their consumers, investors, employees, regulators, and other important stakeholders. This can be labelled as 'stakeholder capitalism.'[2]Here, emphasis is placed on the stakeholders instead of just the shareholders. Keeping in mind the long-term goals, this is a welcome change. The focus is being shifted to socially responsible business practices. Once upon a time, sustainability reports were not considered to be as important as they are now, in terms of their ability to influence the decision-making of businesses and investors. Due to the shift to

[1] M. L. Tannan, *Banking Law & Practice in India* (27th ed., LexisNexis 2021)
[2] Steve Klemash, et al., 'Stakeholder Capitalism for Long-Term Value Creation' (*Harvard Law School Forum on Corporate Governance*, 13 June 2019) <https://corpgov.law.harvard.edu/2019/06/13/stakeholder-capitalism-for-long-term-value-creation/> accessed 17 April 2022

stakeholder capitalism, they are now considered to be one of the most significant factors that facilitate the investment strategies of organizations and individual investors. Such investors are looking to engage with companies that operate in compliance with the law, can tackle a constantly evolving business environment, and are still able to produce sustainable value over a long time. This is attributable to the reason that to be able to make informed and correct decisions, the investors are focusing on not just tangible but also intangible aspects of the impact of these organizations. ESG investing gained momentum after the publication of the United Nations-supported Principles for Responsible Investment (UN PRI). Advancing a more sustainable global system of finance by assimilating ESG issues into investment practices, is the primary goal of these principles. They also laid down the foundation for ESG investing as a common practice.[3]

"A journey of a thousand miles begins with a single step" –

Lao Tzu.

This is why ESG initiatives need to be incorporated into the strategy of the companies so that the ESG ratings and metrics can provide pertinent information to the institutional and individual investors who can go on to take the first steps towards sustainable investing. By embodying these principles in their conduct of business, such companies can thereby pave the way for creating long-lasting value and performance. Keeping all this in mind, it would be reasonable to say that a robust ESG strategy can help organizations to avoid unnecessary, costly, and potentially damaging litigations. An important point to note here would be that it is not enough to merely compose ESG policies and frameworks. To be brought to fruition, they have to be implemented and executed in reality so that the real performance and value can be assessed and the results can be translated into ratings and metrics.

HOW DO ESG INITIATIVES ESTABLISH LONG-TERM VALUE AND PERFORMANCE?

According to Henisz, Koller, and Nuttall (2019), ESG initiatives create long-term value by:

[3] 'What are the Principles for Responsible Investment' (*PRI*) <https://www.unpri.org/about-us/what-are-the-principles-for-responsible-investment> accessed 16 April 2022

- **Creating Top line growth:** An efficient plan catapults the market expansion activities of an organization. Producing sustainable products results in attracting a larger number of customers. It paves the way to gaining improved quality of resources by having a conducive relationship with government authorities.
- **Reducing Costs:** A substantial reduction in costs can be observed by employing ESG strategies as it aids in dealing with increasing expenses of business operations such as costs of raw materials and carbon and decreasing energy consumption.
- **Decreasing regulatory and legal interventions:** Effective ESG measures and disclosures help to gain a greater level of strategic freedom. Through proof of transparent disclosures and compliance with the law and regulations, the trust and support of regulatory authorities and the government can be earned. This results in a decreased need for them to interfere with the functioning of the organization.
- **Elevating Employee productivity:** An increase in the overall efficiency of the workforce boosts employee morale and overall job satisfaction. Increased social credibility aids in attracting and retaining top talent. This can be done by committing to maintaining gender-equal pay, diversity and inclusion in the workplace, and executive compensation. The result of this is an improved business culture and the overall well-being of the employees. The higher the satisfaction of the employees, the better the results will be generated.
- **Optimizing investments and assets:** By directing the flow of capital towards more sustainable and favorable avenues, the organizations can increase their returns on investment. Organizations can accelerate long-term value creation by avoiding investments in non-sustainable investments with a negative impact on society.[4]

Additionally, by investing in responsible research & development, encouraging sustainable innovations, and equipping themselves with the necessary technological know-how, organizations can work towards ensuring the survival of their business and also accomplish

[4] Witold Henisz, Tim Koller, & Robin Nuttall, 'Five ways that ESG creates value' (*Mckinsey Quarterly*, 14 November 2019) <https://www.mckinsey.com/business-functions/strategy-and-corporate-finance/our-insights/five-ways-that-esg-creates-value> accessed 16 April 2022

the goal of creating value for all the stakeholders involved. The 2030 Agenda for Sustainable Development, adopted by all United Nations Member States in 2015, provides the 17 Sustainable Development Goals (SDGs), which are an urgent call for action by all countries - developed and developing - in a global partnership. By Incorporating the UN SDGs into their strategy, organizations can demonstrate how their commitment and contribution to SDGs create long-term value.[5] In 2015, a meta-study was carried out by Arabesque Partners and Oxford University. It consisted of more than 200 sources. It was found that out of all the studies that they reviewed, 80% of the studies showed that investment performance has a positive influence due to reasonable sustainability practices.[6] This just goes on to prove that not only do such practices create extended value but also, they play a crucial role in risk reduction. IOSCO, published a statement about the significance of corporate consideration of ESG matters when disclosing information that is relevant and necessary to the decisions of investors. It was seen that ESG disclosures include the intangible factors such as "environmental factors related to sustainability and climate change, social factors including labour practices, diversity and inclusion, and general governance-related factors that have a material impact on the business of a company." It also "encourages the corporate organizations to take into account the materiality of ESG matters to their business and to assess risks and opportunities pertinent to their business strategy and methodology of assessing risks. When ESG matters are considered to be material, corporate organizations should disclose the impact or potential impact on their financial performance and value creation."[7] Here, emphasis is placed on the materiality and the measurement of the overall impact of corporations. By referring to concrete evidence, the investors can make better-informed decisions. We can say that such ratings are favoured by long-term investors. This is further proof of how ESG measures are pertinent to performance and long-term value creation.

[5] 'The 17 Goals' (*United Nations Department of Economic and Social Affairs Sustainable Development*) <https://sdgs.un.org/goals> accessed 16 April 2022

[6] Gordon L. Clark, Andreas Feiner, & Michael Viehs, 'From the Stockholder to the Stakeholder: How Sustainability Can Drive Financial Outperformance' (*SSRN E-Journal*, 5 March 2015), <http://dx.doi.org/10.2139/ssrn.2508281> accessed 15 April 2022

[7] 'Statement on disclosures of ESG matters by issuers' (*IOSCO*, 18 January 2019) <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD619.pdf> accessed 15 April 2022

IS ESG JUST ANOTHER TERM FOR CORPORATE SOCIAL RESPONSIBILITY (CSR)?

An organization exists in a society. It does not exist in a vacuum. It depends upon and uses the resources like labour, natural resources, and capital from the society in which it is situated. Therefore, the organization must share its profits and give back to society. This can be accomplished via CSR activities.[8] There are a lot of ways in which CSR can be defined and there is no one universally accepted definition. It can be explained as a management philosophy or mechanism for business organizations that are generating profits by utilizing the precious resources of the society to pay back to the society through philanthropy and charitable efforts. Through CSR activities and efforts, these business organizations can keep a tab on their practices, hold themselves responsible well as gauge the effect that their activities have on society at large.[9] While doing so, these businesses are catering to their interests but at the same time, not causing harm to the external environment. With rapid developments in the technological sphere, it has become feasible to evaluate an organization's societal impact in quantifiable terms. This is the point where ESG comes into play. By using metrics that are material to investors, the sustainability of the corporation and its impact on society can be quantified through ESG measures. Not only is the financial performance of the corporation being evaluated but also factors such as its societal impact, environmental impact, and how the business processes are carried out are being evaluated and communicated through disclosures and metrics. In effect, CSR was the precursor to ESG. It would be reasonable to say that while CSR is concerned with accountability, ESG methodology makes the efforts of the organizations measurable. Being able to quantify and measure ESG efforts and demonstrate them in a manner that is useful and comprehensible is what makes ESG the most obvious and favourable option for organizations across industries in the present era.[10] The main differentiator here is the governance (G) component. To answer the question above, ESG is not

[8] Kshama Kaushik, *CSR in India: Steering Business Towards Social Change* (1st edn., LexisNexis, 24 April 2017) 1.1
[9] Piyush Gupta, 'Understanding and adopting ESG-an overview, Part I: The evolution of ESG from CSR' (*RHT Law Asia*) <https://www.rhtlawasia.com/wp-content/uploads/2021/03/ESG-Part-I-The-Evolution-of-ESG-from-CSR.pdf> accessed 15 April 2022
[10] Arend Kooij, 'ESG vs CSR: How Should Your Brand Approach Showcasing Accountable Values' (*Investis Digital*, 22 July 2022) <https://www.investisdigital.com/blog/esg-and-sustainability/how-are-esg-and-csr-different> accessed 14 April 2022

just another name for CSR. Thus, it would not be amiss to say that these are two terms that cannot be used interchangeably. It can be inferred that ESG is broader, more quantifiable, and more apparent than CSR.

COMBATTING ESG CHALLENGES AND RISKS WITH LEGAL AND REGULATORY COMPLIANCE

Climate Change is an issue that cannot be ignored anymore. It is an imminent threat that pervades geographical boundaries. However, this scenario is now changing. To tackle this problem and deal with its negative impacts, world leaders at the UN Climate Change Conference (COP21) in Paris reached a breakthrough on 12 December 2015: the Paris Agreement. Under this agreement, countries have committed to limit increases in global average temperature to less than 2°C above pre-industrial levels, with additional objectives to keep increases within 1.5°C of pre-industrial levels, review commitments of countries every five years, provide financing aid to developing countries to mitigate climate change and increase their abilities to adapt to climate impacts. To evaluate and appropriately respond to the risks associated with climate change, organizations, as well as individual investors, can look at the Taskforce on Climate-related Financial Disclosures (TCFD). The TCFD recommendations are designed in such a way that information that is useful for decision-making would be included in the disclosures. Disclosures in the areas of:

- **Governance:** Disclose the corporate governance processes of the organization along with the role and contribution of the management in dealing with climate-related risks, threats, and opportunities.
- **Strategy:** Disclose the actual and potential impacts of climate-related risks and opportunities identified in the short, medium, and long-term on the organization's businesses, strategy, and financial planning where such information is important to be known by all the stakeholders.
- **Management of Risk:** Disclose how the organization identifies, assesses, and manages the risks related to climate change and the overall impact of its policies and regulations.

- **Metrics and Targets:** Disclose the metrics and targets used to assess and manage relevant risks and opportunities related to climate change and the performance of the organization against these targets where such information is relevant.

However, we can see that this is limited to issues related to climate change. The ESG regulatory landscape is developing at a fast pace. On the Indian front, Section 134 (3) (m) of the Companies Act 2013 stipulates that a report by the Board of directors of the Company should include the financial statement of the year and in addition to that, it should also include the report on energy conservation, absorption of technology, foreign exchange inflow and outflow.[11]

Section 34 (3) of the SEBI (Listing Obligation and Disclosure Requirements) Regulation, 2015 stipulates that the annual reports shall contain various disclosures about risks and opportunities as specified in the Companies Act, 2013 and any other requirements as specified in Schedule V of these regulations.[12] To increase the confidence of the investors and to introduce a regulatory framework for issuing green debt securities, SEBI issued a circular on 'Disclosure Requirements for Issuance and Listing of Green Debt Securities' in 2017. To start a project funded by green debt, there exist numerous disclosures to be included in the offer document. This circular contains the details of which disclosures should be included. By complying with this standard of disclosures, the organizations provide credibility to their business practices. It helps them to address the risks and opportunities that are found. This increases the investor's confidence who rely on these ratings and metrics. This thereby creates long-term performance through sustainable investments. The Securities Exchange Board of India introduced new reporting requirements on ESG parameters called the Business Responsibility and Sustainability Report (BRSR) on 05 May 2021. Reporting under each principle is further bifurcated into essential indicators and indicators of leadership. From the financial year 2022 to 2023 onwards, it is compulsory for filing the top 1000 listed companies (by market capitalization) to file BRSR. This replaces the existing BRR. The main purpose of this is to have quantitative, accurate, and standardized disclosures on ESG parameters that

[11] Companies Act, 2013, s 134 (3) (m)
[12] SEBI (Listing Obligation and Disclosure Requirements) Regulation, 2015, s 34 (3)

make comparability possible across companies, sectors, and time. This encourages the stakeholders to look beyond just the financial performance of funds in the portfolios of the business organizations and towards social and environmental impacts as well. It can be observed that, as of now, these reporting requirements are constricted to only a few select companies based on the size of their market capitalization. However, hopefully, in the future, this will be expanded to a broader range of organizations. It would provide more momentum to the entire process of sustainable investing. The problem of verbose and complex sustainability reports can be tackled by producing accurate, concise, and uniform disclosures that comply with the law and ultimately benefit everyone. GRI(Global Reporting Initiative) is an independent, global organization that provides the common standards to demonstrate sustainability reporting – the GRI Standards.[13] When mandatory and standardized, disclosures are provided, crucial insights into the quantitative and qualitative aspects of the activities of the organization are identified. The risks and opportunities are addressed, and subsequently, informed decisions are made. This creates extended value and ensures that the organizations are not bypassing the law. It gives a clear picture of what the companies claim to do and what they do. It conveys a lot of pertinent information about their ability to sustain themselves over an extended period while still generating results.[14]It can be observed that ESG is, indeed, here to stay for the long run. To provide an all-inclusive benchmark of disclosures related to sustainability for all the companies across the globe to follow, the International Sustainability Standards Board would aid the cause of eliminating discrepancies and gaps in the disclosures related to sustainability.[15]

This will act as a great equalizer. Such disclosures, ratings, and metrics serve as great tools for investors to refer to while making investment decisions. Not only does it provide credibility to the claims made by the corporations but it also gives the investors a sense of stability which

---

[13] 'Setting the agenda for the future' (*Global Reporting*) <https://www.globalreporting.org/standards/> accessed 16 April 2022

[14] K S Ravichandran, *Chapter 2 Environmental, social & governance (ESG) Reporting Practices-Thus far and henceforth, ESG and Charitable Institutions* (1stedn., LexisNexis 2021) 2.3

[15] 'International Sustainability Standards Board' (*IFRS*, 3 November 2021) <https://www.ifrs.org/groups/international-sustainability-standards-board/> accessed 17 April 2022

further increases their trust in the company. This goes on to translate into a good reputation for the organizations. Which consequently attracts more investments.

CONCLUSION

ESG practices ensure that the corporations are not just profit-minded. It can be deduced that if organizations aim to thrive over a long time, they need to incorporate ESG objectives into their corporate strategy & monitor ongoing performance. Investors care about how particular businesses affect their communities and consequently the environment. The organizations which recognize this, align their business strategy with ESG practices, and comply with the law and regulations have an edge over the ones that do not. The proof is irrefutable. Sustainable Investing is the way forward. The future of corporations and all stakeholders subsist on the optimum utilization of resources through efficient ESG integration. It creates a sort of win-win situation. In essence, when the objectives of the organizations are in tandem with the objectives of the society as a whole, sustainable long-term value and overall performance can be established.