Arun Duggal Centre for ESG Research
INDIAN INSTITUTE of MANAGEMENT AHMEDABAD

Webinar on "Is ESG Today a Greenwash or a Value Proposition?" by Dr. Prasad Modak, Managing Director, Environmental Management Centre Pvt. Ltd.

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ABSTRACT

This webinar elaborates upon ESG as a framework in detail, explaining certain related concepts like greenwashing, Development Finance Institutions (DFIs), safeguards, certain finance initiatives, equator principles, Environmental, Health, and Safety (EHS) guidelines, financial intermediaries, etc. Furthermore, this webinar throws light upon ESG in the context of the Indian setting as well.

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About the Speaker

Dr. Prasad Modak is the Managing Director of Environmental Management Centre Pvt. Ltd. and also, the Director of Ekonnect Knowledge Foundation.

Dr. Prasad holds a total experience of more than 40 years with specialties in Environmental policy, Environmental assessment, ESG at financing institutions, business and sustainability, circular economy and capacity building in environmental management.

He holds a BTech (Civil Engg), MTech (Environmental Science and Engg) from Indian Institute of Technology (IIT) Bombay and Doctor of Engg (Environmental Engg) from Asian Institute of Technology, Bangkok.

Dr Modak was a Professor at Centre for Environmental Science & Engineering at IIT Bombay (1984-1994) and later as Professor (Adjunct) at the Center for Technology Alternatives in Rural Areas (CTARA) (2009-2017).

Dr Modak has worked with almost all key UN, multilateral, and bi-lateral developmental institutions in the world. These include the World Bank, IFC, Asian Development Bank, European Investment Bank, UNEP, UNIDO, UNDP, DFID, Swedish and Dutch Embassies in Delhi etc and intergovernmental organizations such as the Asian Productivity Organization, Tokyo. Apart from the Government of India and various State Governments, Dr Modak's advice is sought by Governments of Bangladesh, Egypt, Indonesia, Mauritius, Thailand, and Vietnam.

Introduction

This webinar explained how ESG serves more as a value proposition than a greenwash if it is understood as a strategy/framework thoroughly. Additionally, it explained how investors are more important than regulators in the field of ESG.

Investing in ESG

As of 2022, around the globe, a third of all professionally managed assets or roughly 30 trillion dollars are now subject to ESG criteria. Looking at the investing trends in the domain of ESG, studies of more than 1000 global investors commissioned by the 'Capital Group', showed that about 89% of them had adopted ESG as their investment strategy in 2022. Lastly, there has been a growing awareness among companies, investors and shareholders alike on ESG as well. Henceforth, it is clear that ESG has been dominantly influencing the investing decision-making of investors.

Understanding ESG as a concept

ESG are a set of criteria and standards operated through a management system. The environmental criterion consider how a company performs as a steward of nature or natural capital. Secondly, the social criterion examine how a firm manages its relationships with stakeholders, such as employees, suppliers, customers and the communities where it operates. Lastly, the governance criterion deals with a company's leadership, associated policies supported by procedures, executive pay, audits and accountability, internal control, addressing shareholder rights, etc.

Governance is the foundation for efficient execution of environmental and social criteria of the ESG framework

Governance has become the foundation to support deliveries on both environmental and social criteria. Often, people have realized that it is the poor governance that is the major reason for greenwashing within various organizations. Although, all three elements of the ESG framework are important, it is the governance criterion that stands out as the base for successful implementation of environmental and social components. Henceforth, a strong governance is needed within an organization to ensure complete deletion of greenwashing as a practice within companies.

Salient Points Discussed

1. Greenwashing

Greenwashing refers to false, misleading and untrue actions or sets of claims made by organizations about the positive socio-environmental impacts that their products and services have on the environment. Some examples of greenwashing are enlisted below:

A. Making broad sustainability claims without evidence: e.g. a company might claim that their products are eco-friendly and sustainable without providing any specific information about how they are more environmentally friendlier than other products;

B. Overstating their positive environmental effects: e.g. a company might claim that their products reduce carbon emissions by a certain percentage when in reality the actual reduction is much smaller;

C. Hiding environmentally unsound practices: e.g. a company might source their raw materials from unsustainable suppliers, but not disclose this information to customers;

D. Using vague or misleading terminology: e.g. a company might use terms like natural and organic without providing any specific definition of what these terms mean.

1.1. Reasons Behind Greenwashing

Mostly, a lot of companies and their leadership prioritize the economic benefits more than certain social and environmental problems of the society. They focus on the short term or long term demands of the market more than the socio-environmental problems. As a result, they start working towards satisfying the demands of the market.

1.2. Consequences of Greenwashing

When certain greenwashing practices of firms come out in public, certain demerits follow them which are harmful for them, such as damage to their brand reputation, regulatory actions taken against them, financial losses which affect their profit generation. As a result, they end up losing their customers and their trust. Investors also lose their confidence in them since these companies are considered unethical and immoral.

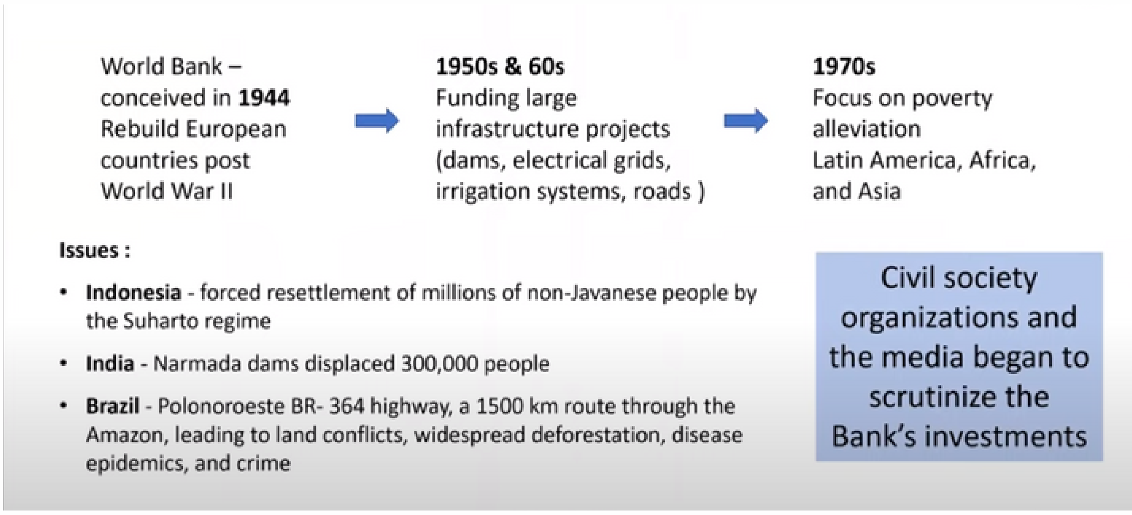
2. <u>Understanding Evolution of ESG</u>

A. Development Finance Institutions (DFI): Safeguards and Category FI;
B. Government or Regulators: Case of PROPER in Indonesia;
C. Private Sector Financing Institutions (PSFI): Equator Principles, International Finance Corporation (IFC) Performance Standards;
D. Investors and the Stock Exchange: The "Reference" Frameworks

2.1. Safeguards at DFIs

Safeguard policies are essential tools to prevent and mitigate undue harm to people and their environment in the development process. When identifying and designing a project, safeguards help assess the possible environmental and social risks and impacts (positive and negative) associated with a development intervention. During project life cycle (including closure), safeguards help define measures and processes to effectively manage risks and enhance the development effectiveness. Process of applying safeguard policies can be an important opportunity for stakeholder engagement, enhancing the quality of project proposals and increasing ownership and in many ways align with the latest ESG framework.

2.2. Below is a detailed elaboration of three case studies in Indonesia, India and Brazil in collaboration with World Bank's association with them:



2.3. Indonesian Case Study: PROPER (Rating Scheme for Industries in Indonesia)

In 1995, a Program for Pollution Control, Evaluation and Rating (PROPER) was launched in Indonesia. Under it, environmental performance of companies was mapped into a five color grading scale, i.e. gold to black. These newfound criteria included efforts to reduce GHG emissions, conserve natural resources and promote biodiversity conservation.

Further, these ratings were then publicly disclosed through a formal press conference and posted on the internet. This simple rating scheme created awareness at a vast level through media and enhanced the environmental awareness of the general public. Henceforth, it resulted in a wide range of performance incentives that showed how markets with environmental information could function in a developing country setting.

2.4. Safeguards in Private Sector Financing

A Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (CERCLA) was passed by the USA as an ESG rating scheme. Additionally, authorized federal agencies recovered the natural resource damages caused by hazardous substances as well. These strict actions resulted in huge monetary losses for the private sector.
Furthermore, ‘superfunds’ were designed to fund the cleaning of all the sites that got contaminated due to industrial byproducts. In addition to that, the value of the collateral diminished as well by contaminations and clean up costs.

3. UNEP’s Sustainable Finance Initiative

United Nations Environment Programme (UNEP) launched a Sustainable Finance Initiative in 1992, post the Earth Summit in Rio. Over 215 institutions including banks, insurers and fund managers were its signatories. In addition to that, UNEP’s Finance Initiative (FI) guide to banking and sustainability was launched, along with introducing e-learning courses on environmental and social risk assessments for increasing awareness about ongoing social and environment problems over the globe.

4. Equator Principles IV (October 2020)

Equator Principles are basically a risk management framework adopted by financial institutions. They are used for determining, assessing and managing environmental and social risks in projects. Provision of minimum standards for due diligence is required to support responsible risk decision making for its functioning. Currently, 140 Equator Principles Financial Institutions (EPFIs) in thirty-nine countries have officially adopted the Equator Principles.

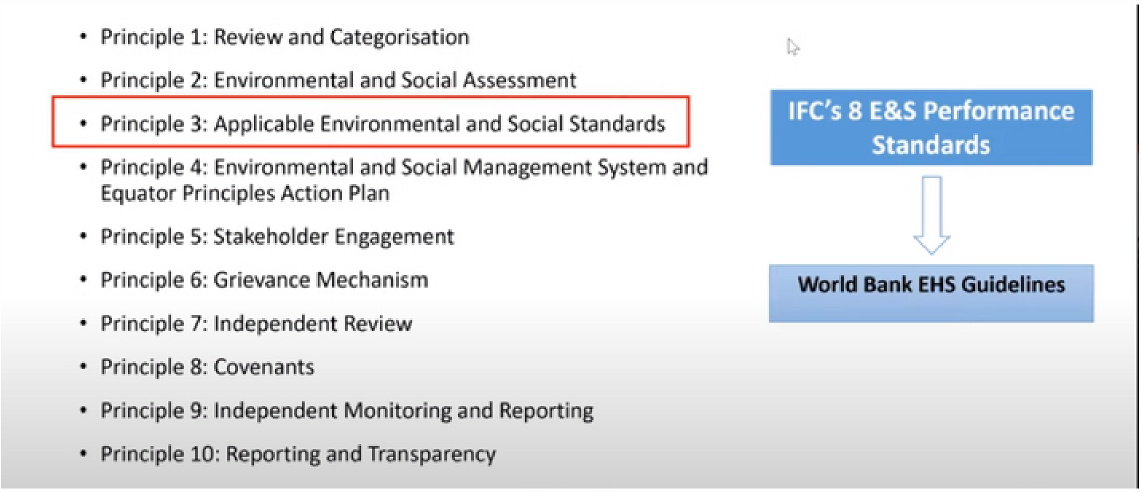
4.1. Equator Principles & their Application

1. Project Finance Advisory Services where total project capital costs are 10 million U.S. dollars or more.
2. Project Finance with total project capital costs of 10 million U.S dollars or more.
3. Project Related Corporate Loans.
4. Bridge Loans.
5. Project Related Refinance and Project Related Acquisition Finance.

Furthermore, while the EP are not intended to be applied retroactively, EPFIs are required to apply the Principles to the financing of expansions or upgrades of an existing project. Some of their implementation requirements are enlisted below:

1. Climate Change Risk Assessment (Task Force on Climate-related Financial Disclosures)
2. Alternative Analysis
3. Quantification and Reporting of GHG (Greenhouse Gases) Emissions

Below is a detailed list of 10 Equator Principles:



4.2. IFC Performance Standards under Sustainability Framework

Under the sustainability framework, International Finance Corporation (IFC) has eight Performance Standards. These eight Performance Standards focus on environment management, occupational health and safety, labor welfare, land acquisition, community health and safety. They are applicable in general to any facility and have to be interpreted in the context of the project under consideration.

4.3. Environment, Health & Safety (EHS) Guidelines

The IFC Performance Standards 3 refers to the World Bank Group's EHS Guidelines. EHS guidelines are of two types:

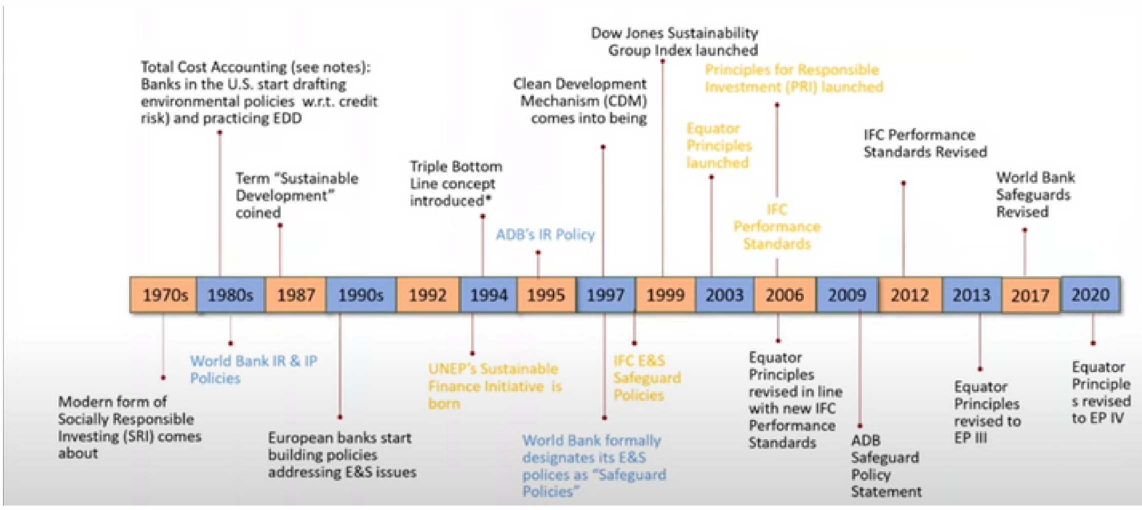
1. General EHS guidelines that are applicable to all sectors;
2. 63 Sector-specific EHS Guidelines that are applicable to the particular sector along with the general guidelines;

The Sector EHS Guidelines provide a typical process flow and activities in the industry. They also provide key impacts associated with the sector under environment, occupational health and safety and community health and safety. Lastly, provision of measures that can be adopted for managing the impacts including best practices is given as well.

5. Financial Intermediaries (FIs)

Today, all financial intermediaries (FIs) in India that set up funds with investments from DFIs or MDBs (Multilateral Development Banks) develop their own set of framework that builds upon IFC performance standards and World Bank EHS guidelines.

Below is a detailed analysis of the global evolution of Environmental & Social (E&S) Safeguards for FIs:



6. ESG in Indian Governance Setting

ESG has become a prominent trend in Indian government bodies and private firms as well. Ministries like the Ministry of Environment, Forests and Climate Change, the Ministry of Rural Development, the Ministry of Corporate Affairs, the Ministry of Labour, and the Ministry of Finance (SEBI) have adopted ESG as a framework for social and environmental regulations as well.

6.1. Challenges in ESG's Efficient Implementation

Although, ESG has become a prominent strategy for major Indian institutions, some challenges are still faced in India for its effective execution like a segmented or siloed view towards its objectives and enforcement, certain ambiguities and overlaps hindering its adoption, regulation or implementation, major issues related to monitoring, implementation and enforcement arising among certain organizations or government bodies, poor human resources and poor data availability also hinder ESG's efficient regulation in India.

7. Findings of the CAG* on Environmental Clearance and Post Clearance Monitoring

Some of the data from the report of the CAG of India on Environmental Clearance and Post Clearance Monitoring Report No. 39 of 2016 is enlisted below:

1. Sampled 216 projects which had been granted EC between calendar years 2011 to July 2015
2. In 25 % cases, the EIA reports did not comply with TOR
3. In 23% cases, they did not comply with the generic structure of the report
4. Cumulative impact studies where needed were not conducted.

8. National Green Tribunal

The National Green Tribunal Act of 2010 was an act of the Parliament of India which enables creation of a special tribunal to handle the expeditious disposal of the cases pertaining to environmental issues.

*Comptroller and Auditor General of India

9. Investment Scenario in Existing Businesses

Firstly, considerable investments are happening in existing businesses, e.g. M&A. Secondly, Environmental Social Due Diligence (ESDD) is not a regulatory process that is asked for and required yet. Thirdly, there are still some missing legal pieces on site assessment. Fourthly, provision in the law that asks for an environmental management cell to be in place has not been enforced till now. Lastly, there is a need for an 'Integrated Instrument' in the interest of investors.

10. Residues, Resources and Risks

Indian environmental governance is residue centric. As a result, resource efficiency, resource sufficiency and a major step towards circular economy have still not been on the center stage. Cumulative impacts have not yet been addressed and strategic Environmental Impact Assessment (EIA) has not been legislated as well. Additionally, climate change associated risks are not yet on the agenda in guiding development and associated investments. Climate change today is one of the major agendas at many financing institutions in India demanding to be addressed.

11. Expanding Envelopes

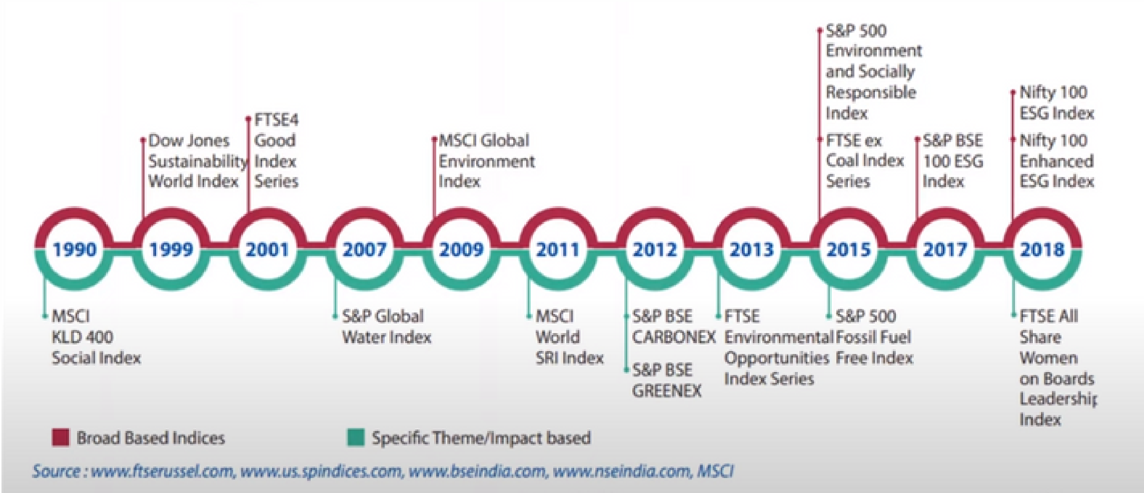
Life cycle thinking is being incorporated into many projects being undertaken in India. Further, institutions are going beyond factory gates for Environmental and Social Due Diligence (ESDD). In addition to that, extended producer responsibility is being enhanced as well. Lastly, market regulations especially on products are being put more strictly.

12. Efforts from OECD

Organization for Economic Cooperation and Development (OECD) in its 2011 edition had put guidelines for multinational enterprises. Secondly, policy framework for investment 2015 edition had taken into account more responsibility towards social and environment related issues. Lastly, OECD Due Diligence Guidance For Responsible Business Conduct 2018 and Sector Specific Guidelines have also been put in place.

13. ESG Rating

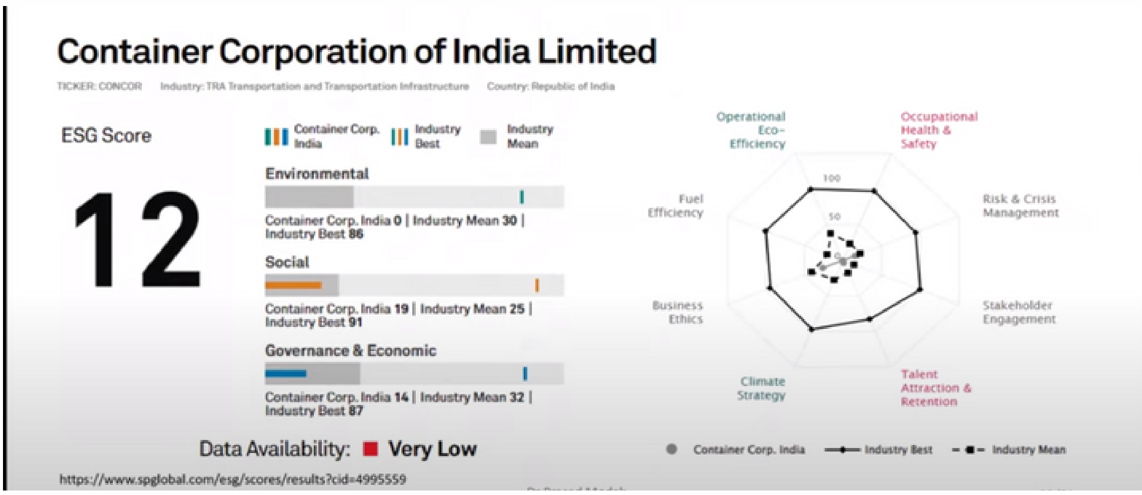
Below is a detailed analysis of ESG Ratings on the timeline from 1990-2018:



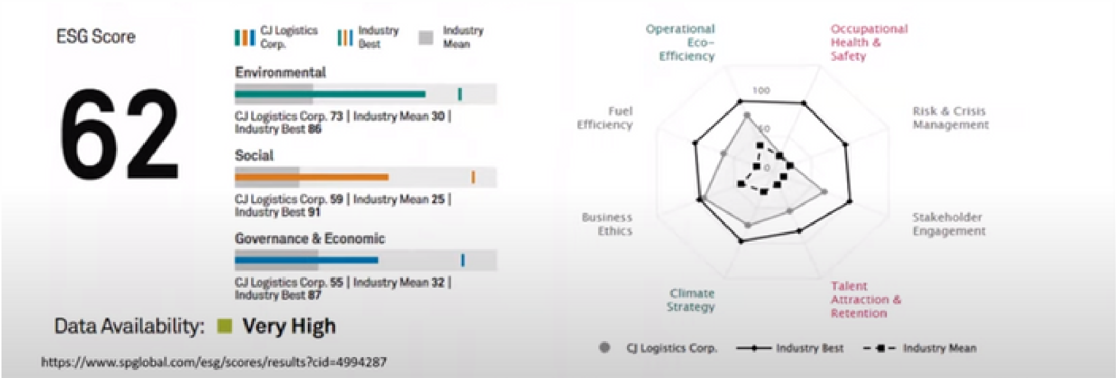
13.1. Disclosure is Critical in ESG Rating

In a recent survey conducted on the company, 'Container Corporation of India Limited", the findings showed that due to low data availability on various factors, the ESG score of the company was very low.

Given below is a detailed analysis of the ESG score of the company.



Furthermore, it has also been observed that data availability makes an immense difference in the ESG scores of companies. For example, another company from the same sector, named "CJ Logistics Corporation" had a **high ESG score of 62** since the company made a lot of information available.



13.2. Which Rating to Choose

Whether ESG ratings are indicators of genuine performances has been a striking question due to poor data quality and reliability, and risks of greenwashing. Various institutions have always been confused whether to use absolute ratings or relative ratings. However, studies have shown that absolute ESG ratings are less relevant than the 'delta' that captures the trend.

14. <u>ESG and Profits</u>

Wall Street Journal examined about 500 U.S. companies with ESG scores. The research showed that companies with higher ESG rating tend to have higher profitability over a period of 5-7 years compared to those with lower ESG rating. Given below is the share-price performance of nearly 500 companies scored by three ESG data providers compared to the market:

15. Need for Harmonization

The World Economic Forum has highlighted the need for a strict transition from shareholder capitalism into stakeholder capitalism. It took four factors into consideration namely, governance, planet, prosperity and people. Under the governance factor, they took into account various issues like setting purpose, governance body composition, issues impacting stakeholder, anti-corruption, protected ethics and reporting, and integrating risk and opportunity.
Secondly, under the prosperity factor it took into consideration, issues like number and rate of employment, economic contribution, financial investment contribution, total R&D expenses and total tax paid.
Thirdly, under the people factor, it examines issues related to diversity and inclusion, pay equality, wage level, risk of incidents of child labor, health and safety, and training provided.
Lastly, under the planet factor, they took into examination, issues like greenhouse gas emissions, TCFD implementation, land use, and water consumption.

16. India Moving Up the Curve

India has made considerable improvements in raising its bar on social and environment sustenance standards. India Net Zero by 2070 has been gaining increased attention from various companies and government bodies. Furthermore, decarbonization is getting into business planning more thoroughly, and climate change risks are being put in appraisals.

In addition to that, Mission Hydrogen, Mission Circular Economy and Mission LiFE have gained significant importance over time. An emphasis on green investments and infrastructure has increased immensely. Sustainable Stock Exchange at BSE has been put into action as well. Lastly, sustainable taxonomy drafted by the Ministry of Finance has been put into action, along with a proposed regulatory framework for ESG mutual funds.

- What's Next?

- Governments to start measuring welfare beyond GDP.
- Impact standards evolvement and integration to take place.
- Reporting standards to shift their focus to impact.
- Stakeholders start to work towards a better understanding of how organizations are measuring and improving their impact. More and more understanding of that will reduce the situations of greenwashing.
- To increase supply chain transparency by utilizing direct data.

Recommendations For FI, Business and Regulators

It is crucial to make ESG a compelling case. ESG should be a default business strategy of every organization to be future ready.

1. There is a need for a common “code” on ESG by the International Financial Institutions (IFIs) to bring in more granularity to Category FI.

2. The Central Banks have to play a very significant role to establish a uniform Environment & Social Risk Management (ESRM). For example, the Bangladesh Association of Banks (BAB) has a common ESRM used by all the financial institutions and banks in Bangladesh.

3. There is a need for more training, case studies and capacity building to better understand the importance of value creation through ESG, and that it is not just limited to risk management.

Q&A Session

Q: How to discern between a genuine ESG effort and a greenwashing effort considering the availability and validity of data. What are the types of data that you employ to help out organizations?

A: Data is obviously the most burning issue, and it is not only about the data but how valid the data is. However, the data validation problem will be getting solved in the future since SEBI is demanding for more assurance of the data being provided by BRSR.

Q: What are some of the ESG policy monitoring and implementation challenges since it has been difficult to come up with a standardized format?

A: I think we need a lot of capacity building. Secondly, awareness about the practicality and depth of this subject is missing, here think tanks should come up and spread more awareness about these problems. Case studies will play a key role in spreading awareness and knowledge about this subject.

Q: There has to be some differentiation in terms of different sectors e.g. what is ESG for a manufacturing firm compared to a different specialization industry. Should there be a uniform framework for all sectors or specialized frameworks for different sectors?

A: I cannot imagine a uniform standard on a global level, but the principles should have some uniformity. However, there are a few things which are non-compromising principles which we call as guiding principles which support the policy statement. Secondly, we have operational principles which are below the guiding principles which focus more on the type of sector we are operating in. Hence, there has to be a hybrid structure which we have to follow.

Q: What does the recent decline in the ESG investment inflow in major economies mean for the future of sustainable investing?

A: Sometimes, the statistics are very funny, the numbers decline on the optic in investments which are tightly rimmed by the ESG, then to have that investment flow and unleash that money, you tend to diverge from the ESG focused investment.

Q: In spite of using various ESG assessment techniques, why is the banking sector far behind in ESG implementation as compared to other sectors?

A: Actually it is a matter of attitude, usually organizations look at ESG as a risk aversion mechanism but they don't look at it as a value system, and this is the main challenge.

Q: What are the challenges related to the implementation and monitoring of policies, in terms of unreliable data and ungrounded perspective of policy makers to solve the problem of marginalized population from a more localized point of view?

A: Yes. There is a disconnect between theory and field practice. We should do more field level assessment of the document oriented claims being made. People in general don't understand the importance of the ESG framework and its benefits. Stakeholder management plans should be there as well. Accountability should always be there.

Q: ESG is not always a win-win situation because of many complexities in the process. If seen through a pragmatic lens, what is your take on ESG being a more practical, rather than an ideal approach?

A: We should engage in discussions with the stakeholders, that is a must. ESG right now is in a transition phase. ESG is not an overnight process to understand but a very old and thorough approach which requires ESG practitioners to have in-depth knowledge about the subject. Some patience about this topic is more important than access.

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Note: The images featured in this summary report have been replicated from Dr. Prasad Modak's presentation during the webinar.

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