EVALUATING ESG PERFORMANCE OF INDIAN COMPANIES (WITH REFERENCE TO FMCG'S INCLUDED IN NIFTY)

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Abstract

Environmental issues like global warming, scarcity of drinking water, depletion of ozone layer, etc., have taken people on a jolt. People are becoming aware of environment and are trying to move towards better sustainable working culture. With this the role of a business enterprise becomes even bigger. Every government has also become more vigilant about the businesses dealing with waste management. Likewise most corporate organisations are self-aware and working towardssustainable business. This takes us to the most talked of practices today i.e. Corporate Social Responsibility (CSR). The motivation to CSR been taken seriously is that people have become Socially Responsible Investors (SRI). Thus SRIs choose their investing company more wisely. A company that does less damage to the environment by working on various factors like reducing carbon footprint, managing waste and learning to give back to the environment.

This paper is an overview of Environmental, Social and Governance (ESG) practices in India. The business houses working in the direction of sustainable development.

Objective- The study focuses on the concept of ESG and the role it plays in the sustainable development. We will also find how the factors of ESG have become important pillars of Corporate Social Responsibility.

Keywords – Environmental, Social and Corporate Governance (ESG), Corporate Social Responsibility (CSR), Socially Responsible Investing (SRI), carbon footprint, National Stock Exchange (NSE), Bombay Stock Exchange (BSE).

Evolution of ESG

Introduction: ESG, the acronym for Environmental, Social and Governance, first came up with a remarkable rise in 2004. The UN Secretary General Kofi Annan invited CEOs of several companies under the initiative: UN Global Compact to join hands to work on an environmentally and socially responsible world.

Though the practice of ESG investing is deep rooted back in 1960s where people first talked about social and ethical consideration to invest responsibly. There was so much happening in the name of sustainable development and sustainable investment that the very first mutual fund with sustainable investment was launched in 1971. This gave rise to collective conscientiousness. Corporate houses became more careful and responsible about the environment.

The awareness of sustainable development and environment protection and social development has raised government's concern over various business houses. Whether a business is doing more harm to the environment or benefitting the society, has been increasing attention from several quarters. So corporate actions that are taken to put a control over misuse or exhaust the natural resources is often referred to as Environmental, Social and Governance (ESG), or Corporate Social Responsibility (CSR).

With so many conferences on climate change, natural capital and pollution taking place globally, came the concept of green economies. When talking about green economy mere carbon emission was not the issue but other components like climate change and pollution and social responsibility and ethical considerations were also accounted for.

Green finance strategy speeded up the sustainable investing process and hence ESG was all over the corporate world.

Review of Literature

ESG is more relevantly been associated with CSR(Corporate Social Responsibility). This brings with it a Three-Dimensional concept –

1. Corporate social responsibility
2. Corporate social responsiveness
3. Social issues

   The responsibility dimension deals with legal, ethical, economic and social concepts. The responsiveness dimension brings with it the accommodation, defence, reaction and proaction. The 3rd dimension deals with consumer safety, environment protection, safety of the product and work culture for the employees and response to the shareholders.(1)

   Many organizations like Chartered Financial Analysts Institution provide guidance to finance professionals on ESG investing. Other institutes like Morningstar, analytics based on ESG to investors and asset managers and bring better understanding of carbon metrics etc. while corporate social responsibility and sustainable investments have been driving force behind ESG popularity, the ESG framework is an expansion to use ESG lens for viewing resilience of organisations and sustainability in communities at large.[2]

Earlier, companies had the sole motto to earn profit. Taking all and giving back was not in the concept. Recent trends show that only taking from the environment will not be enough and sustainable development took over. Companies have taken initiatives to reduce carbon footprints. Efforts have been put to create a more sustainable supply chain which includes purchases from suppliers, who use more energy efficient methods, who are into recycling material, benefit with organic fertilizers, make use of biodegradable material and deal in less toxic material.(3)

Ministry of Corporate Affairs (MCA) and Indian Institute of Corporate Affairs (IICA) have come together to renew National Voluntary guidelines on Social, Environmental and Economic responsibility of business. It provides the principle of safety and sustainable business with a view that throughout the life cycle of the product, the business should minimize the adverse effects on the environment and society. It also focuses on well-being of the employees by not using child labour or coercive labour and also by ensuring on time payment of wages/salary.(4)

Talking about corporate bonds, the environmental factor of ESG tends to be increasingly relevant for recent theoretical and empirical studies. These studies confirm that the idea of stronger governance mechanism could benefit from a lower debt cost for the companies. From the view point of credit ratings, the scholars view is considered most when it comes to ESG risks and assessment of their overall risk. It is believed that stronger ESG performances could attract more investors for their bonds, thereby reducing the debts of the company.[5]

The Business for Social Responsibility Report 2014, states that India with more than 3 million NGOs are dubious about the negative externalities of business and are trying to regulate it with the adoption of more responsible ESG practices by transparent disclosure of ESG/ sustainability report. Such practices have brought changes in business environment globally. The regulatory agencies in India have made it mandatory to file Business Responsibility Report for top 100 listed BSE and NSE companies which focus on ESG performance, w.e.f. Dec.31st 2012. Government is coming up with more new regulations and developments to move Indian companies towards better ESG performance.[6]

Research Methodology

Secondary data- Exploratory work has been done with the help of secondary data available on various websites, government sites, journals and bulletins.

ESG Framework

ESG i.e. Environment, Social and Governance. This includes three different spheres for a company to perform on the basis of these parameters for sustainable development. Let us understand the ESG under various segments i.e. –

i. Environment

The environmental framework takes into account different categories under which the environment is affected. This includes-

a) *Climate change :*

Carbon emission, deforestation and several other factors are responsible for global warming resulting into climate change across the globe. When looking into the matter, the corporate houses get into direct scrutiny. Now since we talk about green accounting, businesses are expected to keep neutral carbon emission, plant more trees than they cut and also use natural resources judiciously.

b) Pollution waste:

With a big 'NO' to plastic, we still so much depend on plastic. In India, most FMCGs are still in a plastic container, plastic packaging or plastic bags. We just can't let go it. Water sources are treated as garbage dump. With ESG parameters companies need to take a hold on these polluting elements and focus on green accounting.

c) Carbon footprint :

The total generation of greenhouse gases (including carbon dioxide and methane) emitted by our actions is carbon foot print. Today every big company is trying to reduce its carbon footprint. The average carbon footprint in the United States is 16 tons per person, one of the highest rates in the world and globally, it is closer to 4 tons.[7].

ii. Social

Taking social opportunity, businesses are set up but do these business houses take up social responsibility? The socially responsible parameter of the ESG concept deals with-

a) Human capital i.e. the rights of the worker and the way they are treated. The labour standards and management should be given priority.
b) Product liability- the business must make sure that the product produced is not harmful to the society in any form. Product safety and quality, the chemical used or even data should be secure and safe.
c) Stakeholder opposition- this simply means taking a risk in the decision making process. The risk involves of putting people first. T**he PPP decision making process considers** best interest of stakeholders and the parties involved in PPP delivery process.[8]
d) Social opportunities- the business must give access to communication, access to finance, to health care and nutrition.

iii. Governance:

a) Corporate Governance

Every government has rules by which the companies must abide. The government frames such laws to sustain moral integrity and bring transparency for the investors. This allows maximum participation by the prospective investors.

Good corporate governance ensures responsibility and accountability.

b) Corporate Behavior

To nurture long term investment positive corporate behavior is important. This can also be termed as ethical behavior. Talented Directors come with green strategies and risk management.

FMCG Framework

The Indian FMCG sector is growing enormously at an average annual growth of about 11% p.a. with an estimated size of 1,300 billion. A considerable part of the sector is highly fragmented, comprising of unorganised, unbranded and unpackaged products. There are approximately 9 million FMCG stores out of 13 million (approx.) retail stores across the country.[9]

Labour cost is lowest in India compared to most Asian countries. This low labour cost and easy availability of raw material result in lower cost of production. Low cost production has attracted many multi-national companies in India. To name a few - HUL (Hindustan Unilever Limited), Nestle, Procter and Gamble have made their roots deep in the country.

We are moving towards limited and expensive energy from a world of cheap and abundant energy.[9]

Thus it is important that sustainability and greening of industry must go hand in hand. Industries must come up with GHG free operations as well as the associated supply chains should also be considered to measure and reduce the carbon emission.[10]

Concepts like ESG and CSR have brought positive changes with them. Studying few corporate companies has given a clearer picture of how corporate institutions are moving towards sustainable development.

Nestle has come with a project GHG(Green House Gas)[11]

- *Climate*- to measure their carbon emission, they have taken 2018 as the base year and compared the carbon emission levels. They aim to reduce carbon emissions by- 20% by 2025, 50% by 2030 and net zero by 2050.
- *Biodiversity*- they have planned primary supply chains to be 100% deforestation-free by the end of 2022 (this includes for products made of meat, palm oil, paper and pulp, soya and sugar). They are also planting 200 million trees under the Forest Positive Strategy.
- *Social wellbeing*- they are trying to boost the well-being of the community by regenerative practices and valuing their potential irrespective of race, gender, religion, ethnicity, age and different abilities.[9].

Britannia sustainability report[12]

- *Energy and Emissions*- They are trying to increase the renewable energy and in select plants they are trying to use biomass. Rain water harvesting helped save 42% water and 30% renewable energy.
- *Waste and Packaging*- Recycled content is used in secondary packaging. They taking steps towards plastic neutrality by finding replaceable plastic and recollection methods.
- *Responsible Procurement*- Moving towards economic empowerment through Animal Welfare Initiatives that yields improvement in farmer extension program.[10].

Hindustan Unilever Sustainability report[13]

- *Climate Action* – This company has planned to achieve net zero emissions by 2039 by employing renewable energies across operations and reformulating products with green carbon ingredients as an alternative to fossil fuels.
- *Sustainable development* – They are working towards nature-positive future by regenerating land, forest and oceans.
- *Waste-free world*- They aim to reduce waste footprints through circular economy approach.[13]

ITC

- *Climate Change*- ITC is moving with a baseline of 2018-19 to reduce purchased grid electricity by 50% by 2030. 30% reduction in specific energy by 2030 and enhance carbon sequestration through ITC's Social and Farm Forestry Programme which works on expansion of forestry projects on wastelands.
- *Water Conservation*- Specific water consumption reduction by 40%by 2030 through water stewardship initiative. By 2030 rain water harvesting will save 5 times the actual usage of water.
- *Sustainable Livelihood*- Conserving biodiversity covering over 250,000 acres through adopting Nature-based solutions to help sustainable livelihood of 10 million people by 2030.[14]

Dabur India

- It aims to be carbon neutral by 2040.
- Dabur, through a series of programs aims to become water positive by 2030 by creating a positive water balance within operations and in communities.
- Aims at zero plastic waste by 2023
- Zero hazardous waste to landfills by 2025
- Aims to achieve positive balance by 2030 by creating circularity in value chain
- Reusable materials to be used to produce 100% packaging material by 2025.
- No net loss to biodiversity by 2030 is another aim.

Godrej Consumer Products

- Reduce specific energy consumption and Increase renewable energy portfolio by 30% .
- Regarding water positivity, Godrej has reduced the specific water consumption by 30.3% and is conserving more water than the company uses. It does rain water harvesting process in its campus and also through community water shed programme.
- Reduced 100% waste matter for filling the low land where it is most required.
- Till date they have been able to reduce GHG emissions to 37.4%.
- Right from fiscal year 2010-2011 (i.e. the base line), the present performance is as in march 2021-
  i. The energy use is shown and calculated per tonne of production .
  ii. Water usage is also calculated per tonne of production.
  iii. The waste matter generated is also calculated per tonne of production.
  iv. Emissions are calculated for energy use and water consumption per tonne of production.

Emami

As per the website of this company the data is made available for the natural resources utilized for the fiscal year 2021-22

i. For one tonne production the energy consumption was 1,8971,793MJ/MT
ii. The water consumption for the production of one metric tonne was 1,51,211kilolitres.
iii. 1,30,143kilolitres was the quantity of effluent generation for producing one metric tonne consumer material.

Measurement

ESG measurement and rating is based on how well a company plans to take the risks. To be specific, these are non financial risks. A company's ESG score can be an internal process as well as external evaluation. Company's focus on ESG can result into better performance and when in the public domain, it is perceived better.

There are various companies associated to calculation of ESG. To state a few are-

MSCI

It calculates ESG by rule-based methodology. It rates the company on a scale of AAA to CCC based on the efficiency of a company to deal with the risk. AAA is the highest score gained by comparing various companies, with score of different countries or mutual funds etc.

3 pillars	10 themes	35 ESG key issues
Environment	Climate Change	Carbon Emissions, Product Carbon Footprint, Financing Environmental Impact, Climate Change Vulnerability
	Natural Capital	Water Stress, Biodiversity & Land Use, Raw Material Sourcing
	Pollution & Waste	Toxic Emissions & Waste, Packaging Material & Waste, Electronic Waste
	Environmental Opportunities	Opportunities in Clean Tech, Opportunities in Green Building, Opportunities in Renewable Energy
Social	Human Capital	Labor Management, Health & Safety, Human Capital Development, Supply Chain Labor Standards
	Product Liability	Product Safety & Quality, Chemical Safety, Consumer Financial Protection, Privacy & Data Security, Responsible Investment, Health & Demographic Risk
	Stakeholder Opposition	Controversial Sourcing, Community Relations
	Social Opportunities	Access to Communications, Access to Finance, Access to Health Care, Opportunities in Nutrition & Health
Governance	Corporate Governance	Ownership & Control, Board, Pay, Accounting
	Corporate Behavior	Business Ethics, Tax Transparency

Framework for Setting key issue weights

Expected Time frame for Risk/Opportunity to Materialize		
	Short-Term (<2yrs)	Long-Term (5+ years)

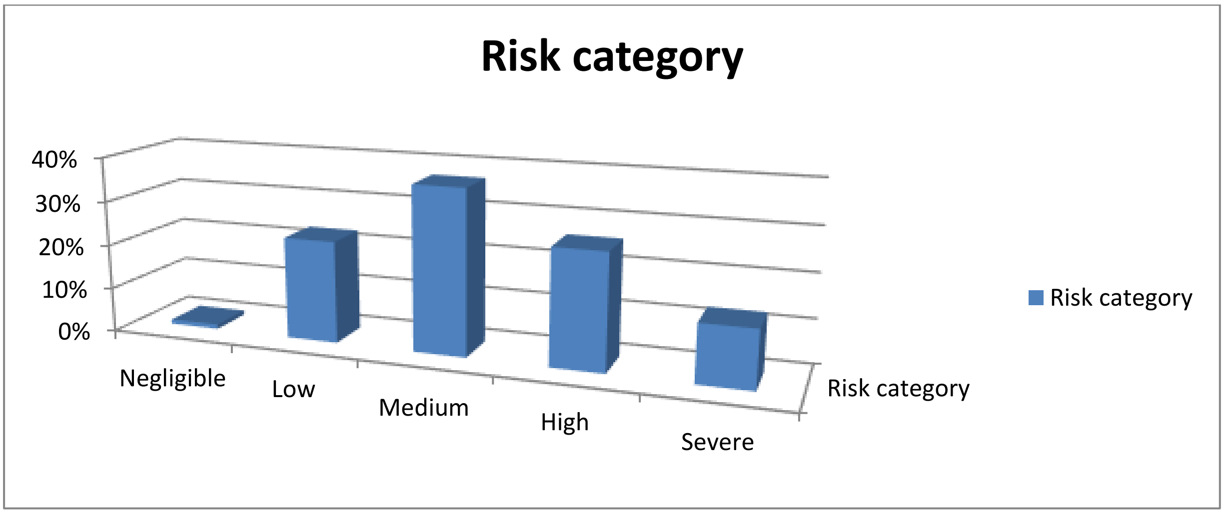
Level of Contribution to Environmental or Social Impact	Industry is <u>major</u> contributor to impact	Highest weight
	Industry is <u>minor</u> contributor to impact	Lowest weight

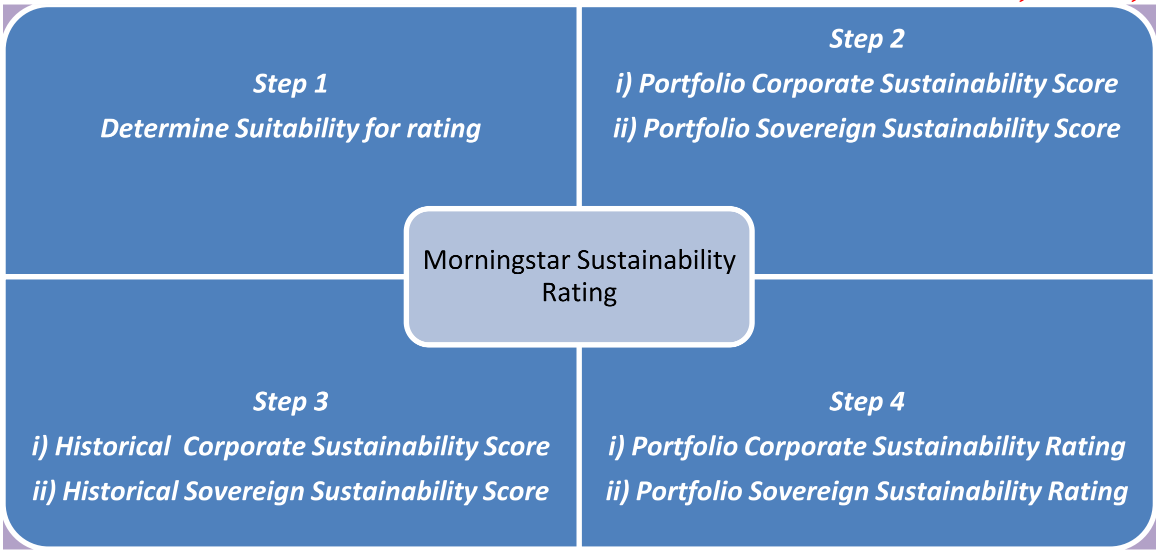
Mapping the Industry Adjusted Company Score to Letter Ratings[17]

Letter rating	**Leader/laggard**	**Final industry- adjusted company score**
AAA	LEADER	8.571-10
AA	LEADER	7.143-8.571
A	AVERAGE	5.714-7.143
BBB	AVERAGE	4.286-5.714
BB	AVERAGE	2.857-4.286
B	LAGGARD	1.429-2.857
CCC	LAGGARD	0.0-1.429

<u>*ROBECO*</u> – Robeco has come up with a 'smart esg' methodology. It discards the traditional view of calculating esg scores. It came up with a new concept because it believes that the old methods can be bias or may not even set in the modern era. It takes into consideration the past evidence of sustainable approach of the company and which indicator of sustainability has had an impact on financial growth.

Morningstar Sustainalytics- It calculates ESG risk ratings by a 5-step process. It first finds qualified holdings (i.e. funds which are potentially exposed to ESG risk). Then a portfolio corporate sustainability score is calculated. The 3rd step is to calculate the Historical Corporate Sustainability Score. In the 4th step Portfolio Corporate sustainability rating is done on the basis of corporate sustainability score. In the 5th and final step the scores are converted into percentage scores and ratings are hence identified.





Morningstar Sustainability Rating= (Corporate Sustainability Rating) + Corporate Contribution Percent) + (Sovereign Sustainability Rating+ Sovereign Contribution Percent)

Bloomberg's ESG– Bloomberg's ESG measurement takes into consideration Air quality, climate change, water and energy management, health and safety, audit risk and oversight, compensation, diversity, board independence, structure and tenure and shareholder's rights.[18]

Thompson Reuters- They have various categories under the three pillars of ESG. Under the environmental pillar they check Resource use, Emissions, Innovation. Under Social norms they check- Workforce, Human rights, Community development, Production Responsibility. And under Governance pillar – Management, Shareholders and CSR Strategy are taken into consideration. They have a formula to calculate the score of the companies by indicators stated above.[19]

10 categories

Pillars	**Category**	**Indicators in scoring**	**Weights**
Environment	Resource use	20	11%
	Emissions	22	12%
	Innovations	19	11%
Social	Workforce	29	16%
	Human Rights	8	4.50%
	Community	14	8%
	Product Responsibility	12	7%
Governance	Management	34	19%
	Shareholders	12	7%
	CSR Strategy	8	4.5%
	Total	178	100%

Calculation Methodology

Score= (No. of companies with a worst score + no. of companies with the same value /2)/ no. of companies with a value

ESG risk rating of few FMCG companies-

FMCG Company	ESG Risk	Risk Category	Rank in the Industry
Nestle	29.3	Medium	144/579
Britannia	26.7	Medium	90/579
HUL	25.8	Medium	90/100
ITC	27.9	Medium	111/579
Dabur India	31.46	High	59/103
Godrej	26.9	Medium	33/103
Emami	29.2	Medium	45/103

Source: Morningstar sustainalytics (Last updated on June 4,2022).

Conclusion

Every country today is worried about environment and to at least preserve what is left. Saving environment is not a day's job. Hence every company must plan consistently. Environmental pollution can be prevented and we all must take a step towards building a healthier place to live in. Abiding by the norms of ESG makes it easier to move towards a better tomorrow.

Greener society is not enough but a healthier approach is far more important. Following social norms and building a society with trust and happiness is what is required by the world today. If we contribute our bit to the society, a larger is contributed altogether. Every company by giving their best and to deliver at least what is taken helps a lot in growth of the society and the economy at large.

Importance of ESG cannot be ignored in this whole wide world of sustainable growth. Every sensible person or investor is keen to know about the esg factor of the company, he is interested in and would invest only where companies show sustainable growth and the future appears to be equally better.

ESG is the new norm to green stocks.

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