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Brahmapuram Landfill Fire

Points towards the Need for Decentralized Waste Management

TERRA YOUTH

Stop Food Waste Day

IN CONVERSATION

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SPECIAL HIGHLIGHTS

The Aluminium-Air Battery
Bite into a Peach

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Sustainability Version 2.0

Revisiting ESG

In light of recent changes and AI-augmented awareness of society, the ESG-oriented approach has an indispensable role to play in its applied linkage to sustainability revisited in the contemporary version. As per India Finance Corporation's definition, sustainability is an approach that ensures long-term business success along with socioeconomic development and a healthy environment. Keep reading to know more…

The ESG framework, in general, operates through three buckets, that is, Environmental, Social, and Governance, each of which is measured by metrics. The environmental bucket typically includes parameters related to the state of the environment, climate, and natural ecosystems. The social bucket includes parameters that look at the relationship of the business with various stakeholders. The governance bucket covers parameters related to fair conduct and accountability of the business. While each bucket has several parameters under them, their importance would vary from sector to sector, and company to company.

Alternatively, a holistic approach to achieve this sustainability lies in the identification of non-financial risks and opportunities with respect to issues related to Environmental, Social, and Governance, respectively. Gone are the days when ESG used to find its relevance only in terms of qualitative mapping of activities under green/sustainability space by most organizations. Especially, on E parameter of ESG that connects it to the applied sustainability landscape is 'Sustainalytics'. This is one of the most popular themes that contain the aim of decarbonization to reach net-zero goals ultimately. Internationally, ESG themes are picking up, such as clean energy, e-mobility, gender, diversity and inclusion, business and human rights, and sustainable supply chains.

Initially, ESG used to be considered a qualitative practice with lesser significance than its quantitative counterpart. However, an ESG-oriented sustainability approach needs to be precise in terms of specific issues to examine under the Environmental, Social, and Governance perspective, typically categorizing them as high risk, medium risk, and low risk. It needs to be measurable in terms of quantitative and semi-quantitative parameters on qualitative data to which scoring can be allotted. Also, it needs to be holistic and integrated, covering financial and non-financial variables that may impact business performance. ESG integration refers to the inclusion of qualitative and quantitative information on ESG-related issues into financial analysis and business value drivers, to gauge their impact on the company's financial performance.

Broadly, ESG integration across activities involves two things. One is to

incorporate ESG issues into the financial institution's own risk management, governance, disclosure, business strategy, branch network, training, capacity building, and updation of data systems such that it leverages KYC and due diligence processes to collect more information on ESG issues. The second is to assess the underlying counterparty's business value drivers such as competitive position, growth prospects, ability to sustain in the long run, and financial condition so that the resultant financial analysis on the counterparty reflects the impact of non-financial risks and opportunities.

Only such an ESG-oriented approach can tangibly assist investment and lending decisions for a bank or any financial institution. To gauge which are the most critical parameters for a bank within an ESG-oriented approach, the materiality mapping exercise is a good place to start. Materiality mapping would typically form part of any bank's sustainability disclosure activity as well. This exercise identifies the key issues affecting a bank, as per their importance to stakeholders and the business. However, while an approach that considers ESG issues in lending and investing decisions can improve the company's long-term social license to operate, there are several challenges to mainstream ESG adoption. For example, there remains a lack of a uniform definition of what is green, or sustainable.

What is ESG for one may vary for another, and this heterogeneity in the absence of specific regulations may lead to inadvertent greenwashing, as everyone makes varying interpretations of the ESG framework. This uplifts the lack of regulations as another related challenge. Nonetheless, corporates have started realizing the ESG approach amidst consideration of issues in lending and investing decisions that could improve the company's long-term social license to operate. Much said and done, several challenges still exist to mainstream ESG adoption.

To conclude, the consideration of ESG issues within lending decisions is still evolving and varies from institution to institution, and this framework only serves as a rough guide. ESG and climate change are not just about the risks that they pose; rather, it is also about the new opportunities they offer. For business-as-usual (BAU) scenarios, opportunities are changing, and hence, it is extremely important that corporates and financial institutions remain agile and tap these ensuing opportunities to build a first-mover advantage over competitors. Nevertheless, with the growing awareness of regulators, investors, and customers on these issues, financial institutions that do not start factoring ESG within their decisions may face higher credit risks and unfavorable terms of funding. ■

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