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ANALYSING THE ROLE OF ESG IN MITIGATION OF BUSINESS RISKS

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ANALYSING THE ROLE OF ESG IN MITIGATION OF BUSINESS RISKS

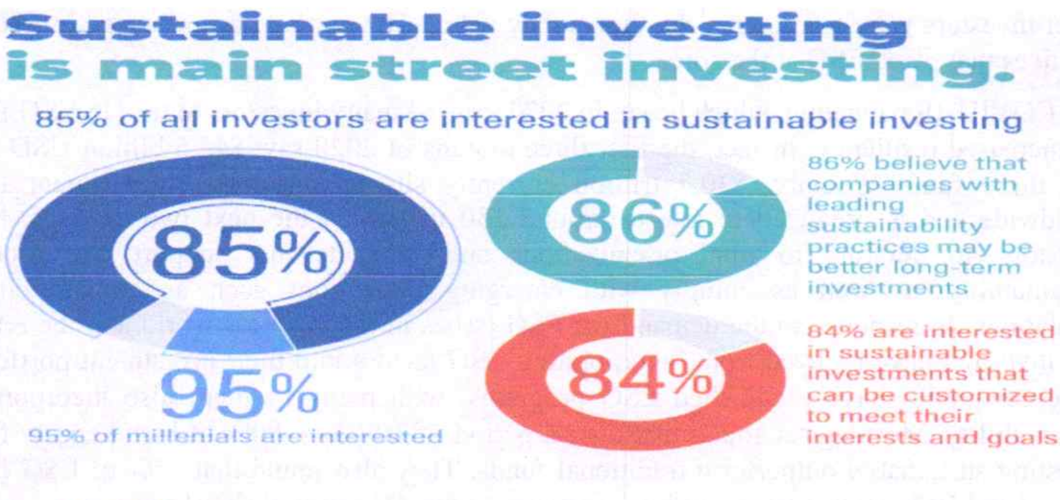
[1]Ruby Ghosh

Introduction

What Is ESG?

ESG (Environmental, Social, and Governance) policy refers to a company's behavior that takes into account its impact on the environment, employees, customers and communities. It is used by socially conscious investors to screen potential investments and measure a company's capability to grow and sustain in the future. Environmental criteria consider how the company safeguards the environment including corporate policies addressing climate change. Social criteria examines how it manages relationships with employees, suppliers, customers and communities where it operates. Governance deals with a company's leadership pay audits internal controls shareholder rights.

Why is ESG important?



Source: Morgan Stanley

Investors favour the term ESG over sustainability, as it removes ambiguity. As such, ESG is a preferred term for investors. Larger discussions in business began with sustainability, but have since evolved to include ESG performance and accountability. ESG data helps identify risk-adjusted returns and highlights relevance to capital opportunities. ESG topics are interlinked and draw attention to the multifaceted risks of social, technological, political, environmental, and economic business aspects. Companies are using the ESG criteria to mitigate business risk and prepare for the future

What is ESG Investing?

The term ESG investing refers to a particular type of investing that prioritizes optimal environmental, social and governance factors or outcomes. ESG investing is widely seen as a way of investing "sustainably," where investments are made with consideration for the environment and human wellbeing, as well as the economy.

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Objectives of the study

This research provides insight into how ESG policy can transform businesses, increase external investments and promote sustainability. Leaders from various industries, investors, government officials, employees, entrepreneurs, environmentalists, academicians and students can benefit from the research because it will unleash massive potential for sustainable business growth and employment opportunities in ESG strategy implementation and reporting.

Research Methodology

This research draws on industry experts and various reliable data sources provided in the reference section. Derived statistical data has been transformed, structured and analyzed to add contextual value and reasoning, enabling actionable insights and recommendations to be made. The ESG-based use cases were developed using domain knowledge, as well as best practices from industries with an established ESG strategy. Specific ESG use cases have been explained in detail for adding contextual value to this research.

Data Analysis

Multiple reports and published data reveal that professional and "main street" investors want to align their investments with critical ESG criteria to achieve long-term returns, while main street investors want to preserve the things they value. The market has embraced investment practices that place ESG at the core.

The COVID-19 pandemic, which began in 2020, caused many investors to turn to ESG funds for increased resiliency. In fact, the first three months of 2020 saw $45.6 billion USD flow into these funds globally. $30.7 trillion currently sits in sustainable investment funds worldwide and is predicted to rise to around $50 trillion in the next two decades. More investors are looking to fund organizations and products that support and promote sustainability, as well as comply with emerging regulations such as climate change regulations. In response to the demand for ESG issues in the business world and the returns that investors have realized from incorporating ESG factors into their investment portfolios, more companies have established ESG programs, with many of them also incorporating sustainability. Morningstar found that over a period of 10 years, 80% of blend equity funds investing sustainably outperform traditional funds. They also found that 77% of ESG funds that existed 10 years ago have survived, compared with 46% of traditional funds.

The recent increase in the number of investors interested in environmental, social and governance (ESG) issues is due to a number of factors. As supply chains become more complex, there is a wider awareness of social, labor and human rights issues for business leaders. Climate change concerns also influence investor decisions. Young people and women are becoming more engaged in traditional investing practices and therefore are more likely to consider ESG risks when assessing investment opportunities. Organizations must adopt forward-looking strategies if they want to remain competitive within their industry and contribute to the common good.

As the world's largest emitters of greenhouse gases, companies in the oil and gas industry are subject to increasing pressure from stakeholders, investors, and concerned citizens alike. Legal obligations are also expected to progressively tighten for these industries. In May 2021, a Dutch court ruled that Royal Dutch Shell cut greenhouse gas emissions by 45% by 2030. In the same week, ExxonMobil and Chevron faced pressure from their shareholders to reduce the companies' contributions to climate change. It is likely these events will spark further transformations within these industries.

What topics fall under ESG and how can companies work on them?

ESG issues cover a variety of topics that are applicable to all industries and organizations in one way or another. While the avoidance of "sin stocks" was traditionally considered central to investing ethically, ESG investing entails a broader scope of issues, including:

Environmental

- Climate change
- Greenhouse gas (GHG) emissions
- Resource depletion
- Waste and pollution
- Water and energy efficiency
- Deforestation
- Biodiversity

Social

- Working conditions
- Equal opportunities
- Human rights
- Employee diversity
- Health and safety
- Child labor and slavery
- Community engagement
- Philanthropy

Governance

- Business ethics
- Executive pay
- Board diversity and structure
- Bribery and corruption
- Political lobbying and donations
- Tax strategy
- Compliance

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Now as we know the impact areas for improving our overall ESG scores, let us deep dive on the specific use cases that can be adopted by businesses to fair well in ESG reporting

Use cases for improving Environmental Reporting Score:

1. The demand for energy in industrial buildings is expected to grow by more than any other sector over the next decade. This is due to an increase in both established and emerging industrial sectors, advances in robotics and automation systems that require more power than traditional operations, and an increased demand for fleet electrification and charging infrastructure. Use of renewable energy and electric-vehicle infrastructure—something that every warehouse will need as the freight sector shifts to electric and adopting an industrial-specific green-building certification program would help improve environmental reporting score by reducing emissions and use of less fossil fuels.

Use cases for improving Social Reporting Score:

1. As a result of the pandemic, employee dissatisfaction has risen and complaints from agitated workers have increased. This situation has been caused by company downsizings, pay cuts due to COVID-19 related reductions in pay packages and inflationary pressures. One way to ease this tension may lie in a very basic

approach—efforts by management to listen to employee feedback or gauge morale. But finding better ways to monitor workforce morale could provide an initial way to address rising dissatisfaction and thereby help in improving Social reporting scores.

Use cases for improving Governance Reporting Score:

1. We observed a correlation between the presence of female directors and strong talent-management practices, as well as higher growth in employee productivity. In 2023, we'll be watching whether the APAC region's regulatory efforts to increase the presence of women on boards also manifests in improvement of companies' human capital management. On average, companies with at least one female director had higher human-capital management performance than those without any female director. So companies need to rethink on their existing hiring and leadership development policy and maintain a balance of diversity in all leadership positions, thereby have a great positive impact on their Governance reporting score.

Conclusion

In light of the long-term benefits of sustainable investing, institutional asset owners, among the most sophisticated investment management professionals, view investing using ESG metrics as "a core element of investing". Numerous studies point to the long-term benefits of sustainable investing and makes it important for businesses to adopt to changing needs of investors and lay down the foundation of Environmental, Social and Governance strategy, programs and reporting framework.

Recommendations

1. There are several different tools available to measure or report on ESG performance. Some of the most popular include CDP, the Global Reporting Initiative (GRI), the Task Force on Climate-related Financial Disclosures (TCFD), and EcoVadis. These groups help companies measure and report on performance in a range of areas including governance, climate-related risks and opportunities, emissions, resource management, procurement and engagement strategy among others.
2. Investors can use several different indices to determine a company's sustainability performance. The Dow Jones Sustainability Index (DJSI), Morgan Stanley Capital International (MSCI), FTSE4Good, and ISS ESG solutions are examples of these indices. These platforms tend to be investor-oriented, providing succinct metrics about a company's financial performance.
3. However, many organizations can choose from a variety of ESG reporting standards. It is up to each organization to assess which best suit their goals and investor preferences in order to optimize their ESG reporting.

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