ESG INVESTING

EXEMPLARS OF ESG PERFORMANCE MAY STILL REMAIN BEREFT OF ESG FUNDING BECAUSE ONE OR MORE OF THEIR BUSINESSES FALL IN "EXCLUSION LISTS"

Relook ESG measuring for a more balanced approach

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Views are personal

THE VAST MAJORITY of economic activity undertaken by humans usually ends up causing some damage to the environment. Even agriculture can potentially damage the environment if it is undertaken with excessive exploitation of water resources including groundwater, usage of harmful chemicals, overuse of fertilisers, pesticides that affect soil and water, or even with burning of stubble. It is, therefore, natural for industrialisation to cause some environmental damage. However, curtailing economic activity or discouraging industries is not a practical solution unless humans renounce everything and go back to the era of cave-dwelling.

The practical way out is for businesses to be environmentally conscious by negating the damage with environmentally-positive and socially-responsible initiatives. Businesses are being held accountable to their ecosystem that includes shareholders, investors, customers, employees from an Environmental, Social and Governance (ESG) standpoint. ESG is a form of investing that measures the impact of a company's ethical contribution to its stakeholders—the environment, society and ethical governance—and enables one to reimagine and responsibly carry out business-activity more innovatively by being conscious about the planet, people and shared prosperity.

ESG owes its origins to then UN Secretary General Kofi Annan's letter in 2004 wherein he had written to over 50 heads of large global financial institutions with the aim of exploring ways to integrate ESG into capital markets. In 2005, a report aptly titled "Who Cares Wins", built the foundations for ensuring ESG is embedded into capital markets along with the UNEP/FI's Freshfield Report. This laid the ground for the Principles for Responsible Investment at the NYSE in 2006, and, today, close to $3 trillion have been invested in funds with ESG focus. Initiatives such as the United Nations Principles for Responsible Investment, Paris Agreement are steps in this direction. In May 2021, SEBI also issued a circular implementing new sustainability-related reporting requirements for the top 1,000 listed companies by market capitalisation. While the technology sector today gains the most from ESG funding, thanks to its environment-friendly image, it is also indirectly dependent on mining and power, thanks to the amount of natural resources that go into manufacturing electronic gadgets used by the sector like aluminium, copper, steel, lithium, carbon, nickel, gold, platinum, cobalt or power generation through coal, uranium, thorium, etc.

The ESG exclusion list for many investment firms include arms, tobacco, palm oil, fossil fuels, military contracting, nuclear power, alcohol, adult entertainment, cannabis, gambling, etc. The most affected are conglomerates that may have the gold- or even platinum-standard ESG practices, but are excluded as one of their businesses may be in the exclusion list.

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To understand this paradox let us take the example of ITC, a conglomerate with tobacco as one of its businesses, but with exemplary ESG practices. It is today benchmarked globally for its sustainability programmes, and despite a growing manufacturing footprint, over 40% of its energy consumption is from renewable sources. It also has 33 Platinum-certified green buildings, including several iconic hotel properties and also the world's first certified data centre. The current chairman, Sanjiv Puri, is further powering this green agenda with a Sustainability 2.0 vision and raising the bar. There are examples of other organisations in industries such as mining and metals—like Vedanta SESA Goa that has created benchmarks in converting mines that have completed their life cycle into arable land, biodiversity parks and community training centres. Vedanta's aluminium business recently became the largest purchaser of green energy, furthering India's clean energy adoption.

All these efforts are testament that industry is working towards being sustainable and responsible. However, there is growing fear that the current focus on ESG is getting dangerously narrow, and despite investors wanting to invest in companies that have adopted great practices, one of their lines of business may be perceived as an exclusion item. The casualty is ESG investments when these companies are made to look unworthy when such companies should be the ones that should be encouraged further. ESG analysts exploit the fact that standardisation in ESG measuring hasn't evolved yet; therefore, investors could be at risk of being misinformed. ESG measuring, in the current practice, often fails to provide insight into complex underlying processes at companies such as ITC.

ESG funds are increasingly being questioned by even the US SEC for their potential to mislead investors. The current performance of global ESG funds are heavily dependent on tech stocks, many of which have been under fire for their 'social performance' given the privacy violations. A policy of exclusion, selective choosing of stocks as 'best in class' despite not being ESG-compliant in spirit is marring the original intention of rewarding companies with good ESG practices. It is time to relook at these metrics and ensure that ESG investors are not deprived of better returns due to a faulty and subjective 'moral' positioning over actual financial performance and risk investors of being misinformed.