MAINSTREAMING ESG AND ROLE OF THE BOARD

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ABSTRACT

*Societal challenges like widespread poverty, inequality, climate and risks posed by threats like the ongoing COVID-19 pandemic, has forced us to revisit the traditional models of conducting business. Environmental, Social and Governance ("**ESG**") framework for decision making and reporting by businesses is one such approach that looks beyond profits and shareholders to create value for other stakeholders. It covers a range of non-financial issues which are now considered critical, especially by the investors while making their investment decisions. The current ESG paradigm is the culmination of different movements in the history focusing on different aspects of Corporate Governance. Though the role of regulatory framework, institutional investors and other external drivers plays a major role in imbibing ESG into the functioning of business in any jurisdiction, the real push can come only from the internal drivers which include the leadership (board of directors, KMPs) and the culture in the organization. The regulatory framework in India has also responded to the need of ESG adoption by introducing Business Responsibility and Sustainability Reporting ("**BRSR**") for top 1000 companies. The paper has presented an overview of the evolution of ESG and the regulatory framework in India and the role of boards in ESG integration.*

Keywords: Corporate Governance**,** Sustainability, ESG, BRSR, non-financial reporting.

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I. BACKGROUND

Environmental, Social and Governance ("**ESG**") norms are a set of standards for a company's operations that are being largely looked into by various stakeholders to ascertain sustainable business practices. It is a review of the social, economic and environmental impact of everyday business operations of the company. Apart from looking at the conventional financial indicators, the focus has now shifted towards how a company contributes to various environmental issues, manage its relationships with the communities and various stakeholders and adhere to various business standards in its operations. ESG has emerged as one of the top themes of discussion in the board rooms.[1,2] The concept of ESG has evolved over the years with the evolution of corporations and various aspects of their governance.

The concept of corporate governance is as old as the corporations themselves and can be traced back to the era of the 16th and 17th centuries when major chartered companies like East India Company, Hudson's Bay Company, Levant Company etc., came into existence. However, the term 'corporate governance' came to the fore only in the 1970s in the US and is largely used to define the functioning and balance of power between the board, executives and shareholders.[3] It also includes the pattern of relationship with employees, customers, communities and other stakeholders to form the strategy of the company. This has been defined as the behavioural side of corporate governance. The normative side of

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[1] Kristen Sullivan et al., *The Role of the Board in Overseeing ESG: Projections on Emerging Board Matters,* GOVERNANCE OUTLOOK FOR NAT'L ASS'N CORP. DIRECTORS (2022).

[2] Jeff Swinoga & Thibaut Millet, *Why ESG is climbing the boardroom agenda,* GOLDHUB INSIGHTS (Jan. 23, 2020), https://www.gold.org/goldhub/gold-focus/2020/01/why-esg-climbing-boardroom-agenda.

[3] Brian R. Cheffins, The History of Corporate Governance (U. Cambridge & ECGI Working Paper Series in L., Working paper no. 184, 2012), http://ssrn.com/abstract=1975404 [hereinafter, BR Cheffins].

corporate governance includes a set of rules that may include various corporate laws, securities regulation, disclosures, listing requirements, self-regulatory mechanisms etc.[4]

A. WAVE ONE: GOVERNANCE IN FOCUS

After World War II, corporations in the US grew rapidly and in this era of corporate prosperity, internal governance of the companies was not a top priority. It was only in the 1970s when certain companies were found making illicit payments to foreign officials, the federal Securities and Exchange Commission ("**SEC**") brought corporate governance into the official reform agenda.[5] The concept became a hot topic among academicians, practitioners and policymakers and there were numerous other developments that took place during this time. In 1978, the Business Roundtable, a group established in 1974 to represent the views of CEOs of major corporations, issued a statement on "The Role and Composition of Directors of the Large Publicly Owned Corporation" focusing on independence of the board and transparency in decision making. After a prolonged debate and deliberations, The American Law Institute ("**ALI**") published *Principles of Corporate Governance: Analysis and Recommendations* in 1992. The attention started shifting outside the US in the 1990s as US companies started getting competition from Japanese and German companies. This led to the comparison of corporate governance systems across the countries. This was also the time when Britain included corporate governance in its agenda, and in 1991 set up the Committee on the Financial Aspects of Corporate Governance under the Chairmanship of Sir Adrian Cadbury (known as the Cadbury Committee). The Committee developed a 'code of best practice' and recommended guidelines to improve corporate governance. The Cadbury Code served as a model for other countries to develop their own corporate governance code. The demand for a strong

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[4] Stiplon Nestor, *International Efforts to Improve Corporate Governance: Why and How*, OECD (2001), https://www.oecd.org/corporate/ca/corporategovernanceprinciples/1932028.pdf.

[5] BR Cheffins, *supra* note 3.

corporate governance structure was also backed by various instances of corporate governance controversies across the globe.[6]

OECD set up a task force on corporate governance in 1998 and after its recommendations; the OECD Principles of Corporate Governance were adopted in 1999. The last revision of the principles was undertaken in 2015.[7]

In India, the focus on corporate governance gained momentum after the opening up of the economy for the private players in the 1990s. The first major institutional initiative towards corporate governance was taken by the Confederation of Indian Industry ("**CII**") in 1996 with an aim to develop a code for the companies. There were numerous initiatives by the Ministry of Corporate Affairs and SEBI to bring corporate governance in the country at par with international standards; setting up of Kumar Mangalam Birla Committee (2000), Naresh Chandra Committee (2002), Narayana Murthy Committee (2003) with the mandate to improve corporate governance in the country are few examples.

Hence 'Governance' was the first broad pillar of ESG to evolve, get consolidated with uniformity in standards across the globe. However, the regulatory frameworks that include various principles, rules, laws and guidelines, would need continuous revision to address various emerging issues in this domain.

B. WAVE TWO: SHIFT OF FOCUS ON SOCIAL RESPONSIBILITY AND STAKEHOLDER ENGAGEMENT

The modern concept of social responsibility started emerging in the 1950s and 1960s. The earliest definition of corporate social responsibility came from Bowen in 1953, who defined it as "the obligations of businessmen to pursue those policies, to make those decisions, or to follow those lines of action which are desirable in terms of the objectives and

[6] *Id.*

[7] OECD, G20/OECD Principles of Corporate Governance, OECD Publishing (Paris 2015) http://dx.doi.org/10.1787/9789264236882-en.

values of our society."[8] In subsequent years, other researchers kept raising their concerns on corporate behaviour towards various societal issues of the time. On the regulatory front, USA made some major advances in the 1970s that includes the creation of the Environmental Protection Agency ("**EPA**"), the Consumer Product Safety Commission ("**CPSC**"), the Equal Employment Opportunity Commission ("**EEOC**") and the Occupational Safety and Health Administration ("**OSHA**"). The publication of *A New Rationale for Corporate Social Policy* by the Committee for Economic Development ("**CED**"), USA, in 1971 pointed towards a broader role of business in society. The first cohesive definition of Corporate Social Responsibility was proposed by Carroll in 1979, according to which "the social responsibility of business encompasses the economic, legal, ethical, and discretionary expectations that society has of organizations at a given point in time"[9]. There was a growing concern towards the environment in the 1980s and 1990s and a number of international bodies were established (see next section on environment), showing the heightened concern towards sustainable development and indirectly pointing towards corporate behaviour.[10]

The institutionalization of CSR gained traction after the famous speech of the Secretary-General of the United Nations, Kofi Annan in 1999, exhorting business leaders to 'give human face to global market'. This led to the formation of the United Nations Global Compact ("**UNGC**") in 2000, which was a call to the companies to align their strategies and operation with universal principles on human rights and work towards societal goals. The ten principles of UNGC brought global attention towards corporate responsibility. The European approach to CSR was

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[8] Doug Caulkins, *President Howard Bowens & Corporate Social Responsibility*, GRINELL C. NEWSL. (Dec. 20, 2013), https://www.grinnell.edu/news/president-howard-bowen-corporate-social-responsibility#:~:text=By%20social%20responsibility%20of%20businessmen,and%20values%20of%20our%20society.%E2%80%9D.

[9] Archie B Carroll, *Carroll's pyramid of CSR: taking another look*, 1 INT'L J. CORP. SOC. RESP. 3 (2016), https://doi.org/10.1186/s40991-016-0004-6.

[10] MA Latapi Agudelo et al., *A literature review of the history and evolution of corporate social responsibility*, 4 INT'L J. CORP. SOC. RESP. 1 (2019).

presented in 2001 in the Green Paper '*Promoting a European framework for Corporate Social Responsibility*'. This was followed by a series of other initiatives by the EU to further strengthen the CSR ecosystem.[11]

The last decade has seen various jurisdictions formulating explicit CSR laws, which were till now assumed as voluntary initiatives. For example, corporate laws in the UK, China and Indonesia have made explicit provisions in their legislation for companies to undertake social responsibilities.[12] India has gone a step further and has made it mandatory for certain companies to spend 2 percent of their annual profits on CSR activities specified by the Companies Act, 2013.

C. WAVE THREE: BRINGING SUSTAINABILITY AND ENVIRONMENT IN FOCUS

The industrial development over the years has impacted the environment and led to serious problems like increased pollution, depletion of natural resources, loss of biodiversity and climate change, which in return have now started affecting businesses as well. As a result, the focus on corporate sustainability has gained momentum in recent times.

Historically, the industrialized countries (USA, Canada, Australia, Japan), in the 1970s and 1980s adopted Environmental Impact Assessment ("**EIA**") for various projects. The tool became a part of policy recommendations of key bodies like OECD (1979), UNEP (1987), World Bank (1989).

The Chernobyl nuclear disaster in 1986 was one of the first major events that brought focus on the role of business in environmental degradation. This was followed by the publication of the Brundtland Commission report titled *Our Common Future* (1987), which defined

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[11] *Id.*

[12] Li-Wen Lin, *Mandatory Corporate Social Responsibility Legislation around the World: Emergent Varieties and National Experiences,* OXFORD BUSINESS LAW BLOG (Nov. 18, 2020), https://www.law.ox.ac.uk/business-law-blog/blog/2020/11/mandatory-corporate-social-responsibility-legislation-around-world.

sustainable development for the first time as "development that meets the needs of the present without compromising the ability of future generations to meet their own needs". The creation of the Intergovernmental Panel on Climate Change ("**IPCC**") (1988), Rio Earth Summit and United Nations Framework Convention on Climate Change ("**UNFCCC**") (1992), adoption of the Kyoto Protocol (1997) were some of the key developments that institutionalized the issue of environment and climate change and businesses' focus on the planet.

D. CONVERGENCE: CONNECTING THE DOTS AND EVOLUTION OF ESG

And finally, we witnessed the consolidation of the three – environmental, social and governance and constructive interference of the waves that have impacted the theory and practice of corporate governance across the globe. The theory of Triple Bottom Line ("**TBL**") which came in 1994, emphasized that companies should focus as much on social and environmental concerns as they do on profits. In 2004, the concept of ESG emerged when the UN Secretary-General Kofi Annan invited CEOs of major global financial institutions under the auspices of the UN Global Compact. The aim of this meeting was to integrate environmental, social and corporate governance philosophies into capital markets. The term ESG was coined a year later in 2005 in the conference report of this group titled 'Who Cares Wins'. Hence, the ESG agenda is largely driven by major global investors. They are using the ESG performance of the companies, assessed through various non-financial metrics, to make their investment decisions.

II. EMPIRICAL ANALYSIS OF CORPORATE GOVERNANCE, ESG AND BUSINESS PERFORMANCE

Studies have shown that corporate governance has a significant relationship with the financial performance of the companies and their market valuation. Gompers, Ishii and Metrick (2003) constructed a firm-level governance index ("**GIM Index**") for US-listed companies based on

24 governance provisions.[13] The study shows that companies with poor governance index scores had significantly lower valuations. These findings were further corroborated by another study by Bebchuk, Cohen and Ferrell (2004)[14] and Bhagat and Bolton (2008).[15] Similar results were also reported in the findings based on other jurisdictions; Bauer et al. (2004[16], 2008[17]) show that improved governance provisions on financial disclosure, shareholder rights, and remuneration have a positive impact on the stock price performance of European and Japanese companies, Kyere and Ausloos (2020),[18] in their study on listed UK firms shows that choosing right corporate governance mechanism can improve the finances of the companies and; Goel (2018)[19] shows improved financial performance of Indian companies in the initial phase of corporate governance reforms. Caixe and Krauter (2014),[20] found that the adoption of good corporate governance practices positively influenced the market value of Brazilian firms.

Studies have also shown that there is a significant relationship between corporate governance and risk management in companies (Tara and Sadri,

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[13] Paul A. Gompers et al., *Corporate Governance and Equity Prices*, 118 (1) Q. J. ECON., 107 (2003), https://ssrn.com/abstract=278920.

[14] Lucian A. Bebchuk et al., *What Matters in Corporate Governance?* 22 (2) REV. FIN. STUD., 783 (2009), https://ssrn.com/abstract=593423.

[15] Sanjai Bhagat & Brian Bolton*, Corporate governance and firm performance*, 14 J. CORP. FIN., 257 (2008).

[16] Rob Bauer et al., *Empirical evidence on corporate governance in Europe: The effect on stock returns, firm value and performance.*, 5 J. ASSET MGMT. 91 (2004).

[17] *Id.*

[18] Martin Kyere & Marcel Ausloos, *Corporate governance and firms' financial performance in the United Kingdom*, 26(2) INT'L J. FIN. & ECON. 1871 (2020); https://doi.org/10.1002/ijfe.1883.

[19] Puneeta Goel*, Implications of corporate governance on financial performance: an analytical review of governance and social reporting reforms in India*, 3 ASIAN J. SUSTAINABILITY & SOC. RESP. 4 (2018); https://doi.org/10.1186/s41180-018-0020-4.

[20] Daniel Ferreira Caixe & Elizabeth Krauter, *The Relation between corporate governance and market value: mitigating endogeneity Problems*, 11(1) BRAZILIAN BUS. REV., 90 (2014); https://doi.org/10.15728/bbr.2014.11.1.5.

2015[21], Gennaro and Michelle 2021[22]). Corporate scandals around the globe are largely attributed to poor corporate governance practices. The global financial crisis of 2008 is also a major example of poor corporate governance leading to failure in risk assessment by major financial institutions (UNCTAD, 2010[23]). Corporate governance is a major tool that can be used by companies for better risk management.

Corporate governance is also instrumental in building a positive reputation of the company among various stakeholders which gives a sustainable competitive advantage in terms of attracting and retaining good employees, customer loyalty, attracting investments etc. leading to improved business performance (Ljubojevic´ and Ljubojevic´ 2008[24], Widerman and Buxel 2005[25]).

The existence of a company is defined by its purpose; the ultimate goal of the business, the essential reason why it exists, and how it contributes to the common good (Joly 2021).[26] Mayer (2021) [27] states that companies need to redefine profits in today's world when they are more than ever dependent and also making an impact on intangible, human, natural and social assets along with physical and material assets. As a result, corporate governance

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[21] Sharukh Tara & Sorab Sadri, "*Corporate Governance and Risk Management: An Indian Perspective*, 1(9) INT'L J. MGMT. SCI. & BUS. ADMIN., 33 (2015).

[22] Alessandro Gennaro & Michelle Nietlispach, *Corporate Governance and Risk Management: Lessons (Not) Learnt from the Financial Crisis*, 4 J. RISK & FIN MGMT., 419 (2021); https://doi.org/10.3390/ jrfm14090419.

[23] U.N. Conference on Trade and Development, *Corporate Governance in the Wake of the Financial Crisis: Selected International Views*, U.N. Doc. UNCTAD/DIAE/ED/2010/2 (Oct. 2010), https://unctad.org/system/files/official-document/diaeed20102_en.pdf.

[24] Cedomir & Gordana Ljubojevic´, *Building Corporate Reputation through Corporate Governance*, 3 MANAGEMENT (BOSN. & HERZ.) 221 (2008), https://www.fm-kp.si/zalozba/ISSN/1854-4231/3_221-233.pdf.

[25] Klaus-Peter Wiederman & Holger Buxel, *Corporate reputation management in Germany: Results of an empirical study*, 8(2) CORP. REPUTATION REV. 145 (2005).

[26] Hubert Joly, *Creating a Meaningful Corporate Purpose*, HARV. BUS. REV. BLOG (Oct. 28, 2021), https://hbr.org/2021/10/creating-a-meaningful-corporate-purpose.

[27] Colin Mayer, The Governance of Corporate Purpose, (Eur. Corp. Governance Inst. (ECGI), Working Paper No. 609, 2021), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3928613.

has started shifting focus from shareholders to stakeholders; that include interests of employees, customers, suppliers, communities etc. for long term value creation (Price 2019[28], Bottenberg et al. 2016[29]).

The shift towards stakeholders led to the development of non-financial parameters, metrics and frameworks to capture the performance of companies in these areas. This resulted in the development of non-financial reporting, which has gained prominence in recent years. Europe has taken lead with its Non-Financial Reporting Directive and its 2018 Action Plan on Financing Sustainable Growth. Several reporting standards and frameworks have emerged to help companies report on sustainability and other non-financial themes; Global Reporting Initiative ("**GRI**"), International Integrated Reporting Council ("**IIRC**"), Sustainability Accounting Standards Board ("**SASB**"), The Task Force on Climate-related Financial Disclosures ("**TCFD**"), The Carbon Disclosure Project ("**CDP**").[30] At this stage when non-financial reporting is still voluntary in most jurisdictions and reporting structures are still under development, sound corporate governance practices in the companies will ensure the quality of non-financial reporting, which can be further used in shaping sustainable business strategies.

The impact of climate change on business has received increased attention in recent years. This has been brought into focus largely by the report of the Intergovernmental Panel on Climate Change ("**IPCC**") on global warming, the Paris Agreement and recommendations of the Task Force on Climate-Related Financial Disclosures ("**TCFD**") set up by the Financial Stability Board. In their study on US companies, Aggarwal and

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[28] Konstantin Bottenberg et al., *Corporate Governance Between Shareholder and Stakeholder Orientation: Lessons from Germany,* 26(2) J. MGMT. INQUIRY, 165 (2017).

[29] Nicholas J Price, *The Stakeholder Model of Corporate Governance*, DILIGENT CORP. INSIGHTS (Nov. 8, 2019) https://www.diligent.com/insights/shareholder-engagement/stakeholder-model-corporate-governance/.

[30] PUBLIC POLICY, GLOBAL REPORTING INITIATIVE, https://www.globalreporting.org/public-policy-partnerships/the-reporting-landscape/ (last visited May 13, 2022).

Dow (2011)[31] show the significant impact of corporate governance on corporate actions to mitigate adverse climate change and environmental impacts. The findings show that despite regulatory ambiguity, the market is penalizing large emitters, while at the same time rewarding firms for their mitigation efforts. Firms across the jurisdictions are facing pressure from various stakeholders; regulators, investors, NGOs, consumers and many have adopted various sustainable practices to bring down their emissions (Sullivan and Gouldson, 2017[32]).

Nowadays non-financial reporting is synonymous with reporting on ESG issues identified by the business and adopted in its operations. There are various studies that have shown a positive relationship between ESG adoption and corporate financial performance.[33] A meta-analysis carried out for more than 2000 empirical studies finds a strong relationship between ESG and corporate financial performance ("**CFP**") over time (Friede et al., 2015[34]). The findings are further substantiated by studies based on specific jurisdictions (Santis et al., 2016[35], Velte, 2017[36], Matos., 2020[37]). These findings make a strong economic case for the adoption of ESG into business operations.

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[31] Raj Aggarwal & Sandra Dow, *Corporate governance and business strategies for climate change and environmental mitigation*, 18(3-4) THE EUROPEAN J. FIN 311 (2012).
[32] Rory Sullivan & Andy Gouldson, *The Governance of Corporate Responses to Climate Change: An International Comparison*, 26(4) BUS. STRATEGY & ENV'T, 413 (2016).
[33] Witold Henisz et al., *Five ways that ESG creates value: Getting your ESG Propositions right links to higher valuation,* 2019 (4) MCKINSEY Q. (2019).
[34] Gunnar Friede et al., *ESG and financial performance: Aggregated evidence from more than 2000 empirical studies*, 5 J. SUSTAINABLE FIN & INV., 210 (2015).
[35] Paula Santis et al., *Do sustainable companies have a better financial performance? A study on Brazilian public companies*, 133 J. CLEANER PROD., 735 (2016).
[36] Patrick Velte, *Does ESG performance have an impact on financial performance? Evidence from Germany*, 8(2) J. GLOBAL RESP., 169 (2017).
[37] Pedro Matos, *ESG and Responsible Institutional Investing Around the World: A Critical Review,* CFA Institute Research Foundation Literature Reviews (2020), https://ssrn.com/abstract=3668998.

III. CONCEPTUAL UNDERPINNINGS

A. ROLE OF DIRECTORS IN THE REGULATORY FRAMEWORK

The role of directors in the boards has enhanced over time. In the case of India, the laws and rules have been revised and the role of directors has formed part of the evolving regulations in a more explicit manner.

1. Companies Act 2013:

The Companies Act 2013 makes it mandatory for every company to have a Board of Directors with specified composition. The Act also recognizes the concept of Independent Director which was earlier included only in the listing agreement, to bring more transparency into the board functioning. **Schedule IV** of the Act contains Code for Independent Directors which includes guidelines for professional conduct, provisions on role, duties, appointment, re-appointment, removal and evaluation of independent directors. One of the key roles of independent directors is to safeguard the interests of all stakeholders, particularly the minority shareholders. **Section 166** of the Act defines the duties and responsibilities of the directors which explicitly states that they must act in good faith and in a diligent manner to promote the objects of the company.[38] Mainstreaming ESG and the legal obligations of the directors are intertwined as professionals and experts are of the opinion that adopting measures on various ESG issues builds a strong brand image and creates long term value for the business (Forbes[39], McKinsey[40]). The Act also provides for penalties if the directors fail to discharge their duties as per the provisions. They are expected to keep the interest of the company and the shareholders ahead of their personal interests.

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[38] Companies Act, No. 18 of 2013, §166 (India).

[39] Bo Bothe, *Building Brand Integrity through ESG Reporing*, FORBES (Aug. 28, 2020) https://www.forbes.com/sites/forbesagencycouncil/2020/08/28/building-brand-integrity-through-esg-reporting/?sh=63c048e85369.

[40] Witold Henisz, et al., *Five ways that ESG creates value*, 2019 (4) MCKINSEY Q. (2019), https://www.mckinsey.com/business-functions/strategy-and-corporate-finance/our-insights/five-ways-that-esg-creates-value.

2. SEBI LODR:

Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015 ("**SEBI LODR**") also contains various provisions on responsibilities of directors of listed companies. The Regulations require all the Board members to act transparently and disclose all material information that can affect the listed entity. The Board of Directors are responsible to ensure high standards of corporate governance in the company and making necessary changes as needed. They must ensure that an appropriate system is in place for risk management and compliance with the law and various standards.[41]

There are various other laws and rules that cover various aspects of ESG but the provisions under the Companies Act 2013 and the SEBI LODR are the principal sources that explicitly lists the duties and responsibilities of directors, both individually and as part of the Board as a whole, to ensure that the decision-making process should keep in mind the long-term interest of the company and its stakeholders.

B. EVOLVING FRAMEWORKS AND STANDARDS PUSHING ESG AGENDA

The regulatory framework for responsible business in the country is shaped largely by the various legislations, guidelines and rules framed by the Ministry of Corporate Affairs and SEBI, the regulatory body for securities and commodity markets in India.

1. Corporate Social Responsibility Voluntary Guidelines, 2009

Though several laws, at Union and State, were formulated at different times covering various non-financial aspects of business, a more comprehensive approach to responsible business behaviour was first taken in 2009 when the Ministry of Corporate Affairs announced **Corporate**

[41] Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) (Fourth Amendment) Regulations, 2019, Gazette of India, pt. III, sec. 4 (July 29, 2019).

Social Responsibility Voluntary Guidelines. As the name suggests, these were voluntary and non-prescriptive in nature and encouraged businesses to develop a formal CSR policy with some core elements to fulfil society's expectations. As per the guidelines, the core elements of the CSR policy should include: 1. Care for all Stakeholders 2. Ethical functioning 3. Respect for Workers' Rights and Welfare 4. Respect for Human Rights 5. Respect for Environment 6. Activities for Social and Inclusive Development.[42]

2. **National Voluntary Guidelines on Social, Environmental and Economic Responsibilities of Businesses (NVGs), 2011**

Building on the CSR voluntary guidelines and further increasing the scope of responsible business behaviour, the Ministry of Corporate Affairs announced the National Voluntary Guidelines on Social, Environmental and Economic Responsibilities of Businesses ("**NVGs**") in 2011. The NVGs 9 principles state that Businesses should: 1. conduct and govern themselves with ethics, transparency and accountability. 2. provide goods and services that are safe and contribute to sustainability throughout their life cycle. 3. promote the wellbeing of all employees. 4. respect the interests of, and be responsive towards all stakeholders, especially those who are disadvantaged, vulnerable and marginalized. 5. respect and promote human rights 6. respect, protect, and make efforts to restore the environment 7. when engaged in influencing public and regulatory policy, should do so in a responsible manner. 8. support inclusive growth and equitable development. 9. engage with and provide value to their customers and consumers in a responsible manner.[43]

[42] MINISTRY CORP. AFF., GOV'T OF INDIA, CORPORATE SOCIAL RESPONSIBILITY VOLUNTARY GUIDELINES (2009), https://www.mca.gov.in/Ministry/latestnews/CSR_Voluntary_Guidelines_24dec2009.pdf.

[43] MINISTRY CORP. AFF., GOV'T OF INDIA, NATIONAL VOLUNTARY GUIDELINES ON SOCIAL, ENVIRONMENTAL & ECONOMIC RESPONSIBILITIES OF BUSINESS (2011), https://www.mca.gov.in/Ministry/latestnews/National_Voluntary_Guidelines_2011_12jul2011.pdf.

3. Business Responsibility Reports (BRR), 2011

Both CSR guidelines and NVGs were voluntary in nature, but played an important part in preparing businesses in terms of society's expectations from them and also what they can expect from the regulatory mechanism going further. SEBI issued a circular in 2011 making companies disclose their performance on the NVG principles through **Business Responsibility Reports** ("**BRR**"). This information was made part of the annual report of the company and was also to be submitted to Indian stock exchanges. Initially, the BRR was mandatory for the top 100 listed entities based on market capitalization in BSE and NSE. This was subsequently increased to the top 1000 entities. Non-adherence to BRR reporting is considered a violation of Clause 55 of the Equity Listing Agreement. Other listed companies may voluntarily include BRR as part of their Annual Reports. This was the earliest initiative in India to integrate ESG into the country's regulatory system and make it mandatory for companies to disclose their ESG performance.[44]

4. Integrated reporting by SEBI, 2017

After the introduction of non-financial disclosures under the BRR, the information available on the performance of a company increased significantly. Companies were reporting on their financial performance, CSR initiatives, sustainability initiatives and responsible business practices. However, this information was available in different documents - Annual report, BRR, Sustainability report etc. - in different formats. To overcome this problem and to develop integrated thinking in the decision-making process, SEBI, in 2017, asked top 500 companies to shift to Integrated Reporting structure, which was developed by the International Integrated Reporting Council, on a voluntary basis.[45] The council defines the objective

[44] MINISTRY OF FIN., GOV'T OF INDIA, (SEBI) BUSINESS RESPONSIBILITY REPORTS, https://www.sebi.gov.in/sebi_data/attachdocs/1344915990072.pdf.

[45] SEC. & EXCH. BD. INDIA, INTEGRATED REPOSTING BY LISTED ENTITIES, SEBI/HO/CFD/CMD/CIR/P/2017/10, (Feb. 6, 2017), https://www.sebi.gov.in/sebi_data/attachdocs/1486375066836.pdf.

of integrated reporting as to 'promote a more cohesive and efficient approach to corporate reporting that draws on different reporting strands and communicates the full range of factors that materially affect the ability of an organization to create value over time.'[46]

5. National Guidelines on Responsible Business Conduct (NGRBC), 2018

The NVGs released by the Ministry of Corporate Affairs, in 2011 was expected to provide guidance on responsible business conduct and the performance in this respect was captured through the BRR structure. However, there were some major developments in the following years including; The UN Guiding Principles for Business and Human Rights (2011), the Companies' Act 2013, UN Sustainable Development Goals (2015) and Paris Agreement on Climate Change (2015). In order to align the NVGs with these major developments, the revised updated guidelines known as the **National Guidelines on Responsible Business Conduct** ("**NGRBC**"), were released by the Ministry of Corporate Affairs in 2018.The revised principles address a range of issues including environmental safety, human rights, fair labour practices and business ethics.[47]

6. Business Responsibility and Sustainability Report (BRSR), 2021

After the introduction of the National Guidelines on Responsible Business Conduct ("**NGRBC**"), the Ministry of Corporate Affairs constituted Committee on Business Responsibility Reporting to revise the BRR format, to dovetail it with the revised guidelines. In May 2020, the committee developed and recommended **Business Responsibility and Sustainability Report ("BRSR")** format, to replace the BRR framework.

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[46] *Structure*, VALUE REPORTING FOUNDATION, https://www.integratedreporting.org/the-iirc-2/structure-of-the-iirc/ (last visited May 13, 2022).

[47] MINISTRY CORP. AFFAIRS, GOV'T OF IND., NATIONAL GUIDELINES ON RESPONSIBLE BUSINESS CONDUCT (2019), https://www.mca.gov.in/Ministry/pdf/NationalGuildeline_15032019.pdf.

The committee proposed two formats for disclosures, a comprehensive and a *lite* version. SEBI, through its circular in March 2021, made it mandatory for the top 1000 listed entities by market capitalization to make their disclosures as per the BRSR.[48] To start with, BRSR reporting would be on a voluntary basis for FY 2021-22 and will be mandatory from FY 2022-23. It is proposed to be extended to all listed companies in the next 5 years (Table 1).

Type of Organization	**Non-financial Disclosures under BRSR**
Top 1000 listed companies (by market cap)	• On a voluntary basis for FY 2021-22 • Mandatory from FY 2022-23 • Currently reporting under BRR
Other listed entities (small and mid-cap)	• Voluntary and encouraged to adopt BRSR *lite* • Proposed to be mandatory in 5 years
Non-listed companies/MSMEs	• Voluntary and encouraged to adopt BRSR *lite*

Table 1: Status of implementation of BRSR for non-financial disclosures by Indian Companies

The BRSR framework, which is a substantial improvement over the BRR, is considered as a significant step towards bringing non-financial reporting at par with financial reporting. The BRR framework, based on the NVGs, had a standard format to report on various initiatives taken by the companies for sustainable business practices. It was also felt that, though the disclosure of information under the framework was complete

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[48] SEC. & EXCH. BD. IND., CIRCULAR FOR BUSINESS RESPONSIBILITY AND SUSTAINABILITY REPORTING BY LISTED ENTITIES, SEBI/HO/CFD/CMD-2/P/CIR/2021/562.

but lacking in clarity and accuracy.[49] The BRSR, on the other hand, has a more holistic approach and would include both qualitative and quantitative information on metrics related to key ESG issues. This will help different stakeholders to compare the performance of companies based on various non-financial indicators and also provide deep insights into the business policies and processes. The information can also be used by asset managers and investors to screen the companies that fail to perform on important ESG metrics.

ESG pillars	**Disclosure Requirement under BRSR**	**NGRBC Principles**
General	• An overview of the company's material ESG risks and opportunities and approach to mitigate or adapt to the risks, together with relevant financial implications • Sustainability related goals and targets and related performance • Management structures,	General management and process disclosures

[49] *Business Responsibility and Sustainability Report: An Attempt to mainstream ESG* (2021), PRICE WATER HOUSE COOPER, https://www.pwc.in/assets/pdfs/consulting/esg/business-responsibility-and-sustainability-report.pdf.

	policies and processes related to sustainability	
Environment	• Resource usage (energy and water) and intensity metrics • Air pollutant emissions • Greenhouse gas emissions (Scope 1, Scope 2 and Scope 3) • Waste generated and waste management practices Impact on bio-diversity	**Principle 6**: Businesses should respect and make efforts to protect and restore the environment
Social	*Employees* • Gender and social diversity including measures for differently-abled employees • Turnover rates • Median wages • Welfare benefits to permanent	**Principle 3**: Businesses should respect and promote the well-being of all employees, including those in their value chains **Principle 5:** Businesses should respect and promote human rights

	and contractual employees • Occupational health and safety Trainings	
	Communities • Social Impact Assessments • Rehabilitation and Resettlement • Corporate Social Responsibility	**Principle 8:** Businesses should promote inclusive growth and equitable development
	Consumers • Product labelling, Product recall • Consumer complaints in respect of data privacy, cyber security etc.	**Principle 9:** Businesses should engage with and provide value to their consumers in a responsible manner
Governance	• Training on the principles in the RBC Guidelines for members of the Board, senior managers and employees • Anti-corruption and anti-bribery policies	**Principle 1:** Businesses should conduct and govern themselves with integrity, and in a manner that is Ethical, Transparent and Accountable.

	• Awareness programs conducted for value chain partners on the principles in the RBC Guidelines	

Table 2: Connecting ESG, NGRBC and BRSR (*Source:* Uhrynuk, M.R, Burdulia, A and Lee, J.C (2021))

7. SEBI consultation paper on Environmental, Social and Governance (ESG) Rating Providers for Securities Markets, 2022

In January 2022, SEBI floated a consultation paper on regulating ESG rating providers in the country. It is expected that the flow of sustainable finance into the business will see an exponential increase in the coming years which will increase demand for more ESG products and subsequently demand ESG ratings in the securities market.[50]

It was found that the wide number of ESG rating players and related products were creating ambiguities in the absence of standard methodologies and definitions. There are also issues of transparency and conflicts of interest in the existing set-up. Some of the key proposals made in the paper are:

- Regulation of ESG ratings and other related products:
    - Currently wide range of ESG ratings and other related products are offered by various ESG rating providers

[50] SEC.& EXCH. BD. INDIA, CONSULTATION PAPER ON ENVIRONMENTAL, SOCIAL AND GOVERNANCE (ESG) RATING PROVIDERS FOR SECURITIES MARKETS (Jan. 24, 2022), https://www.sebi.gov.in/reports-and-statistics/reports/jan-2022/consultation-paper-on-environmental-social-and-governance-esg-rating-providers-for-securities-markets_55516.html.

(ERPs). There are ambiguities and inconsistencies in various terminologies, definitions and objectives of such products due to lack of transparency and inadequate disclosures on data, methodology etc.

- The ESG ratings market is largely unregulated and most of the ERPs also provide advisory services on ESG resulting in conflict of interest. This can result into misallocation of funds by investors and greenwashing (misleading information about a product/service/company to pass it as environment friendly)

- Eligibility for accreditation as ERP:
    - The paper has proposed that only SEBI-registered credit rating agencies and analysts should be accredited by SEBI as ERPs subject to the set criteria, which shall be based on net worth, infrastructure, manpower etc.
- Better categorization of rating products:
    - In the absence of any regulation and standards, there are a wide range ESG ratings and ESG products with varying methodologies followed by various ERPs. The ratings can be classified under two major heads; ESG "risk" ratings and ESG "impact" ratings. These two sets of ratings have different methodology and would also cater to different stakeholders. However, the current practice does not differentiate on this categorization.
- ESG rating process:
    - It is also proposed that proper process must be followed by the ERPs while preparing ESG ratings and other products. There should be consistency in methodology, in-depth research and evidences to support findings, trained staff, committee for ratings, due diligence while preparation of ratings, operating guidelines for the ESG rating process etc.
- Governance and prevention of conflict of Interest:

- ERPs should have a governance process in place and prepare a detailed policy on managing conflict of interest.

IV. ESG: THE DRIVING FORCE FOR CORPORATE GOVERNANCE 2.0

A. MAINSTREAMING ESG INTO BUSINESS OPERATIONS

The process for successful ESG integration into business operations would require it to become part of the company-wide decision making and embedded in the DNA of the corporate strategy. ESG integration would entail that the business decisions and strategies would take into consideration not just the profits but also its immediate and long term social and environmental impact. For example, the ESG lens should be used while assessing the supply chain, taking decisions on inclusion and diversity, corporate investing, risk management etc.[51]

The process of ESG integration can help businesses to analyse their operational efficiency and help in improving the long-term viability. It also helps in assessing the risks and opportunities for a business; for example, extreme weather conditions, increased air pollution and water scarcity pose direct risks to certain businesses whereas opportunities will increase in areas like green building, renewable energy or clean technology. Successful ESG integration has many benefits for any business; it attracts investors, builds and broadens a loyal customer base, helps in retention of talent, and improves risk management.[52]

Though the broader process of integration would remain similar, the finer details would vary depending on various factors like the sector, size, and location of the business. The first step in integrating ESG into business is to bring on board the key stakeholders and agree on the **definition of ESG** and its relevance for the business. This process would include sensitization of the board members and top management on their

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[51] Kezia Farnham, *The Board's Guide to ESG Integration,* DILIGENT INSIGHTS (May 14, 2021), https://insights.diligent.com/esg/integration/.

[52] Michelle Winters, *What is ESG integration and why is it important*, GOBY INC (Mar. 24, 2022), https://www.gobyinc.com/what-is-esg-integration/.

understanding of the value and relevance of ESG for the business and incorporating it in the purpose of the organisation.

ESG issues would vary for different companies depending on a number of factors like sector of operation, geographical location, size of the company, and as a result, the issues that need to be focused on will also vary. Also, for practical reasons, a company must identify major ESG issues that it wants to focus on. Through the process of **materiality assessment**, companies would identify and assess the most relevant ESG topics for their business and stakeholders. Materiality defines why and how certain issues are important for a business or a sector. Material issues can impact the financial as well as reputational and legal aspects of any business. The origin of the concept is in auditing and accounting where materiality refers to the significance of an amount, transaction, or discrepancy. The process of materiality assessment should take into consideration the purpose of the organisation, key ESG issues for the business and engage key stakeholders in this exercise.

After the identification of the material ESG issues, the company should put in place an **ESG governance structure** to monitor the overall progress. Sound ESG governance offers a solid foundation for functional board oversight and proactive management on ESG issues. The board should have members with relevant ESG expertise and experience. External experts can also be engaged to enhance the board's capabilities in ESG. Clear roles and responsibilities of the board members, as well as committees, should be defined in order to make the personnel/committees accountable and thus facilitate the overall development of ESG.

All ESG issues identified as material or strategically significant should be appropriately addressed in the company's **risk management** processes. Appropriate enterprise risk management ("**ERM**") framework should be applied to assess the ESG-related risks. Companies can also refer to the existing risk management frameworks for ESG related issues such as suggested by the World Business Council for Sustainable Development ("**WBCSD**").

ESG strategy is important to provide a roadmap for guiding the company's actions and provides a framework to engage stakeholders and drive performance. Successful implementation of such a strategy should contribute towards achieving the vision of the company and business growth. Studies have shown that a sound sustainability strategy minimises the reputational risks of a company and protects the brand.[53]

For ease of successful implementation and assessing the overall success of the ESG strategy for a business, it is important to have well defined **KPIs and targets** because, "if you can't measure it, you can't manage it". Hence, a robust data management system is imperative for any company for disclosures, target setting, monitoring and evaluating the ESG performance.

Regulators in many jurisdictions have now made it mandatory for businesses to make non-financial **("ESG") disclosures**. Businesses should not think of this as mere compliance but use the opportunity to assess their performance on these issues and undertake course correction if needed. Such information should also be communicated regularly with all the stakeholders. The company would also get an opportunity to showcase its contribution towards a society which would strengthen the brand value and gain the trust of all the stakeholders.

Effective communication channels should be setup to reach all stakeholders and inform them about the vision, direction and progress of relevant ESG issues. Companies can choose from various international reporting standards and frameworks for preparing their ESG or sustainability reports.

To keep the entire exercise unbiased and transparent, companies should seek **independent assurance**. This ensures that the reporting meets certain standards, builds trust and further strengthens the credibility of EGS

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[53] KPMG, *Integrating ESG into your Business*, KPMG, CLP, HKICS, https://assets.kpmg/content/dam/kpmg/cn/pdf/en/2020/01/integrating-esg-into-your-business.pdf. (last visited May 13, 2022).

information disclosed in their relevant reports. The independent assurance can be provided by the traditional external audit firms or other sustainability consulting firms. To further improve the robustness of the process, companies can also go for certification (for example GHG emission, waste water treatment) from specialized agencies. The level, scope and processes adopted for the assurance should also be made part of the report to showcase the authenticity of the report building processes.[54]

B. Role of Board and management in ESG integration (Internal Drivers)

The process of ESG integration has to be driven from the top and hence the role of the Board is critical. The Board should put in place a proper governance structure for ESG and be actively involved in the functioning of such structure. It should also be ensured that there is a robust stakeholder engagement process in place and all the stakeholders are engaged while developing the ESG policy for the organisation. The board should regularly review the ESG strategies and the performance of the company on the agreed ESG parameters to ensure relevance and continuity in reporting.

Management will be responsible for executing the ESG strategy chalked by the Board of Directors. Due to the increasing demand for information on non-financial parameters, management has to shift towards integrated thinking. Under this approach, the management has to go beyond financial capital and also think about other capital including natural, social and relationship, human, manufactured, and intellectual. Successful ESG integration would need effective management of all types of capital and value creation through them.[55]

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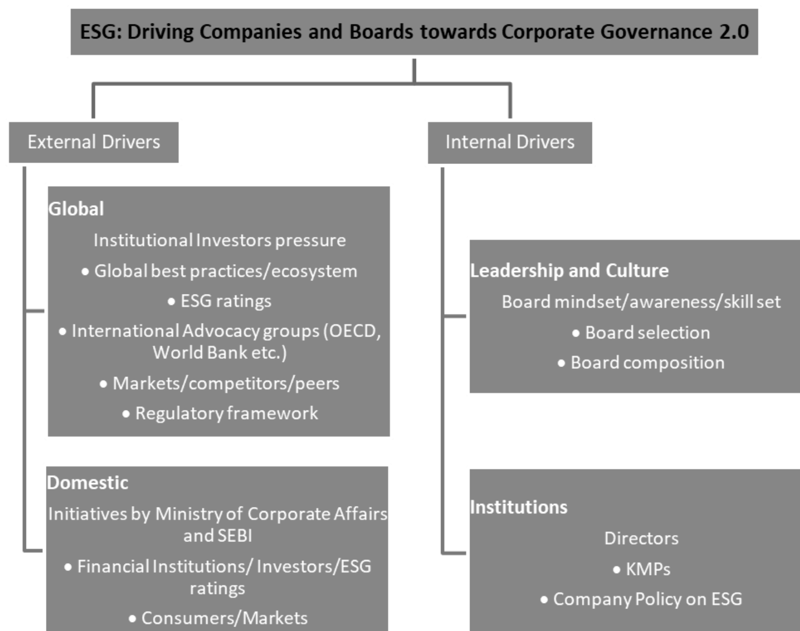
[54] *Id.*

[55] International Finance Corporation (2022), "IFC ESG Guidebook", https://www.ifc.org/wps/wcm/connect/3435180b-6506-4960-86ed-a0beabdcb02e/IFC-ESG-Guidebook2.pdf?MOD=AJPERES&CVID=nSBhl7-

C. APPRECIATING DRIVING FORCES (EXTERNAL DRIVERS)

There are also various external drivers, at the domestic and international level, that affect the adoption of ESG into business operations. This includes various initiatives in the form of laws, rules, guidelines etc. by the Ministry of Corporate Affairs, SEBI and other regulatory bodies, and pressure from institutional investors and consumers to shift towards more sustainable business practices. At the international level, there are guidelines set by advocacy groups like World Bank, OECD etc. which is largely driven by global institutional investors and other bodies which are directing companies to address various ESG issues in their business operations (see chart 1).



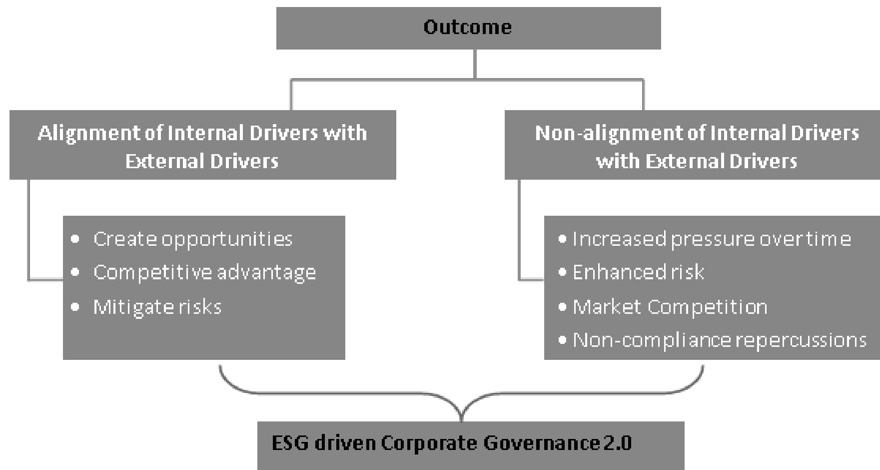


Chart 1: ESG Driven Corporate Governance 2.0 (*Source:* Authors)

V. CONCLUDING REMARKS BASED ON EVIDENCES FROM ACTION RESEARCH

The importance of the adoption of ESG issues by the companies can be derived from the philosophy of stakeholder capitalism. According to this philosophy, companies should seek long term value creation and should take into account the needs of all their stakeholders and society at large.[56] This can involve creating secure jobs for employees, embracing sustainable practices, serving customers loyally, cultivating long-term supplier relationships, paying fair taxes or working to minimize the environmental footprint of operations.[57] In the backdrop of various disruptions caused by the COVID-19 pandemic, more investors now believe that companies that perform well on ESG parameters are likely to be less risky and are better

[56] Klaus Schwab & Peter Vanham, *What is Stakeholder Capitalism,* DAVOS AGENDA, WORLD ECON. FORUM (Jan. 22, 2021), https://www.weforum.org/agenda/2021/01/klaus-schwab-on-what-is-stakeholder-capitalism-history-relevance/.
[57] Matthew Bell, *Why ESG performance is growing in importance for investors,* EY (Mar. 9, 2021), https://www.ey.com/en_in/assurance/why-esg-performance-is-growing-in-importance-for-investors.

prepared in the long run to meet various uncertainties compared to those that follow the business-as-usual approach.[58]

ESG integration is also directly related to the financial performance of the businesses. The non-financial initiatives help in improving and maintaining a good corporate reputation which further strengthens the brand image. This also helps to attract, retain and motivate employees, improve risk management and strengthen the overall competitive position of the organization.[59] Along with the long term value creation, companies need to have sound business strategies for safeguarding such value. Managing various ESG factors also helps companies in identifying risks associated with these issues and improves the overall Enterprise Risk Management ("**ERM**") strategy. Neglecting ESG issues can damage the reputation of the company and can also lead to financial loss and erosion of value.

A growing number of investors are now choosing investment opportunities (stocks, funds etc.) that are not just profitable but also fulfil certain social values. Estimates show that the size of global ESG assets at the end of 2021 is estimated at USD 37.8 trillion and is expected to reach USD 53 trillion by 2025, which will be more than one-third of the total assets under management ("**AUM**").[60] Reporting on ESG performance is also being demanded by the regulators and the rigor of such disclosures will further increase in the future. Companies that are already reporting their performance on various ESG metrics will find it easier to comply with such requirements. Businesses ignoring ESG as a passing fad would be doing it at their own peril. Environmental and social challenges have redefined the way state's function and businesses operate. ESG was part of the World Economic Forum's 2021 Davos summit agenda, which shows that the

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[58] *Id.*

[59] Lindsay Delevingne et al, *The ESG premium: new perspectives on value and performance*, MCKINSEY SURV. (2021).

[60] Research, *ESG assets may hit $53 trillion by 2025, a third of global AUM*, BLOOMBERG INTELLIGENCE, https://www.bloomberg.com/professional/blog/esg-assets-may-hit-53-trillion-by-2025-a-third-of-global-aum/ (last visited May 13, 2022).

notion will gain further traction in the near future. Integration of ESG metrics into financial reporting and product innovation will further gain momentum and will substantially change the way business is conducted.[61]

[61] Jeff McDermott, *ESG: Fad or Future?* NOMURA (July 7, 2021), https://www.nomuraconnects.com/focused-thinking-posts/esg-fad-or-future/.