<u>'G' IN ESG – THE STEERING FORCE OF THE COMPANY</u>

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<u>ABSTRACT</u>

E, S and G, just three random alphabets of English language, but when put together have given businesses across the globe something to think about, especially in the wake of COVID-19 and the changing regulatory regime. ESG – Environment, Social and Governance factors are becoming increasingly important as investors are moving towards impact investing and sustainable development. This shift is evident from the number of ESG initiatives taken across the globe. Of late we have even seen funds launching specific ESG related products for investment as an answer to the public demand for sustainable investments. The inflows in ESG funds increased 76% to INR 3,686 Crores in financial year 2021 against INR 2,094 Crores in financial year 2020 and ESG funds together had an asset base of nearly INR 9,900 Crores as of March-end.[1] *In another research publication by Bloomberg Intelligence, it stated that global ESG assets are on track to exceed USD 53 trillion by 2025, representing more than a third of the USD 140.5 trillion in projected total assets under management.*[2]

The ESG reporting in India has been recently revised by the Securities and Exchange Board of India (hereinafter referred to as "**SEBI**") *and a new reporting format, the Business Responsibility and Sustainability Report (hereinafter referred to as* "**BRSR**")*, has been introduced by SEBI on May 10, 2021. The concept of ESG, however, is not new in India. One of the first notable step in the area of social responsibility of businesses was the release of the Corporate Governance Voluntary Guidelines in 2009 by the Indian Ministry of Corporate Affairs* (*hereinafter* referred to as "**MCA**")*, which encouraged corporates to voluntarily achieve high standards of*

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[1] Suresh P. Iyengar, *India must devise its own ESG investment strategy,* BUS. LINE (June 19, 2021) https://www.thehindubusinessline.com/news/national/india-must-devise-its-own-esg-investment-strategy/article34861443.ece.

[2] Adeline Diab & Gina Martin Adams, *ESG assets may hit $53 trillion by 2025, a third of global AUM,* BLOOMBERG (Feb. 23, 2021) https://www.bloomberg.com/professional/blog/esg-assets-may-hit-53-trillion-by-2025-a-third-of-global-aum/.

corporate governance. This was followed by the release of the National Voluntary Guidelines on Social, Environmental and Economic Responsibilities of Business (*hereinafter* referred to as "**NVGs**") *in 2011, which were subsequently used by SEBI to frame the Business Responsibility Reports* (*hereinafter* referred to as "**BRR**") *in 2012. The BRR has now been replaced with BRSR, which will be implemented in a phased manner, and aims at further strengthening the social responsibility of businesses. The BRSR requires reporting on various Governance aspects and is likely to help business to be more organized and help in monitoring their compliances in a more effective manner. In this article we look at the Governance aspect of ESG reporting under the BRSR.*

Keywords: Business Responsibility and Sustainability Report, Corporate Governance, ESG.

TABLE OF CONTENTS

I. CORPORATE GOVERNANCE IN INDIA

Corporate governance is the system by which companies are directed and controlled.[3] There is no single legislation which presently predominates the corporate governance framework in India, but it is encompassed within various legislations including the key legislations such as Companies Act, 2013 (*hereinafter* referred to as "**CA 2013**") and the Securities and Exchange Board of India (Listing Obligations and Disclosure Requirement) Regulations, 2015 (*hereinafter* referred to as

[3] CADBURY, A., COMM. FIN. ASPECTS CORP. GOVERNANCE, REPORT OF THE COMMITTEE ON THE FINANCIAL ASPECTS OF CORPORATE GOVERNANCE (1992), https://ecgi.global/sites/default/files/codes/documents/cadbury.pdf

"**LODR Regulations**").

The concept of governance is however not new to India. Over the years, various committees have been constituted to give recommendations for improving the governance of companies in India. One such major milestone was the report issued by the Committee on Corporate Governance under the chairmanship of Shri Kumar Mangalam Birla based on which Clause 49 of the listing agreement was issued by SEBI in February 2000. Such clause dealt with several aspects including board constitution and independent directors, constitution of audit committee, report on corporate governance, etc. Several other committees have been constituted over the years to review and recommend changes to the corporate governance framework, including those under the chairmanship of Mr. Narayana Murthy, Mr. Naresh Chandra, and Mr. Uday Kotak.

The report of the Committee on Corporate Governance under the chairmanship of Mr. Uday Kotak dated October 5, 2017, *inter alia* looked into the aspect of why corporate governance really matters. The said committee noted that based on the research it is evident that the companies that exhibit sound corporate governance generate significantly greater returns when compared to companies that exhibit poor corporate governance.[4] Mr. Uday Kotak had stated that the report is "*a sincere attempt to support and enable sustainable growth of enterprise, while safeguarding interests of various stakeholders. It is an endeavour to facilitate the true spirit of governance. Under the leadership of a vigilant market regulator -SEBI, and with the persistent efforts of key stakeholders, corporate governance standards in India will continue to improve. A stronger corporate governance code will enhance the overall confidence in Indian markets and in India*."[5]

The corporate governance framework under CA 2013 (including the erstwhile Companies Act, 1956) has also over the years evolved to include

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[4] KOTAK COMM., SEBI, REPORT OF THE COMMITTEE ON CORPORATE GOVERNANCE (2017), https://www.sebi.gov.in/reports/reports/oct2017/report-of-the-committee-on-corporate-governance_36177.html.
[5] *Id.,* at 2.

directors' responsibility statement, from "voluntary" to "mandatory" corporate social responsibility spending, etc. Recently, SEBI overhauled the regulatory framework for independent directors, which is to come into effect from January 01, 2022, increasing their participation in composition of audit committee and nomination and remuneration committee, requiring approval of related party transactions to be given only by independent directors, etc.

II. UNDERSTANDING "G" - GOVERNANCE ASPECT UNDER ESG

G - governance, is an integral part of company's performance and effective leadership helps steering the company in the right direction. The Report of the CII Task Force on Corporate Governance chaired by Mr Naresh Chandra noted that "*Good corporate governance involves a commitment of a company to run its businesses in a legal, ethical and transparent manner - a dedication that must come from the very top and permeate throughout the organisation. That being so, much of what constitutes good corporate governance has to be voluntary. Law and regulations can, at best, define the basic framework - boundary conditions that cannot be crossed.*"[6]

In many ways the G in the ESG is not new and has evolved and coupled into a reporting requirement of such existing obligations in an organized manner. Different regions around the globe have adopted different approaches to achieve sustainable development and impact investments. The European Commission in its Action Plan: Financing Sustainable Growth dated Mach 8, 2018[7] recognized one of the action points as fostering sustainable corporate governance and attenuating

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[6] CONFEDERATION IND. INDUS., REPORT OF THE CII TASK FORCE ON CORPORATE GOVERNANCE CHAIRED BY MR. NARESH CHANDRA (Nov. 2002), https://www.mca.gov.in/Ministry/latestnews/Draft_Report_NareshChandra_CII.pdf.

[7] EUR. COMM'N, COMMUNICATION FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT, THE EUROPEAN COUNCIL, THE COUNCIL, THE EUROPEAN CENTRAL BANK, THE EUROPEAN ECONOMIC AND SOCIAL COMMITTEE AND THE COMMITTEE OF THE REGIONS FINANCING SUSTAINABLE GROWTH 12 (2018), https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52018DC0097&from=EN.

short-termism in capital markets. It recognizes that "*Corporate governance can significantly contribute to a more sustainable economy, allowing companies to take the strategic steps necessary to develop new technologies, to strengthen business models and to improve performance. This would in turn improve their risk management practices and competitiveness, thus creating jobs and spurring innovation.*" On February 25, 2019, the European Parliament and Member States agreed on a new generation of low-carbon benchmarks needed to help boost investment in sustainable projects and assets. On 18 June, 2020, the Taxonomy Regulation for climate change mitigation and adaptation was published by the European Commission which establishes the criteria for determining whether an economic activity qualifies as environmentally sustainable for the purposes of establishing the degree to which an investment is environmentally sustainable.[8] The Taxonomy Regulation deals with various aspects of sustainable economic activities, including requiring transparency of environmentally sustainable investments in pre-contractual disclosures and in periodic reports, transparency of financial products that promote environmental characteristics in pre-contractual disclosures and in periodic reports, contribution towards climate and climate adaptation.

In the Indian context, the Indian regulators, MCA and SEBI have in recent years increased focus on sustainable investment and reporting with the introduction of corporate social responsibility (CSR) norms under CA 2013 and the recent replacement of the BRR (Business Responsibility Report) with BRSR.

Some of the key governance related disclosures provides under BRSR read with the guidance note for ESG reporting format released by SEBI have been discussed below.

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[8] Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088, 2020 O.J. (L 198) 13.

A. GRIEVANCE REDRESSAL MECHANISM FOR STAKEHOLDERS

The National Guidelines on Responsible Business Conduct (*hereinafter* referred to as "**NGRBC**")[9] defined the term "*Stakeholder*" as an "*Individual or group concerned or interested with or impacted by the activities of the businesses and vice-versa, now or in the future. Typically, stakeholders of a business include, but is not limited to, its investors/shareholders, employees (and their families), customers, communities, value chain members and other business partners, regulators, civil society actors, and media.*" Grievance Redressal Mechanism refers to a mechanism for any stakeholder individually or collectively to raise and resolve reasonable concerns affecting them without impeding access to other judicial or administrative remedies.[10] A transparent and unbiased grievance mechanism often helps in reducing legal disputes and making company to be more accessible and connected with its stakeholders.

The BRSR reporting requires disclosure of grievance redressal mechanism adopted by the company for each of the stakeholders, disclosure of comprehensive data on the total number of complaints received in the financial year and number of such complaints resolved or pending.

B. BUSINESS RESPONSIBILITY POLICY AND REPORT

The BRSR reporting requires that a statement to be provided by director responsible for the business responsibility report, highlighting ESG related challenges, targets, and achievements.[11] Even details of highest authority responsible for implementation and oversight of the business responsibility policy(ies) is required to be reported. Even before

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[9] MINISTRY CORP. AFFAIRS, NATIONAL GUIDELINES ON RESPONSIBLE BUSINESS CONDUCT 7 (2019), https://www.mca.gov.in/Ministry/pdf/NationalGuildeline_15032019.pdf.

[10] *Id.,* at 8.

[11] SEC. & EXCH. BD. IND., BUSINESS RESPONSIBILITY AND SUSTAINABILITY REPORTING FORMAT 6 (2021), https://www.sebi.gov.in/sebi_data/commondocs/may-2021/Business%20responsibility%20and%20sustainability%20reporting%20by%20listed%20entitiesAnnexure1_p.PDF.

BRSR, in many mergers and acquisition transactions we have seen investors/ purchaser insisting on ESG diligence on the target companies before investment.

C. Ethical, Transparent and Accountable Conduct

Principle 1 of the National Guidelines for Responsible Business Conduct (*hereinafter* referred to as "**NGRBC**") incorporated under BRSR requires businesses to conduct and govern themselves with integrity and in a manner that is ethical, transparent, and accountable. Under this segment, company is required to disclose *inter alia* details of fines/penalties /punishment/ award/ compounding fees/settlement amount paid in proceedings (by the entity or by directors/key managerial personnel) with regulators/ law enforcement agencies/judicial institutions, in the financial year. This requirement to disclose details of fines /penalties/punishment/ award/compounding fees/settlement amount is to be made based on materiality specified under Regulation 30 of LODR Regulations. Now, the companies will need to revisit their materiality policy drafted under Regulation 30 of LODR and accordingly, collate such information relating to fines/penalties/awards, etc.[12]

In addition, under this principle, companies are also required to make disclosure on the anti-corruption or anti-bribery policy, which may include details of risk assessment procedures and internal controls, mechanism to deal with complaints on bribery/corruption and details of trainings on anti-corruption issues and make available a web-link to the policy. Today, companies are required to take efforts and ensure compliance with the anti-corruption and anti-bribery laws of India, however, now the anti-corruption and anti-bribery policy will need to be drafted in a manner to specifically cover aspects of risk assessment procedures and internal controls, mechanism to deal with complaints on bribery/corruption and details of trainings on anti-corruption issues undertaken by the company.

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[12] *Id.,* at 8.

Another aspect that is required to be disclosed under Principle 1 is details of number of complaints received in relation to issues of conflict of interest of the directors and key managerial personnel.[13] Conflict of interest simply put refers to a situation where an individual is confronted with choosing between the requirements of his or her function and his or her own private interests. Presently, Section 166 of CA 2013 requires directors to act in the best interest of the company and to not involve himself/ herself in a situation in which he/she may have a direct or indirect interest that conflicts, or possibly may conflict, with the interest of the company.[14] Section 184 of CA 2013 has further mandated that every director of the company to disclose, at the first meeting of the board in which he/ she participates as a director and thereafter at the first meeting of the board in every financial year or whenever there is any change in the disclosures already made, his/ her concern or interest in any company or companies or bodies corporate, firms, or other association of individuals.[15] In addition, the section also requires directors of a company to disclose nature of his/her concern or interest at the meeting of the board in which the contract or arrangement in which he/she is directly or indirectly concerned or interested is being considered. As apart from directors, key managerial personnel play a key role in the management and governance of the company, details of complaints in relation to issues of conflict of interest of key managerial personnel under the BRSR reporting will help in increasing transparency in the management decisions.

D. SAFEGUARDING INTEREST OF ALL STAKEHOLDERS

Another governance aspect incorporated under the BRSR reporting relates to Principle 4 of NGRBC which requires businesses to respect the interest of and be responsive to all its stakeholders. Under this segment, company is required to disclose the process for identification of key stakeholders, identification of vulnerable and marginalized groups, using

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[13] *Supra* note 11.
[14] Companies Act, No. 18 of 2013, §166 (Ind.).
[15] *Id.*, §184.

stakeholder consultation to support the identification and management of environmental and social topics, etc.

Over years, we have seen a shift from shareholder centric need to protect the interest of various stakeholders involved with a company. The duties of directors were for the first time codified under Section 166 of CA 2013, which *inter alia* requires director of a company to act in good faith in order to promote the objects of the company for the benefit of its members as a whole, and in the best interests of the company, its employees, the shareholders, the community and for the protection of environment. Even the code for independent directors provided under CA 2013 requires independent directors to *inter alia* safeguard the interest of all stakeholders. Now under the BRSR reporting, engagement by the company with each stakeholder group will need to be disclosed by the company. Such disclosures will help all stakeholders, especially the potential investors in identifying the key concerns raised by the stakeholders and how the company has responded to the same, thus indulging more faith in the company's internal controls and management.

III. "G" – SUPPORTING THE "E" AND "S" IN ESG

While "E" and "S" in ESG are important aspects, they cannot function without an effective and efficient "G" and all are intertwined with each other.

The E – Environmental reporting of the company is aimed at ensuring that the company is contributing towards sustainable development and is committed to reducing discharge of pollutant in the environment. Under this segment, various disclosures are covered such as resource usage (energy and water), air pollutant emissions, green-house emissions, waste generated and waste management practices, biodiversity etc.

The S – Social related disclosures cover the workforce, value chain, communities, and consumers. For employees/workers, one needs to disclose the gender and social diversity including measures for differently abled employees and workers, turnover rates, median wages, welfare benefits to permanent and contractual employees/workers, occupational health and safety, trainings etc. It also includes disclosures on Social Impact Assessments, Rehabilitation and Resettlement, Corporate Social Responsibility, disclosures on product labelling, product recall, consumer complaints in respect of data privacy, cyber security, etc.[16]

However, the E and S aspect cannot be achieved without effective "*Governance*". To put it simply, there needs to be in place effective corporate governance framework requiring board and management to promote sustainable business conduct, encourage sustainable research projects, adopt environment friendly business policies, implement worker/employee centric benefits and measures, etc., thus making corporate governance the key aspect of ESG compliance.

IV. CLOSER LOOK REQUIRED AT GOVERNANCE REQUIREMENTS AND WAY FORWARD

Although the BRSR is presently applicable to the top 1000 listed entities (by market capitalization calculated as on 31st day of March of every financial year), for reporting on a voluntary basis for financial year 2021–22 and on a mandatory basis from financial year 2022–23, the attraction that ESG principles have globally is huge and one should not get deluded by selective enforcement on specified companies by SEBI. Even the corporate social responsibility spending under CA 2013 which started as a voluntary requirement has with time been made mandatory.

In the ESG sector, many countries are moving towards mandatory ESG disclosure, and this is likely to become one of the major

[16] SEC. & EXCH. BD. IND., CIRCULAR FOR BUSINESS RESPONSIBILITY AND SUSTAINABILITY REPORTING BY LISTED ENTITIES, SEBI/HO/CFD/CMD-2/P/CIR/2021/562 (May 10, 2021), https://www.sebi.gov.in/sebi_data/meetingfiles/apr-2021/1619067265752_1.pdf.

considerations for investors evaluating investment opportunities. Transparency through reporting and disclosure gives comfort to stakeholders and it is imperative that companies evaluate to what extent they can comply with BRSR reporting. This will not only reflect highly on the transparent conduct of the organization but also attract more stakeholders to partner with the company.