# ESG SCORES
## HOW TO IMPROVE






Theme 2022-23
INDIA 2047

INDIAN CHAMBER OF COMMERCE

FutureStation
Going Beyond

## What is an ESG Score?

An ESG score is an objective measurement or evaluation of a given company, fund, or security's performance with respect to Environmental, Social, and Governance (ESG) issues. Specific evaluation criteria vary between the different rating platforms that issue ESG scores; however, they all fall within one (or more) of the E, S, or G categories.

ESG scoring systems tend to be either industry-specific or industry-agnostic. Industry-specific scoring systems assess issues that have been deemed material to the industry at large. Industry-agnostic ESG scores tend to incorporate widely accepted factors that are meaningful across industries – issues like climate change, diversity, equity and inclusion (DEI), and human rights. ESG scoring platforms determine a weightage for each measurement criterion; then, they assess an organization's performance against each criterion. An organization's final ESG score is typically a sum-total of the criteria *ratings* and the (proprietary) criteria *weightages*

## What Does an ESG Score Mean?

High ESG scores are a constantly-moving target as the scores are frequently impacted by the performance of other industry players, macro industry trends, and alterations to the scoring platform's internal methodologies.
Scores are also hard to assess in "absolute" terms. However, all other things being equal, an organization that consistently achieves high ESG scores across a variety of rating platforms is likely to perform well *relative* to its peers.
Leveraging insight from a given ESG score in a meaningful way can only be achieved by understanding the broader context of the situation, as well as knowing what inputs are being measured (and what kind of weightings are being used) to arrive at a particular score.

## How ESG Score is Used

While ESG score of a company can be used by all stakeholders of the company to arrive at objective decisions, the most widely used purpose is for **investors** who use it to decide on their potential future investments, **customers** who use it to decide on their supply chain risk and **financial institutions/ asset owners** who use it to decide their funding strategies.

Most ESG scores measure companies' exposure to risks and opportunities related to E (Environmental), S (Social) and G (Governance). A high score, among other things, mean that the company is good at handling these risks. Good ESG scoring companies are expected to have easier access to capital, better brand reputation, better market share, easier to attract talent and have better control over their risks

## Who does ESG Scoring?

There are over 600 independent agencies worldwide who do ESG scoring for businesses. While some of these agencies like CDP (https://www.cdp.net/en) focuses primarily on the environmental performance there are others who give lot of importance to social responsibilities, MSCI (https://www.msci.com/our-solutions/esg) and S&P (https://www.spglobal.com/spdji) are emerging as the most widely used ESG scoring agencies across sectors worldwide. Most of the investors, analysts, customers and financial institutions rely on MSCI and/or S&P scores of ESG in their decision making processes.

While all these agencies are active in India, S&P's CRISIL ESG Ratings has covered maximum Indian companies in their annual ESG performance ratings since 2021.

### 1. MSCI ESG Rating

According to the MSCI ESG Rating, ESG risks and opportunities are posed by:

- large scale trends (e.g. climate change, resource scarcity or demographic shifts);
- the nature of the company's operations.

The MSCI considers a risk or an opportunity to be material to industry as follows:

- A risk is material to an industry when it is likely that companies in a given industry will incur substantial costs in connection with it (for example, a regulatory ban on a key chemical input).
- An opportunity is material to an industry when it is likely that companies in a given industry could capitalize on it for profit (for example, opportunities in clean technology for the LED lighting industry).

MSCI assess material risks and opportunities for each industry through a quantitative model that compares ranges and average values in each industry for *externalized impacts* (such as carbon intensity, water intensity and injury rates). Company-specific exceptions are allowed for companies with diversified business models, facing controversies, or based on industry rules. Once identified, these **Key Issues** are assigned to each industry and company.

To arrive at a final ESG Rating, the weighted average of individual Key Issue Scores is normalized relative to ESG Rating Industry peers. After any committee are factored in, each company's Final Industry-- level overrides Adjusted Score corresponds to a rating between best (AAA) and worst (CCC). These assessments are not absolute but are explicitly intended to be interpreted relative to a company's industry peers.

**MSCI ESG Key Issue Hierarchy**

| 3 Pillars | 10 Themes | 35 ESG Key Issues | |
|---|---|---|---|
| Environment | Climate Change | Carbon Emissions<br>Product Carbon Footprint | Financing Environmental Impact<br>Climate Change Vulnerability |
| | Natural Capital | Water Stress<br>Biodiversity & Land Use | Raw Material Sourcing |
| | Pollution & Waste | Toxic Emissions & Waste<br>Packaging Material & Waste | Electronic Waste |
| | Environmental Opportunities | Opportunities in Clean Tech<br>Opportunities in Green Building | Opportunities in Renewable Energy |
| Social | Human Capital | Labor Management<br>Health & Safety | Human Capital Development<br>Supply Chain Labor Standards |
| | Product Liability | Product Safety & Quality<br>Chemical Safety<br>Financial Product Safety | Privacy & Data Security<br>Responsible Investment<br>Health & Demographic Risk |
| | Stakeholder Opposition | Controversial Sourcing<br>Community Relations | |
| | Social Opportunities | Access to Communications<br>Access to Finance | Access to Health Care<br>Opportunities in Nutrition & Health |
| Governance* | Corporate Governance | Ownership & Control<br>Board | Pay<br>Accounting |
| | Corporate Behavior | Business Ethics<br>Tax Transparency | |

** The Governance Pillar carries weight in the ESG Rating model for all companies.*

The table above indicates the 'Key Issues' which are then normalized for specific companies based on the industry. Further details on each specific issues across Environmental, Social and Governance (ESG) Pillars can be found at: https://www.msci.com/esg-and-climate-methodologies.

The data sources used by MSCI include:

- macro data at segment or geographic level from academic, government and NGO datasets; and
- company disclosure (e.g. annual report filings, sustainability report, proxy report or annual general meeting (AGM) results).

### *1.1 MSCI ESG risk score*

MSCI argues that to understand whether a company is adequately managing a key ESG risk, it is essential to understand both:

- what management strategies it has employed (i.e. risk management); and
- how exposed it is to the risk (i.e. risk exposure).

The MSCI ESG Ratings model attempts to measure both of these. For MSCI to score a company highly on a key issue, the management needs to be judged commensurate with the level of exposure:

- a company with high exposure must also have very strong management; but
- a company with limited exposure can have a more modest approach.

The risk exposure and management scores are combined so that a higher level of exposure requires a higher level of demonstrated management capability in order to achieve the same overall key issue score. Key issue scores are also on a 0 to 10 scale, where 0 is very poor and 10 is very good.

### *1.2 MSCI ESG opportunity score*

The assessment of MSCI ESG opportunities works similarly to risks, but the model for combining exposure and management differs:

- exposure indicates the relevance of the opportunity to a given company based on its current business and geographic segments; and
- management indicates the company's capacity to take advantage of the opportunity.

Where exposure is limited, the key issue score is constrained toward the middle of the 0 to 10 range, while high exposure allows for both higher and lower scores.

### *1.3 MSCI controversy assessment*

MSCI ESG Ratings also reviews controversies, which may indicate structural problems with a company's risk management capabilities. A controversy case is defined as an instance, or ongoing situation, in which company operations or products allegedly have a negative environmental, social or governance impact.

### *1.4 MSCI final letter rating summary*

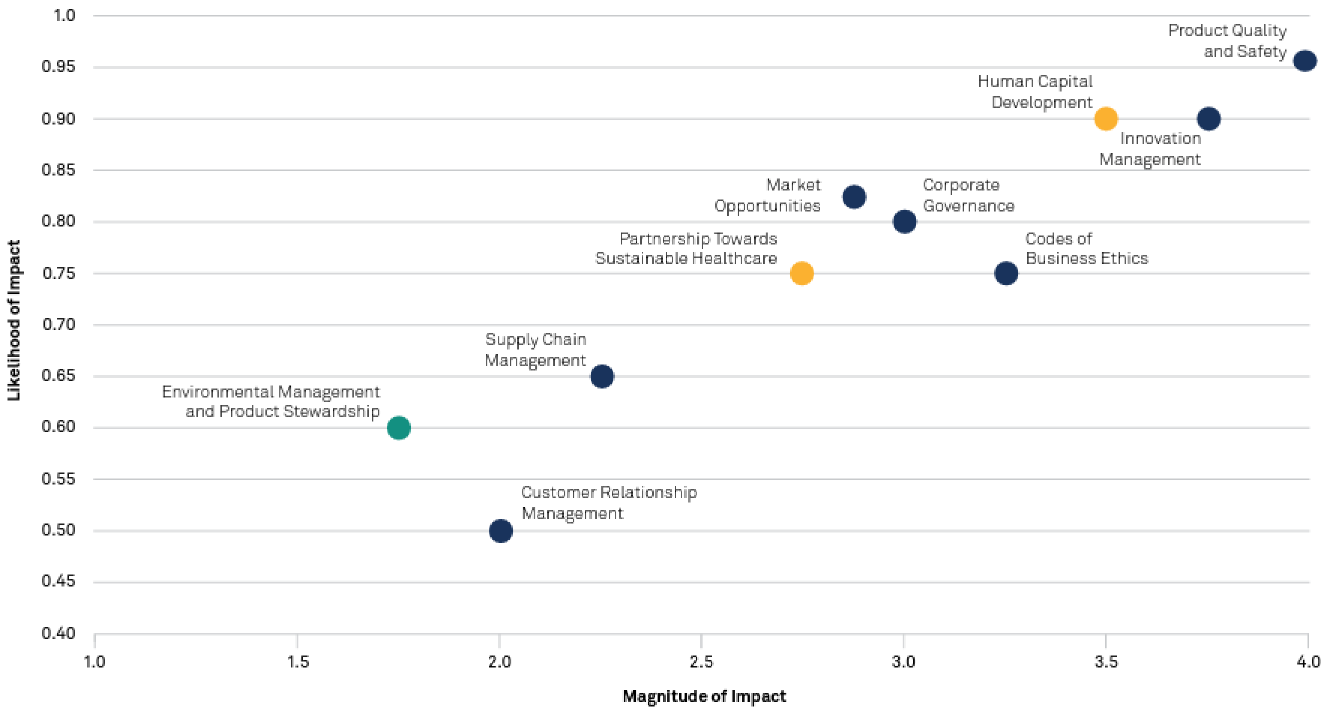
To arrive at a final letter rating, the weighted average key issue score is normalized by industry. The range of scores for each industry is established annually by taking a rolling three-year average of the top and bottom scores among the MSCI ACWI Index constituents; the values are set at the 97.5th and 2.5th percentile. Using these ranges, the weighted average key issue score is converted to an industry-adjusted score from 0 to 10, where 0 is worst and 10 is best. The industry-adjusted score corresponds to a rating between best (AAA) and worst (CCC).

## 2. S&P Global - Corporate Sustainability Assessment

The Corporate Sustainability Assessment (CSA) is one of the most accepted ESG Ratings. The rating is undertaken through research expertise (ESG Research) and industry benchmarking (ESG Benchmarking).

**Focus on Financial Materiality**

The starting point for the CSA is the financial materiality framework, which draws upon more than 20 years of experience in integrating sustainability into the investment process. For each of the 61 industries evaluated through the CSA, a financial materiality analysis is conducted to identify those sustainability factors that drive business value and that have the greatest impact on the long-term valuation assumptions used in financial analysis. This analysis results in a materiality matrix for each industry, which serves as the basis for determining the applicability and weights of the various sustainability criteria in the CSA. A sample materiality matrix for an industry (Pharmaceutical) is provided in the following.

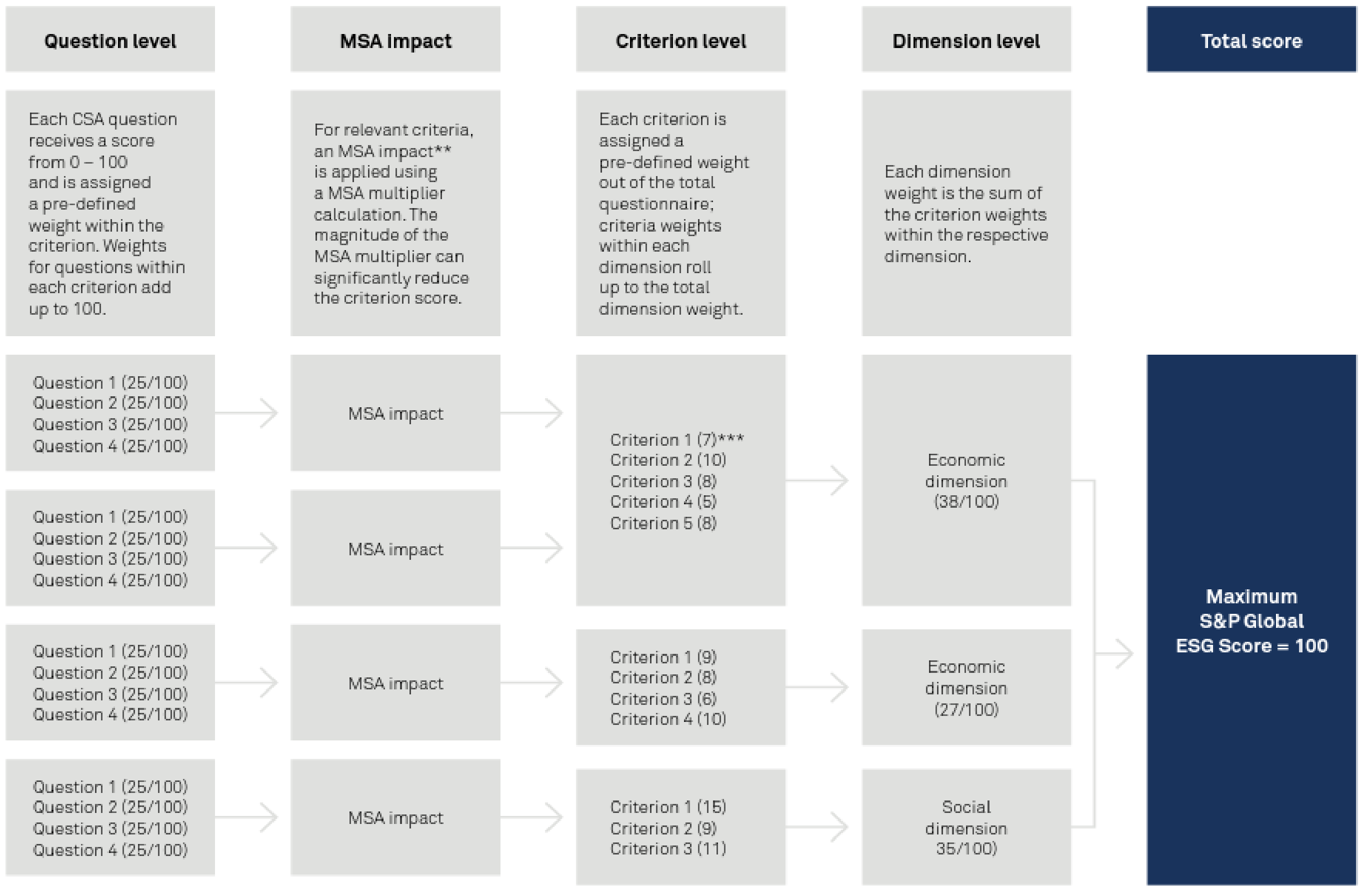



**Structured Approach**

The starting point for the annual corporate assessment is an industry-specific questionnaire focusing on financially-relevant economic, environmental and social criteria. Calculating a company's S&P Global ESG Score is a process of applying sub-level scores which are progressively weighted and summed until a final aggregated score is reached.

The starting point consists of individual questions, the values of which are weighted, summed and aggregated into broader areas called criteria. Similarly, criteria scores are weighted, summed and aggregated into even broader areas called dimensions. Following the same pattern, dimensions values are then weighted and summed to find a maximum sustainability score.

**Structure of the Corporate Sustainability Assessment**




## Scoring the Questions

The questionnaire is designed to be objective and uses predefined scoring approaches in which each potential answer is assigned a number of points between 0–100. For questions in which qualitative answers are allowed, S&P Global ESG Research analysts codify the response using a predefined appraisal method which then results in a quantitative score. In addition, many questions request companies to submit documentation to support the answers they have provided. Lack of publicly available documentation is one of the criteria affecting the score at question-level.

*The S&P Global ESG Score*
*= Σ (Number of Question points received x Question Weight x Criterion Weight)*

**Media and Stakeholder Analysis (MSA)**
An integral component of the CSA is the ongoing monitoring of publicly available information from print and online media, government bodies, regulators, think tanks and other sources to identify companies' involvement and response to environmental, economic and social incidents that may have a damaging effect on their reputation, financial situation or core business. S&P monitors news coverage of companies in the universe using media and stakeholder information compiled and pre-screened on a daily basis by RepRisk, a leading ESG data science firm specializing in environmental, social and governance issues. MSA cases vary considerably; individual cases can range from economic crime, corruption, fraud, illegal commercial practices, human rights abuses, labor disputes, workplace safety, to catastrophic accidents and environmental violations.

Measuring MSA impact is a step-wise process that begins with identifying an MSA case. The MSA case is scored based on the impact of the case and the response of the company to the incident. The MSA score is then used to assign an "MSA multiplier" — a coefficient used to adjust relevant CSA criteria in proportion to the negative impact of MSA cases. The MSA multiplier is then accounted for in the final CSA score as highlighted below.

**Applying the MSA Multiplier* to CSA criterion scores**

| | | | | |
|---|---|---|---|---|
| CSA criterion score without MSA adjustment | X | MSA Multiplier Calculation | = | Final Criterion Score |
| Unadjusted Score Codes of Business Conduct | X | MSA Multiplier Calculation | = | Final Score for Business Conduct |
| Unadjusted Score Risk and Crisis Management | X | MSA Multiplier Calculation | = | Final Score for Risk and Crisis Management |

## 3. CRISIL ESG Score
CRISIL has started annual disclosure of ESG scores of Indian companies since 2021. In the year 2022, they disclosed the ESG scores of top listed companies and some unlisted companies too. It is understood that the coverage will increase gradually. The investors and customers of these Indian companies have started considering these scores with priority while making their investment / procurement decisions

## Methodology

CRISIL's ESG scores are designed to support financial institutions and corporates to measure and monitor inherent ESG risks across their financial exposures – both equity and debt. They also provide standardised and sanitised ESG information, including benchmarks that can easily integrate into analysis and risk management processes. In 2022 CRISIL has used their ESG methodology to score 586 companies across 53 sectors in India. This evaluation is based on publicly available information released by the companies through their websites, exchange filings, annual reports, investor presentations, sustainability reports, CDP filings, etc. It also factors in other material ESG information available in the public domain through reliable sources, such as data reported by industry associations, regulators and various government agencies. The assessment is based on quantitative as well as qualitative disclosures.

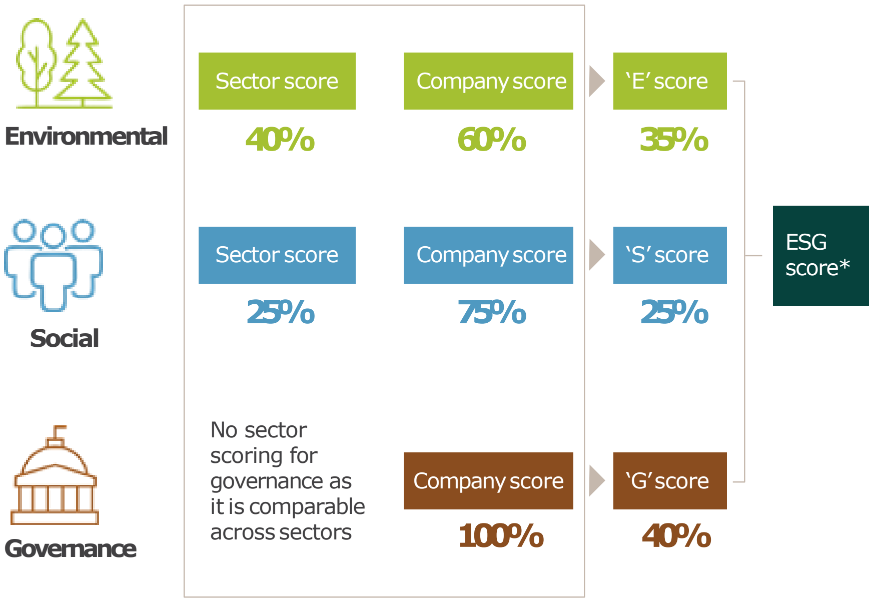
Since this is an objective evaluation based on publicly available information, the quality of disclosures provided in the public domain is an important determinant of the ESG score. Each company under the coverage is monitored on a continuous surveillance basis for ESG material events that could potentially lead to a change in scores.

## Scoring Framework

To arrive at the overall company ESG score, relevant weights are assigned to E (35%), S (25%) and G (40%) attributes, to reflect the relative importance of factors. Companies are scored on a scale of 0-100, where 100 is the highest.

In case of E and S assessment, the final score is a combination of the company and the sector scores. For instance, the final E score for a company is arrived at by applying the sector E score overlay on the company E score. The company E score assesses its material environment parameters in relation to its peers within the sector. The sector E score is an indicator of how the sector fares relative to other sectors on various environment issues. This approach allows CRISIL the flexibility to bring sector-specific parameters into their assessment and make it extremely nuanced, while at the same time retaining the cross- sector comparability of the final scores.

**Company assessment framework**




## Key E parameters assessed

**Energy and emissions**

- Intensity of $CO_2$ emission (Scope 1+2+3; kg $CO_2$ sector-specific metric)
- Intensity of air pollutants (includes SOx, NOx, SPM, and ODS)
- Emission trend (% reduction over past 3 years)
- Energy consumption (MWh per sector-specific metric)
- Share of renewable energy as % of total energy consumption
- Trend in capital investment in energy conservation equipment (for energy conservation equipment per sector-specific metric)

**Waste generation and recycling**

- Hazardous waste generation
- Waste recycling level
- Non-hazardous waste generation, eco-friendly materials used, and other waste management initiatives undertaken

**Water use**

- Water recycling as a proportion of overall water consumption
- Water consumption trend
- Water withdrawal trend (fresh water, groundwater, and saline water)

**Resource use and biodiversity**

- Raw material use efficiency (per sector-specific metric)
- Diversity in raw material sourcing
- Land use (forest, arable land) and natural resources use
- Biodiversity (operations at hotspots, presence of rare species, and impact due to operations)

**Compliance/controversy checks – deflators**

- Instances of emission-related show cause notices issued by regulatory authority
- Compliance with discharge/dumping of effluent/sludge as per norms prescribed by regulators, which includes safe disposal and sale to CPCB certified recyclers
- Instances of waste-related show cause notices issued by regulatory authorities
- Violation of environmental laws/notices issued by CRZ, NGT, etc.

## Factoring in sector-specific nuances and materiality

The ESG risk assessment framework for each sector includes sector- specific parameters that have been developed based on CRISIL's multi- decade experience in industry research as well as global reporting frameworks such as SASB, GRI and CDP. For a parameter to be considered material, CRISIL applies filters both from a risk perspective as well as an impact perspective. Weightages of individual parameters vary across sectors, depending on the materiality and relevance.

## Key S parameters assessed

**Employee and worker management**
- Gender diversity and attrition rate
- Sexual harassment (incidence and redressal rates)
- Safety (lost time injury frequency rate)
- Wage equality (CEO-to-median pay ratio)
- Training to employees – skill and safety (training hours per employee and % of employees trained)
- Permanent vs temporary employees
- Unionisation (employee participation in management-recognised employee unions)

**Supply chain management**
- Customer satisfaction – NPS, CSI, and feedback
- Customer complaint and redressal rates
- Product innovation (% of R&D expenditure)
- Vendor management – procurement from locals/MSMEs, fairness, ESG screening, and pending dues to MSMEs
- Ease of access – network and inclusion

**Communities**
- Employment generation
- Corporate social responsibility spend and taxes paid
- Grievance/complaint redressal, families affected because of company's projects, and compensation offered to the affected families

**Compliance/controversy checks – deflators**
- Child labour, discrimination, strikes, product recalls, irresponsible marketing (banned substance, minimum wages, and sale of sin goods), and non-compliance

## Key G parameters assessed

**Board structure and functioning**

**1. Board composition**
- Board skill matrix – competency evaluation and skill / functionality mapping % of non-executive directors on Board and committees
- Integrity – investigations or indictment by law enforcement agencies; debarring /suspension by authorities

**2. Bord independence**
- Conflict of interest/segregated roles of chairman and CEO
- Degree of independence – background of independent directors – association with the company (ex-employee, independent consultant, executive at a parent/sister company, tenure)
- Independent chairman or lead independent director in case of executive chairman
- Role allocated to independent directors

**3. Board functioning and experience**
- No of Board/committee meetings held and attendance
- Independent directors' meeting without management
- Average Board tenure; directors with 10+ years tenure

**Management track record and disclosures**

**1. Management track record and control**
- Operating and net profit, market cap growth, sector outperformance
- Financial support to group/associate entity
- CEO tenure and number of Boards served on in past 1 year
- Shares pledged by promoter and remuneration

**2. Disclosures (quality and timeliness)**
- Key financial disclosures, quality of investor PPT, subsidiary reporting and disclosure, BRR/sustainability reporting, and endorsement of ESG principles and policies
- Tax disputes – longevity and quantum of dispute
- Involvement of auditors on non-audit assignments; fees paid and rationale for auditor resignation (if any)
- Complaints (customer, employee, whistle-blower, etc.)

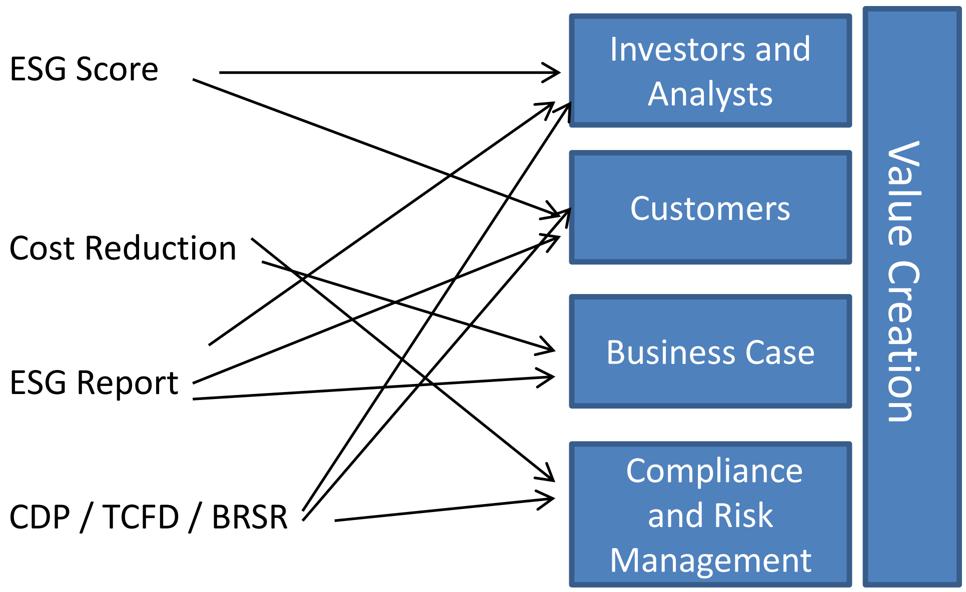
**3. Shareholder relations**
- Disclosure of cross holdings, beneficial ownership details, investor com- plaints, resolution and outstanding, special rights
- Clearly articulated policies – dividend payout

## Process to obtain a high ESG Score – A Journey of ESG

Now that we have discussed in the previous pages the three widely used ESG scoring platforms and how they assign ESG scores, let us discuss the process that a company may like to follow to obtain high ESG score.

Few things to be appreciated at the very beginning:

1. The Environmental, Social and Governance performances can be improved over a time period through sustained and consistent efforts.
2. It is only through a well planned and designed path across the aspects of E, S and G, that this journey of ESG has to be undertaken
3. While implementing initiatives of ESG are important, it is equally important to periodically disclose the ESG performance in a credible manner
4. It is important to participate in specific information sharing platforms that are set up specifically for investors and/or customers - CDP, TCFD, EcoVadis, BRSR etc.
5. The entire process of planning and progressing along the path of ESG is expected to cost some time and money. The primary objective of business being stakeholder value enhancement and not just ESG score, it is important to plan the journey of ESG keeping in mind the impact on stakeholder interests.



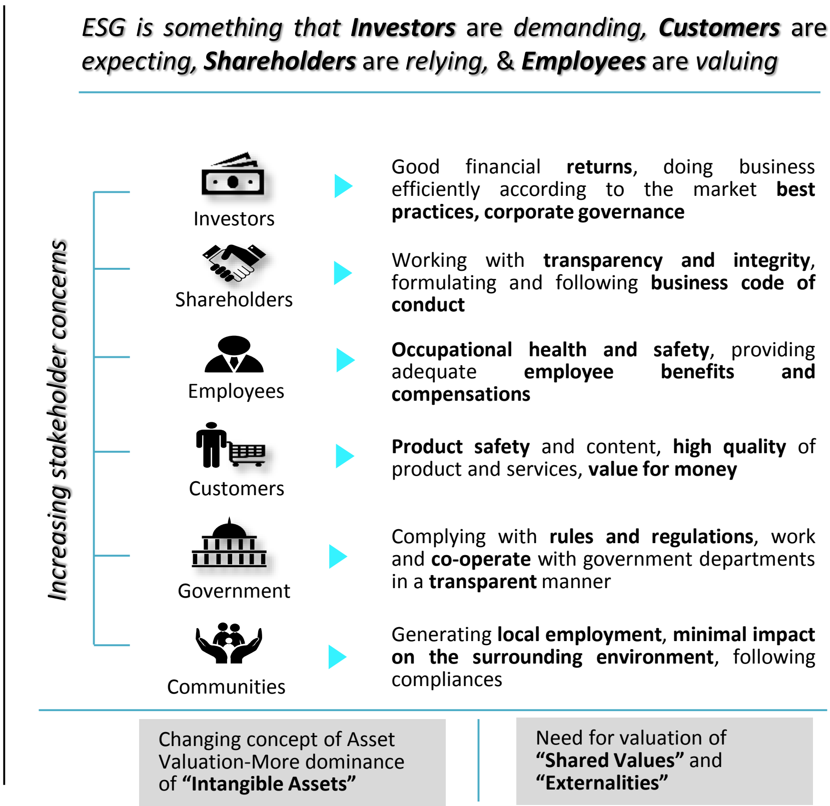

The journey of ESG for any business is similar to a journey towards excellence – where there is no limit to performing better and better. The path of the journey may be planned keeping in mind the following aspects

1. The expectations of relevant stakeholders like investors, customers and regulators
2. Prioritizing material topics
3. What peers are doing
4. Futureproofing the business particularly from changing regulations, more demanding customer needs and changing concepts of value creation
5. Risk management – business as well as environmental and social risks, climate risks

## What does ESG mean for an Organisation?


The journey has to be planned and treaded by

a. Understanding the current state of ESG
b. Prioritize aspects
c. Setting practical metrices and targets
d. Action plans to achieve the targets on a timebound manner
e. Implementation of the actions as planned
f. Planning appropriate disclosures
g. Review status and plan next leg of the journey
h. Repeat the above steps
i. It is a never ending journey towards excellence in ESG



INDIAN CHAMBER OF COMMERCE

# About Indian Chamber of Commerce

Founded in 1925, Indian Chamber of Commerce (ICC) is the leading and only National Chamber of Commerce operating from Kolkata, and one of the most pro-active and forward-looking Chambers in the country today. Its membership spans some of the most prominent and major industrial groups in India.

ICC had made its humble contribution in the pre-independence era during 1925 – 1947 towards promotion of Indian businesses and Swadeshi movement. Post Independence, ICC had the honour of engaging closely on Economic development and Reforms with Govt. of India. ICC had the privilege of hosting Session with Indian Prime Ministers like Shri Lal Bahadur Shashtri, Smt. Indira Gandhi, Shri Chandra Shekhar Azad, Shri Atal Bihari Vajpayee and several other leaders.

Recently, ICC was fortunate to host a Session with Shri Narendra Modi, Hon'ble Prime Minister of India on 11th June 2020.

Set up by a group of pioneering industrialists led by Mr G D Birla, the Indian Chamber of Commerce was closely associated with the Indian Freedom Movement, as the first organised voice of indigenous Indian Industry. Several of the distinguished industry leaders in India, such as Mr. B M Birla, Sir Ardeshir Dalal, Sir Badridas Goenka, Mr. S P Jain, Lala Karam Chand Thapar, Mr. Russi Mody, Mr. Ashok Jain, Mr. Sanjiv Goenka, have led the ICC as its President.

ICC is the only Chamber from India to win the first prize in World Chambers Competition in Quebec, Canada.

The Indian Chamber of Commerce headquartered in Kolkata, over the last few years has truly emerged as a national Chamber of repute, with full-fledged offices in New Delhi, Mumbai, Guwahati, Siliguri, Agartala, Ranchi, Bhubaneshwar, Hyderabad, Tamilnadu & Patna functioning efficiently, and building meaningful synergies among Industry and Government by addressing strategic issues of national significance

**Futurestation Advisors LLP** (www.futurestn.com) is an ESG Advisory and Assurance firm, serving clients in Value Creation through ESG. The firm is a platform of highly experienced professionals across industry sectors and leading consulting firms. With presence in Delhi, Hyderabad, Kolkata and Mumbai, the firm is serving clients in India, Europe and the USA.

**Guest Author – Suryadipta Das**

With hands-on experience of serving Indian as well as Global companies in analysing ESG scores as well as in helping them improve, Surya has written this paper with the intention of supporting Indian companies in not only realising the importance of ESG scores but also helping them to improve these scores.

linkedin.com/in/suryadipta-das

CAPITALS COALITION

*Member*

TCFD

*Supporter*

UN GLOBAL COMPACT

*Member*

AccountAbility

*AA1000AS Licensed assurance provider*

FutureStation Going Beyond

**Creating Value through ESG**