INDIAN CHAMBER OF COMMERCE

THEME 2022-2023
INDIA 2047

FutureStation
Going Beyond

Harnessing the power of CFOs

DRIVING THE ESG AGENDA IN INDIAN CORPORATIONS

Introduction

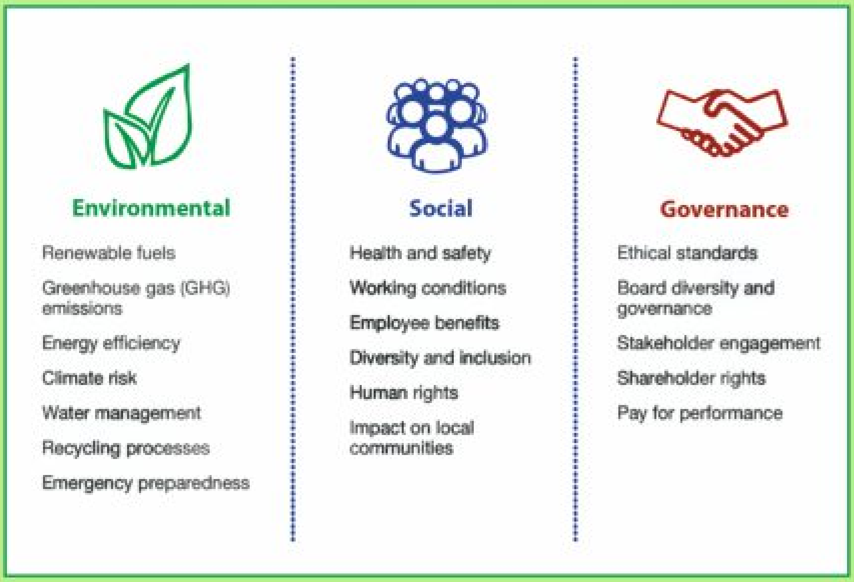
In recent years, Environmental, Social, and Governance (ESG) factors have emerged as vital considerations for businesses worldwide. As companies increasingly recognize the importance of sustainability and responsible business practices, the role of the Chief Financial Officer (CFO) has evolved significantly. This article explores how CFOs can effectively champion ESG initiatives, act as risk managers to mitigate climate risks, and address the growing need for green finance in large Indian companies.

What is ESG?

It is a way of doing business following a path of excellence in environmental, social and governance aspects. Here's a breakdown of each component:

Environmental: This aspect focuses on assessing the environmental impact of a company's operations. It includes factors such as carbon emissions, energy efficiency, waste management, biodiversity management, innovation and technological development, climate risk management and resource utilisation. Companies with strong environmental practices strive to minimize their negative impact on the environment and promote sustainability.

Social: The social component of ESG considers a company's impact on society, both internally and externally. It encompasses factors such as employee welfare, diversity and inclusion, learning and development, appraisal practices, labor relations, health and safety human rights, community engagement. Companies with strong social practices prioritize fair treatment of employees, respect for human rights, and positive community engagement.



Governance: Governance refers to the system of rules, practices, and processes by which a company is directed and controlled. It includes factors such as board composition, executive compensation, transparency, accountability, and shareholder rights. Good governance ensures that a company operates ethically, with integrity, and in the best interests of its shareholders.

Why ESG?

Organizations across industries are realizing that prioritizing sustainability is good for business, society, and the planet, and rising pressure from stakeholders, particularly the investors, customers, regulators is increasing urgency to act. ESG is thus gaining importance for several reasons:

Environmental Concerns: With increasing awareness about climate change and environmental degradation, there is a growing recognition of the need to address these issues. ESG focuses on the environmental impact of companies, encouraging sustainable practices, reducing carbon emissions, and promoting renewable energy sources. Investors and stakeholders are increasingly concerned about the long-term viability and resilience of businesses in the face of environmental challenges. Procter & Gamble was one of the first companies to market cold-water detergent, which allows consumers to save on energy and increase clothing longevity. It reduces the energy used in washing by up to 90%. In another example one natural resources firm, for example, was able to earn a 30 percent price premium from its customers because its ESG initiatives have made it the most sustainable producer of its commodity.

Social Responsibility: Companies are being held accountable for their impact on society. ESG emphasizes social aspects such as diversity and inclusion, labor rights, human rights, community engagement, and product safety. Consumers are more conscious of the social values and ethical practices of the companies they support. Investors also recognize that companies with strong social responsibility are better positioned to manage risks and build strong relationships with their stakeholders. According to data from Sprout Social, 70% of consumers believe it's important for brands to take a public stand on social and political issues. And 66% of consumers who want brands to take a stand on social say it's because they believe brands can create real change.

Patagonia campaigned their "Don't Buy This Jacket" ad for their own jacket. The message behind the campaign was to encourage people to consider the effect on the environment and to only purchase what they need.

Governance and Transparency:

ESG emphasizes good corporate governance, including factors such as board diversity, executive compensation, shareholder rights, and transparency in reporting. Strong governance practices ensure that companies are well-managed, reducing the risk of fraud, corruption, and mismanagement. Investors and stakeholders value transparency and accountability, as it fosters trust and confidence in the company's operations.

Financial Performance:

Studies have shown a positive correlation between strong ESG performance and financial performance. Companies that prioritize ESG factors are often better able to manage risks, innovate, attract talent, and build long-term value. Investors are increasingly integrating ESG considerations into their investment strategies to identify companies with sustainable business models and growth potential. According to a study by McKinsey, companies in the top quartile of ESG performance have a 4% higher return on equity (ROE) than companies in the bottom quartile. They also have a 5% lower cost of capital. (McKinsey Global Institute, 2020) The study further reveals that effective ESG management can result in a 2% increase in annual revenue growth and a 20% decrease in the volatility of earnings. (McKinsey Global Institute, 2020)

Regulatory Environment:

Governments and regulatory bodies are implementing policies and regulations that promote sustainable and responsible business practices. This includes carbon pricing mechanisms, emissions reduction targets, mandatory ESG reporting, and stricter regulations on corporate behavior. Compliance with these regulations is becoming essential for companies to avoid legal and reputational risks.

Investor Demand:

There is growing investor demand for ESG-focused investments. Institutional investors, such as pension funds and asset managers, are integrating ESG considerations into their investment decision-making process. Retail investors are also increasingly interested in investing in companies aligned with their values. As a result, companies that prioritize ESG are more likely to attract investment capital.

Overall, the increasing importance of ESG is driven by a combination of ethical concerns, long-term sustainability considerations, financial performance benefits, regulatory pressures, and investor demand. As stakeholders demand greater accountability and sustainability from companies, ESG is becoming a critical factor in assessing the overall value and impact of businesses.

How ESG creates value?

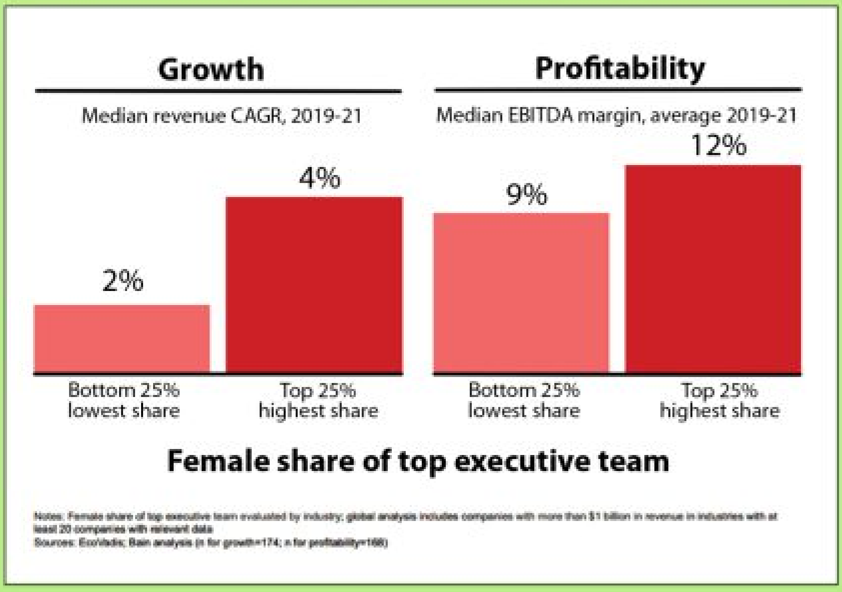
Research by Bain & Company and EcoVadis indicates that positive ESG outcomes are a trait of successful companies.

Companies with strong ESG activities produce strong ESG outcomes. They improve carbon emissions, use renewable energy, and have more diverse leadership and talent. Working together like the gears of a pocket watch, these activities correlate with improvement in financial and operational results, including higher profitability and revenue growth, customer satisfaction, and employee satisfaction.

Among the many areas ESG covers, the research found connections between business results and four different aspects of sustainability.

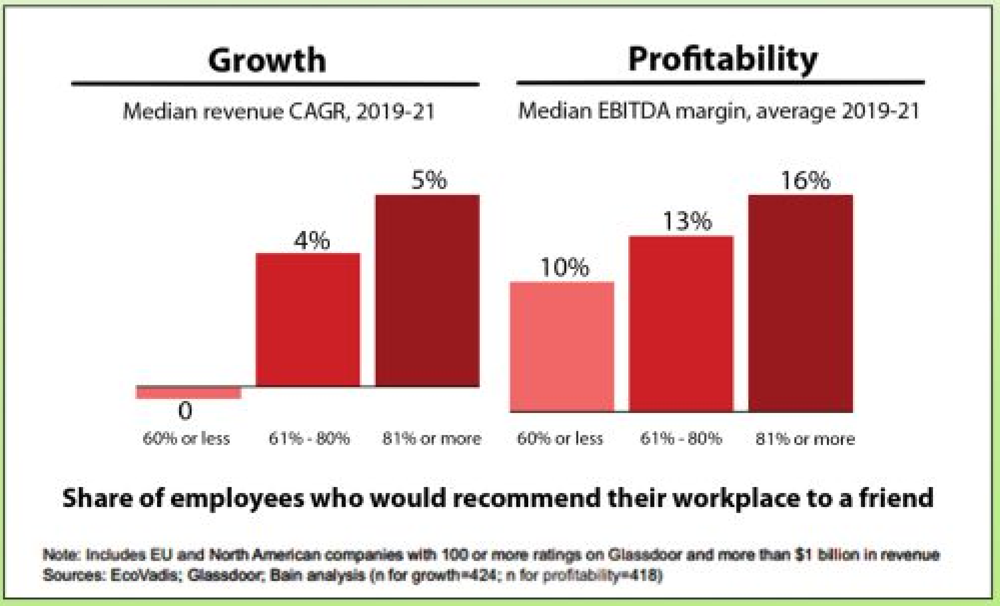
Diversity, equity, and inclusion: Companies highly rated by EcoVadis on the S (social) component of ESG have greater female executive team representation, on average, and companies with the greatest female representation on their executive team have better financial results.

Companies that rank in the top 25% of their industry for executive team gender diversity have annual revenue growth approximately 2 percentage points above that of companies in the bottom quartile (see graph). And their EBITDA profit margins are also 3 percentage points higher than that same group. Other studies have attributed this to the fact that having a diverse leadership team provides a broader view of opportunities and risks.



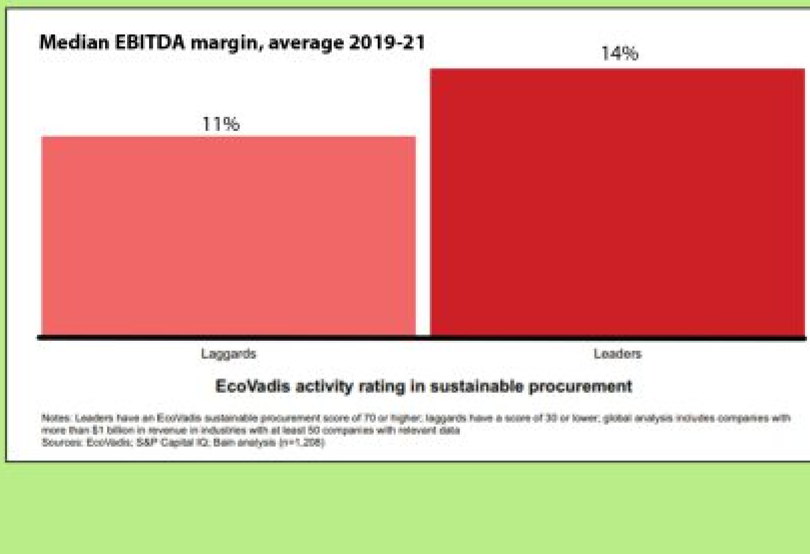
Renewable energy: In the natural resources, transportation, and industrial goods sectors, companies with high Eco Vadis ratings on environmental topics use more renewable energy and have higher EBITDA margins. In the EU, where there is a carbon tax, lowering emissions directly benefits the bottom line; around the world, greater use of renewables also helps hedge against fluctuating fossil fuel prices, and sometimes it's just cheaper.

Employee satisfaction: ESG leaders have higher employee satisfaction, and companies with the most satisfied employees grow faster and are more profitable. They have three-year revenue growth up to 5 percentage points above those with less-satisfied employees and margins as much as 6 percentage points higher than those laggards.



ESG activities focused on the workplace help companies do better by their employees. Beyond the basics of fair pay and ensuring a safe work environment, benefits may include career training, mental and physical healthcare, childcare, and educational opportunities, all of which boost employee satisfaction and, as a result, productivity, retention, and the employer's ability to attract top talent.

Sustainable supply chain: Companies at the forefront of sustainable procurement also have a profitability edge, with margins 3 percentage points above those that don't focus on their suppliers' ethics, environmental, and labor practices.



Role of CFO in ESG

CFOs can provide a broad viewpoint informed by deep financial expertise, in the traditional roles of steward and operator, the CFO preserves assets, minimizes risks, and manages an effective, efficient finance function. In expanding to the complementary roles of strategist and catalyst, CFOs can assist in setting strategy and direction and instill a financial approach in all organizational activities –including sustainability. This calls for the CFO to play a role in making and reviewing the business case, and in most other financial aspects of sustainability. In India, where companies are facing increasing regulations regarding their environmental impact, social responsibility, and climate risk, the CFO plays a crucial role in driving the ESG agenda while providing advisory support to the CEO.

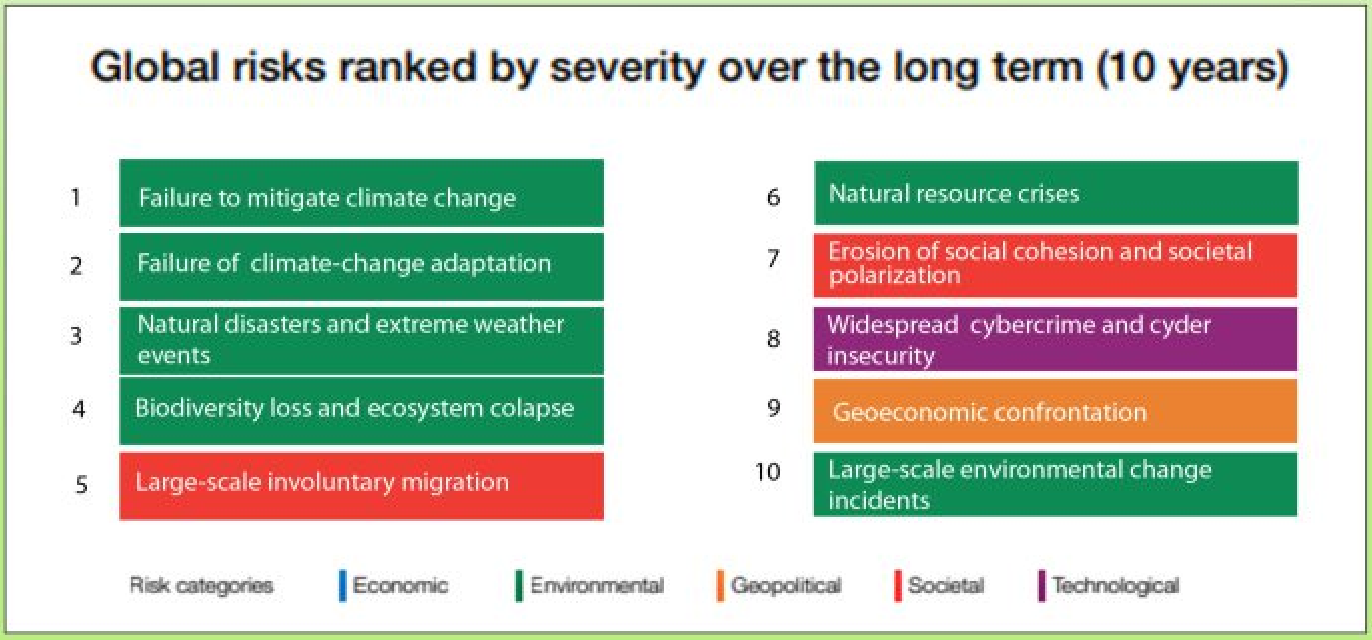
1.Understanding the CFO's Advisory Capacity:

As the CFO serves as the CEO's trusted advisor, they are well-positioned to influence the organization's strategic direction. As CFO, one can help business leaders understand whether, how, and to what extent ESG-related initiatives are connected to the company's strategy.To drive the ESG agenda effectively, the CFO will ensure that sustainable practices align with the company's long-term financial goals. By providing relevant data, financial analysis, and projections, the CFO can demonstrate how ESG initiatives can generate value, mitigate risks, and improve long-term financial performance. Research conducted by McKinsey shows that when CFOs help develop ESG programs, the results suggests greater alignment with critical company objectives.

For all three areas related to environmental, social, and governance programs, CFO involvement seems to support greater alignment between these programs and the company's strategic and financial objectives.

2. Incorporating Climate Risk Management:

Climate change poses significant risks to businesses, including physical, transitional, and liability risks. A survey by World Economic Forum conducted in 2023 lists 6 risks as environmental in the top 10 global risks by severity over the long term. The CFO, as the risk manager, plays a critical role in identifying and mitigating climate risks. This involves assessing the financial implications of climate change on the company's operations, supply chains, and assets. By conducting scenario analysis, stress testing, and integrating climate risk considerations into financial models, the CFO can guide strategic decision-making, identify vulnerabilities, and implement risk mitigation measures.



3. Embedding ESG in Financial Decision-making:

CFOs can incorporate ESG considerations into financial decision-making processes. This involves assessing the financial impact of ESG risks and opportunities, integrating ESG metrics into investment analysis, and aligning capital allocation with sustainability goals. A business-specific approach toward allocating resources to ESG can facilitate top-line growth, reduce costs, minimize regulatory and legal interventions, increase employee productivity, and optimize investments and capital expenditures. By employing tools like Environmental Profit and Loss (EP&L) accounting, CFOs can quantify and communicate the monetary value of environmental impacts, enabling informed decision-making. Pepsi Co famously saved $80 million in five years by recycling water used in its Arizona Frito-Lay snacks facility. Additional energy, packaging and waste reduction initiatives saved the company more than $600 million over that same period.

For finance leaders, half of the battle is ensuring that ESG initiatives are implemented with an eye on the bottom line. Integrating ESG into cost management means striking a balance between targeted, socially responsible cost reduction initiatives and smart spending to fuel growth.

4. Leveraging ESG Ratings for Better Financing:

ESG ratings have become an essential tool for investors, lenders, and stakeholders to evaluate a company's sustainability performance. CFOs can play a pivotal role in improving the company's ESG ratings by implementing and monitoring ESG practices. Higher ESG ratings not only demonstrate the company's commitment to sustainable practices but also enhance its access to better financing options. Financial institutions and investors increasingly consider ESG ratings when making investment decisions, enabling companies with higher ratings to attract more favorable financing terms and capital inflows.

According to Sustainalytics, most major banks now screen their loan portfolios against ESG risks, following guidance from the Organisation for Economic Co-operation and Development on due diligence for responsible corporate lending. Failure to meet lenders' ESG criteria may disqualify businesses from financing or spoil borrowing terms. The investment community has also embedded ESG into their evaluation criteria. A recent survey of the private equity industry found that 95% of PE firms conduct ESG assessments as part of due diligence.

5. Integrating Green Finance:

As sustainable finance gains momentum globally, CFOs must familiarize themselves with green finance practices and opportunities. Green finance refers to financial instruments and investments that support environmentally friendly projects and businesses. CFOs can actively explore options like green bonds, sustainability-linked loans, and impact investments to fund ESG initiatives and climate resilience projects. By collaborating with banks, investors, and development institutions, CFOs can leverage their financial expertise to access green finance, mobilize resources for climate adaptation and mitigation, and further improve the company's ESG ratings.

6. Driving Transparency and Reporting:

CFOs have a crucial role in ensuring accurate and transparent ESG reporting. Effective CFOs also consider using new and emerging standards to report on the company's ESG activities, such as alerting investors and other key stakeholders to positive outcomes from green initiatives and averting risks from misreading stakeholder priorities. By implementing robust ESG reporting frameworks, such as the Global Reporting Initiative (GRI) or Sustainability Accounting Standards Board (SASB) guidelines, CFOs can provide stakeholders with comprehensive and standardized ESG disclosures. This transparency builds trust among investors, customers, and regulatory bodies, and positions the company as a responsible corporate citizen.

7. Cultivating Stakeholder Engagement:

Effective stakeholder engagement is key to driving the ESG agenda, managing climate risk, and securing better financing. CFOs can work with Investor Relations and Corporate Communications teams to communicate the company's commitment to sustainability, climate resilience, and highlight ESG achievements and goals. Engaging with shareholders, customers, employees, and local communities fosters trust, enhances brand reputation, and attracts ESG-conscious investors, thereby strengthening the company's resilience to climate risk and its ability to secure favorable financing options

8. Collaboration across Departments:

Driving the ESG agenda requires collaboration across departments and functions. CFOs can act as catalysts by engaging other key executives, such as the Chief Sustainability Officer, Chief Risk Officer, and Chief Strategy Officer. Collaborative efforts facilitate the integration of ESG considerations into various business functions, ensuring a holistic and coordinated approach towards sustainability.

Conclusion:

In the face of increasing ESG expectations and climate risks, CFOs hold a pivotal position to drive the ESG agenda, manage climate risk, and secure better financing for Indian corporations. By leveraging their financial expertise, advisory capacity, and collaboration skills, CFOs can champion sustainable initiatives, integrate climate risk management, improve ESG ratings, and attract favorable financing terms. Through transparent reporting, embracing green finance options, and cultivating stakeholder engagement, CFOs can position their companies as leaders in sustainability, resilience, and responsible business practices, ultimately ensuring a more sustainable and financially robust future.

Thus once again, the CFO's job description is being rewritten. Companies are increasingly tasking CFOs with various responsibilities that support their sustainability goals. If companies are to find the right balance between fulfilling short-term performance requirements and capturing longer-term opportunities related to sustainability, the CFO's leadership is indispensable.

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.

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Sameer Shah is an Executive Director of FutureStation Advisors LLP. Sameer has led finance functions of MNCs and entities of large Indian Group. Sameer is a Sustainability Professional with certifications in GRI Standards and Business Responsibility and Sustainability Reporting Standards issued by ICAI.

By qualification, he is a Chartered Accountant, a Company Secretary and a Certified Public Accountant (USA).

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Creating Value through ESG