ESG series

Part I - What is ESG?

Content

Summary

The future is completely in our hands.

It’s time to take action. The lens of corporates and individuals need to widen to incorporate sustainable goal sets along with financial ones. We are experiencing change like no other. At the core of these dynamics is the climate change.

This article summarises the basic understanding of ESG and what each of these letters signify in our journey towards a sustainable world.

Happy reading !

What is ESG?

ESG stands for environment, social and governance. These are know as the three pillars of ESG framework and areas in which companies are expected to report in.

- Environment – this has to do with an organisation's impact on the planet.
- Social – this has to do with the impact an organisation has on people, including staff and customers and the community.
- Governance – this has to do with how an organisation is governed. Is it governed transparently?

The goal of ESG is to capture all the non-financial risks and opportunities inherent to a company's day to day activities.

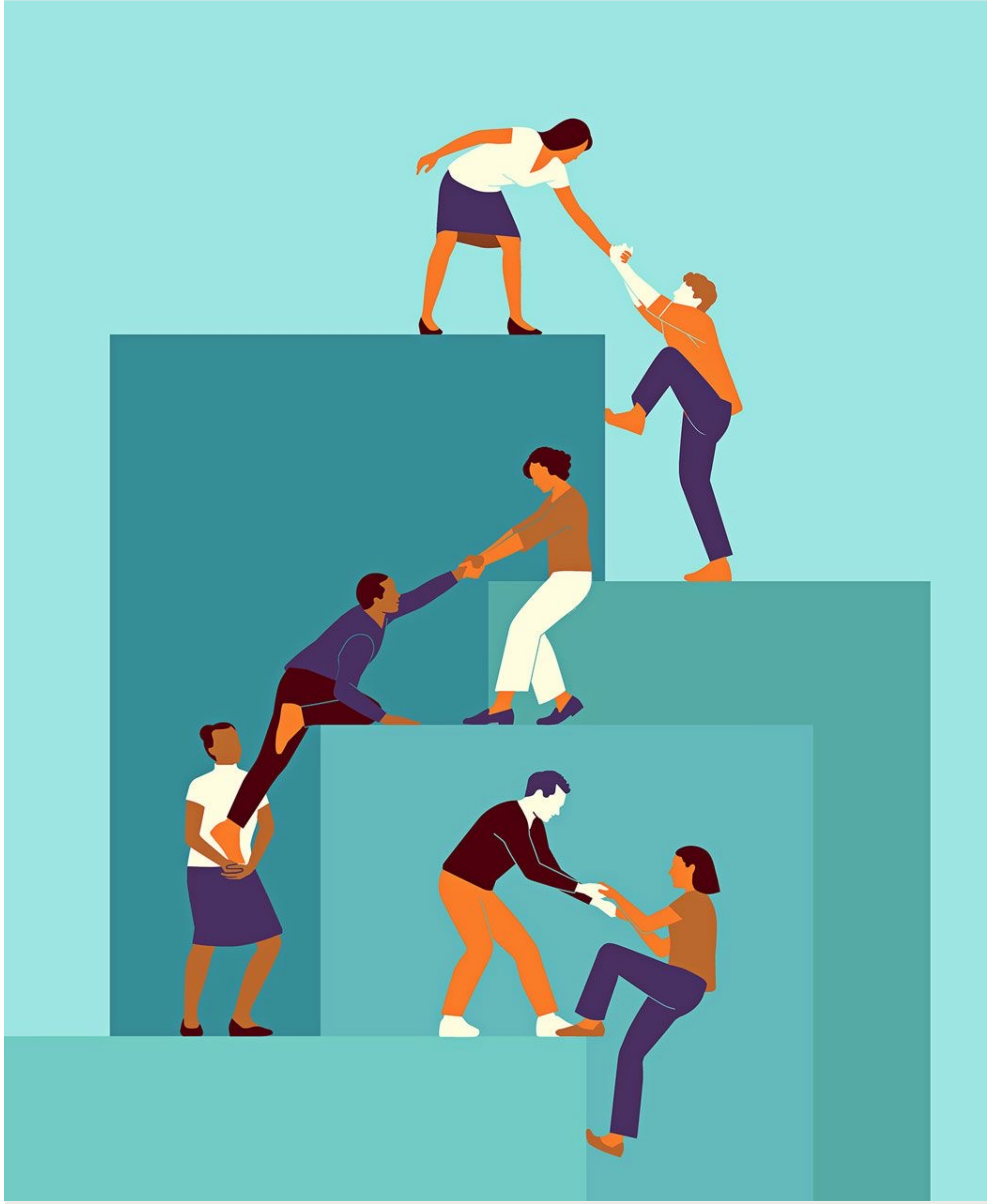
It is a set of aspects considered when investing in companies that recommends taking environmental, social and corporate governance issues into account.

Environment

The interaction of the company with the environment is one of the important factors in understanding ESG risks and opportunities.

Environmental issues would include corporate climate policies, energy use, waste management, air and water pollution, deforestation and treatment of animals.

There are opportunities for companies to report on positive sustainability impacts they might have. This can be translated into long-term business advantage. ESG considerations could help evaluate any environmental risks a company might face and how it would manage those risks. If we consider the reporting perspective, this pillar remains the most complex one.



Social

ESG social is about human rights and equity – it encapsulates the interaction a company has with the broader society. Within this social dimension several key elements come into play like diversity and inclusion, labour practices, human rights, customer relations, employee wellbeing, philanthropy and health and safety.

In essence, the social pillar emphasises a company's role as a responsible corporate citizen that goes beyond profit making.

Governance

Governance refers to an organisation's internal policies and practices, leadership structure, compliance, and overall decision-making processes. The unprecedented events of 2020 have made it obvious for the stakeholders including investors to draw boards attention to social, environmental and governance issues. The rising pressure will demand the board to understand and respond to the risks and align business practices around ESG.

The main issues reported under the Governance Pillar of the framework are, internal controls, shareholders rights, board diversity, executive compensation and how their compensation is aligned with the company's sustainability performance. It also includes matters of corporate behaviour such as anti-competitive practices and corruption.

Why is ESG compliance inevitable ?

Due to recent global events such as climate change and COVID 19 pandemic, there is increased focus on how the companies are responding to similar risks and the level of readiness they have in terms of developing capabilities. Going forward, companies are going to be viewed through the lens of how they address ESG concerns.

The demands of investors, regulators, as well as consumers and employees now require companies to have business vision incorporating natural, social and governance framework.

Investment decisions are now made by investors post incorporating ESG elements. Hence, it is becoming imperative for the companies to have focus on these aspects if they are looking to obtain capital in any form.

In order to create value, manage risk and remain relevant, companies need to develop a strategic approach to ESG.

ESG as a part of business has moved from ‘nice to have’ to the normal way of doing business and it will be at the core of the future success of the companies.

Why is this relevant for your company?

ESG related risks faced by the companies vary based on the industry or sector in which the entity operates. For example, for companies operating in the manufacturing sector, the greenhouse gas emissions (scope 1 and 2) are important however, for consulting or banking sector, the same are not much relevant.

The company needs to have readiness to understand the risks it faces from ESG perspective considering the materiality.

Usually, materiality is looked at from a perspective of financial materiality. Increasingly, double materiality is being recognised as an important concept in choosing what is considered material by a company.

Double materiality implies that along with financially material issues, sustainability related issues are also treated as material.

Coming up next under the ESG series

Greenhouse Gases (GHG) and its scopes

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I am an accomplished Chartered Accountant with seven years of experience working with top accounting firms. As an enthusiast of ESG and accounting, I am always seeking ways to expand my knowledge and share it with a broader audience.

It's time to do our part to save the planet and make the world a better place to live.