ESG Ratings: To Lay Benchmark for India's Sustainable Future

CareEdge ESG RATINGS
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ESG Ratings: Enabler for Indian Corporates Towards Sustainability Transition

In today's business environment, where corporate responsibility and sustainability are imperative rather than optional, Environmental, Social, and Governance (ESG) ratings serve as a crucial benchmark for companies worldwide. These ratings have become essential to the global investment landscape, driven by a growing demand for sustainability and ethical considerations in decision-making. ESG ratings allow companies to evaluate and improve their sustainability performance by comparing themselves against industry benchmarks and assessing their positions among peers. They consolidate various aspects of a company's disclosures, compliances, strategies, initiatives, and performance across ESG areas into a comprehensive score. As the momentum for sustainable investing accelerates, ESG ratings are increasingly influencing the future trajectory of businesses. CareEdge-ESG, a leading ESG Rating Provider (ERP), aims to be a catalyst for change towards sustainability with the most credible ESG assessments.

Why ESG matters more than ever?

Despite the challenges, the significance of ESG ratings should not be underestimated. A strong ESG performance for companies translates into more than just good public relations. It enhances brand reputation, reduces risk exposure, and increases attractiveness to both equity and debt investors. In an environment where investors seek entities capable of managing ESG-related risks and opportunities, a robust ESG rating is a significant differentiator. Furthermore, companies with solid ESG credentials are often better positioned to diversify their investor base and raise capital more efficiently.

Based on assessing its non-financial information, disclosures and policies, ESG ratings evaluate how well a company manages environmental, social, and governance risks and opportunities. CareEdge-ESG's India-specific approach to ESG ratings considers the challenges specific to Indian companies within the given sector. From enhanced brand reputation to reduced risk exposure, the advantages of better ESG performance are diverse and far-reaching. Solicited ESG ratings provided by ERPs following the "Issuer-Pays" model (ERP-IP) equip stakeholders with an independent assessment of companies' ability to manage ESG-related risks through a comprehensive evaluation of its public and non-public data in the form of frameworks, transition strategy, disclosures, policies and performance.

There are various compelling reasons why companies should focus on improving their ESG Ratings and the tangible benefits it can bring. Some of the obvious benefits of ESG ratings include following key aspects:

- Establishing and effectively communicating clear ESG goals and targets significantly enhances the company's appeal to equity and debt investors
- A strong ESG performance and demonstrated commitment to ESG principles bolster a company's brand presence and foster stakeholder loyalty
- A company with robust ESG credentials often finds greater opportunities to diversify its investor base and raise capital more efficiently
- ESG rating provided by an independent SEBI regulated ERP assists the users of ESG rating to understand company's level of transparency in ESG reporting and disclosures

Identifying and managing environmental, social, and governance risks and opportunities can impact long-term financial performance. Companies with strong ESG performance may be better positioned to mitigate risks and capitalise on opportunities such as climate change, human rights, and corporate governance.

Beyond Just Numbers

At a glance, ESG ratings may appear as another set of metrics in a data-saturated world. However, these ratings transcend mere numerical assessments; they represent a comprehensive evaluation of a company's dedication to sustainable practices. ESG ratings provide a detailed overview of a company’s performance across environmental, social, and governance dimensions, presenting a complete picture of its operations. These ratings go beyond reflecting a company’s ethical stance – they provide an insight on its long-term sustainability in an ever-evolving global landscape.

For Indian companies, ESG ratings provide a critical tool for benchmarking themselves against peers within their industry. They offer a pathway to improve sustainability performance, not only by identifying areas for improvement but also by enhancing transparency and accountability. While numbers are used in calculations for performance-related Key Indicators (KIs), ESG ratings also analyse qualitative factors like a company’s ESG frameworks policy, statements, leadership commitment, and transparency regarding their ESG practices. ESG ratings provide quantitative medians and benchmarks for critical parameters, e.g., comparing one’s scope-1 emissions against industry benchmark emissions for the sector, which can provide insights regarding short–and long–term emission reduction target setting. With benchmarking, companies can understand the velocity and magnitude of their actions towards transition. Another instance is the median female-to-male ratio in the workforce. Gender equality and equal opportunity are essential to the core of human capital. Still, the criteria vary across industries; hence, comparing one’s ratios with those if the industry shall provide a better understanding of self-performance. For example, services-based organisations generally have a better female-to-male ratio; however, Non-Banking Financial Companies (NBFCs) have a relatively lower ratio compared to banks or IT services. Therefore, it is pertinent that companies assess themselves against peers to gauge their performance.

ESG ratings and disclosures (whether voluntary or regulatory) have also emerged as a crucial tool for companies to demonstrate their commitment to sustainable practices and responsible business conduct. Companies report their non-financial performance, risks, and opportunities related to sustainability practices based on ESG frameworks. These frameworks guide reporting the underlying data that the ERPs use in their rating assessment. ESG ratings go beyond just numbers because they consider not only quantitative data on E, S & G parameters but also undertake granular and objective scoring of qualitative factors like company policies, training to board members, employees, and value chain partners, stakeholder engagement, and overall commitment to sustainability, providing a broader picture of a company's impact beyond just financial performance. The ERP-IPs carry out comprehensive engagement with the companies to understand their level of commitment, goal setting and future transition. These aspects are then judiciously combined with publicly available data and disclosures in assigning a comprehensive ESG score on the SEBI mandated 100-point scale.

The Regulatory Push

India’s regulatory landscape has begun to reflect the growing importance of ESG. The Securities and Exchange Board of India (SEBI) has taken significant steps to embed ESG principles into the fabric of corporate India. Introducing the Business Responsibility and Sustainability Reporting (BRSR) framework for the top 1,000 listed entities is a landmark move aiming to standardise ESG disclosures. And promote transparency and accountability. As the ambit of the BRSR framework and other disclosure regulations/frameworks expand, all companies, listed or private, as well as SMEs, will have to address ESG principles if they want to sustain any competitive advantage in the market.

In July 2023, SEBI introduced guidelines for ERPs. India now has a regulatory framework that mandates ERPs to assign ESG scores on a uniform 100-point scale together with the constituent Environmental, Social and Governance scores and their respective weights. As spearheaded by SEBI, India brought the first such mandate of a regulatory framework for ERPs, setting a precedent for other jurisdictions. This move is groundbreaking, not just for its rigour but for its potential to bring consistency and comparability to ESG ratings in India.

International Financial Services Centres Authority (IFSCA), GIFT City, has provided a roadmap for ESG Rating services in the IFSC (International Financial Services Centre). IFSCA is working towards increasing the mobilisation of sustainable finance into India. IFSCA has taken significant steps in accelerating global sustainable capital flows by creating a conducive regulatory environment based on international best practices focused primarily on the needs of India and developing countries. The use of proceeds verification of these sustainable finances shall be conducted by the ESG Ratings providers.

Financial sector-regulated entities (REs) play a crucial role in financing the transition towards an environmentally sustainable economy. Thus, they must implement robust climate-related financial risk management policies and processes to counter the impact of climate-related financial risks. Given this, the Reserve Bank of India (RBI) developed a draft disclosure framework on Climate-related financial risks (2024) requiring REs to report information on governance, strategy risk management and metrics and targets from FY26 and FY27 reporting period onwards, respectively. These disclosures are in addition to the SEBI-mandated BRSR data disclosure requirements.

Not Without Challenges

While the global shift towards ESG is undeniable, the Indian context presents unique challenges. India's energy security status and its socio-economic conditions differ significantly from those in developed economies, and a one-size-fits-all approach to ESG ratings won't work. Consequently, India has a different net zero trajectory and its own Nationally determined contributions (NDCs). These national goals and targets should be integral to India's taxonomy and its regulatory and supervisory disclosure frameworks for its BFSI and industrial/service sectors.

However, the journey is not without its hurdles. The availability and quality of ESG data in India are still evolving. Accordingly, an issuer-pays model of rating assignments leads to a more refined approach to ESG assessment. Companies can share their non-public information with the ERPs and explain their strategies in detail, providing better insights into their sustainability initiatives. Issuer-pays ERPs, such as CareEdge-ESG, provide such assessments through a structured approach, leading to consistency and reliability in the ratings.

The current BRSR framework helps investors assess non-financial parameters related to ESG and sustainable activities. However, the framework is generic and does not consider sectoral nuances. To improve transparency and effectiveness in ESG reporting, the BRSR should be:

- Customized for each industry (e.g. ESG parameters are different for banks vs manufacturing sector)
- Addressing the distinct environmental, social, and governance risks which are unique to each sector
- Providing detailed guidelines on reporting to eliminate ambiguity
- Dispense clear guidelines usage of unit for reporting on quantitative indicators
- Sector specific data points need to be introduced to make reporting relevant to respective industries

There is an impending need of framework revision to reflect market expectations. It is witnessed that many companies either do not understand the nuances of data reporting under BRSR or feel that the data is not relevant to them and, hence, do not report appropriately in BRSR. The current one-size-fits-all approach often leads to the omission of crucial sector-specific data.

India Taxonomy

The 2024 Budget announced the development of an India-specific sustainable taxonomy, which needs acceleration to direct funds towards climate adaptation, mitigation, and reduced financed emissions. A Green/Sustainable Taxonomy is essential for efficient climate financing to meet national climate goals. It helps screen green projects, prevents greenwashing, and lowers financed emissions in loan portfolios. The financial system can support the transition to a sustainable economy by efficiently allocating resources to green/sustainable activities. RBI acknowledges the need for consistent, comparable disclosure frameworks. Upcoming RBI guidelines on climate-related financial risks will further standardise sustainability data reporting. An India-specific taxonomy will help price financial risks and allocate capital for transitioning to a sustainable economy.

India's ESG future

As India continues its journey towards a sustainable future, ESG ratings will play an increasingly critical role. The focus on evaluation-oriented, objective assessments of sustainability risks is essential for fostering positive transformation and building stakeholder trust. Globally, there is a push towards more regulated and transparent ESG ratings, which are crucial for building investor confidence and ensuring consistency among rated companies. Accurate ESG data fosters consistency and comparability among rated companies, enhancing trust in the ratings. India stands at a crossroads. On one hand, the country faces significant socio-economic challenges that complicate the adoption of ESG practices. Conversely, an enormous opportunity exists to lead the way in sustainable development, setting an example for other emerging economies. By adopting a localised approach to ESG assessments, Indian companies can better navigate the complexities of their operating environment while contributing to the global push for sustainability. As ESG disclosures gain prominence, especially in the financial market, CareEdge-ESG's India-specific ESG Ratings Framework will support enhanced decision-making across stakeholders and contribute to the growth of the Indian economy.

A Strategic Imperative

In conclusion, ESG ratings are not just a regulatory checkbox but a strategic imperative. For India, embracing ESG is more than aligning with global trends; it is about securing a sustainable and prosperous future. As ESG ratings evolve, they will undoubtedly add significant value to the global economy by promoting responsible business practices and fostering long-term sustainability. The question is not whether India will join this movement—it already has. The real question is how quickly, and effectively Indian businesses can leverage ESG to drive growth and ensure their place in the global economy.

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About Us:
CareEdge is a knowledge based analytical group that aims to provide superior insights based on technology, data analytics and detailed research. CARE ESG Ratings Limited (CareEdge-ESG) is one of the India's leading ESG rating provider fostering sustainability with ESG insights. With an aim of being a catalyst of change for a sustainable future with the most credible ESG assessments, CareEdge-ESG provides a 360-degree appraisal for the ESG performance benchmarking cum transition enabling ESG risk mitigation and enhanced decision-making capabilities for all stakeholders.