

The Role of ESG (Environmental, Social, and Governance) Metrics in Investment Strategies

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Project Report

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1 Introduction to ESG

The term ESG, or Environmental, Social, and Governance, is a very well known concept in the investor community. It refers to a set of metrics used to measure an organization's environmental as well as social impact and has become increasingly important in investment decision making over the years. Although, the term ESG was first coined in 2004 by the United Nations Global Compact, the concept has been around for much longer.

The three main areas which ESG encompasses are:

- **Environmental:** This explains how a company interacts with the natural environment. Key factors include carbon emissions, resource usage, waste management, and efforts by the company to mitigate climate change. It also encompasses the company's initiatives to promote sustainability and reduce its environmental footprint through innovative practices and technologies.
- **Social:** This area assesses a company's relationships with its employees, suppliers, customers, and the communities where it operates. It includes labour practices, diversity, equity, inclusion, and community engagement. This evaluation ensures that the company fosters positive and ethical interactions which contributes to sustainable and responsible business practices.
- **Governance:** It mainly focuses on the internal practices and policies which ensures that a company operates with transparency and integrity. This includes board composition, executive compensation, shareholder rights, and compliance with laws and regulations.

ESG metrics are used by different stakeholders namely investors, customers, suppliers, and employees, which are then used to evaluate corporations' sustainability, including their impact on the planet and the communities where they operate. High ESG ratings are very crucial as they can decrease risks and attract more investments, making companies more appealing to investors and other stakeholders.

The market momentum for ESG highly accelerated in 2006 with the publication of The Principles for Responsible Investment (PRI). The PRI introduced six principles that institutional investors can adopt to integrate ESG issues into their investment analysis and decision making processes. These principles highlight the fiduciary duty of investors to address the ESG issues which can affect the performance of their investment portfolios.

Since then, the ESG has become a dominant way to assess how companies contribute to the world, in addition to generating their profit. Companies with higher ESG scores are often seen as more sustainable, which can directly impact long-term risks and returns on investment (RoI). Consequently, corporations with robust ESG practices are considered less risky and more likely to succeed in the longer run.

However, the measurement of a company's efforts toward ESG might be intimidating, as the majority of the ESG metrics do not report through a common framework with standardized measuring mechanisms. At the moment, there are multiple such frameworks with metrics and methodologies regarding an analysis of a company's ESG impact. Despite all these challenges, ESG investing continues to gain traction, driven by increased regulatory scrutiny, rising consumer expectations, concerns over the climate change, and national commitments to achieving net-zero emissions.

In conclusion, ESG is critical for any business aiming to succeed in the long run. By integrating ESG principles into their operations, companies can create a more sustainable and socially responsible future while becoming more attractive to investors and all stakeholders.

2 Evolution of ESG Investing Strategies

Over the past few years, there have been several crucial phases over time:

Early Adoption and Initial Skepticism (2010-2014):

The early 2010s nailed the beginning of the ESG considerations in main-stream investment strategies. Initially, the ESG investing was met with a lot of skepticism, with concerns about the potential trade-off between the financial returns and ethical considerations. However, pioneering investors and funds began to demonstrate that the ESG factors could lead to better risk management and, in some cases, even enhanced returns.

Growing Awareness and Integration (2015-2018):

From 2015 onwards, there was a remarkable increase in awareness and integration of ESG factors in the investment strategies. The United Nations' Sustainable Development Goals (SDGs) and the Paris Agreement in 2015 played crucial roles in highlighting the Importance of Sustainability. During this period, major asset managers started incorporating ESG metrics into their investment processes, leading to the creation of ESG-focused funds and indices.

Mainstream Acceptance and Innovation (2019-2021):

By the end of the 2019, ESG investing had already been moved into the mainstream. The number of ESG-focused funds surged remarkably, and ESG metrics became a standard part of financial analysis. Innovations in data analytics and reporting standards, such as the Task Force on Climate-related Financial Disclosures (TCFD), enhanced the quality and availability of the ESG data. Investors began to recognize that the ESG factors could drive long term value and mitigate risks.

Regulatory Support and Market Transformation (2022-Present):

In the recent years, regulatory support for ESG investing has strengthened. The European Union's Sustainable Finance Disclosure Regulation (SFDR) and the EU Taxonomy for Sustainable Activities are the important examples of policies aimed at promoting transparency and standardization in the ESG reporting. These regulations have accelerated the adoption of ESG metrics, and hence transforming the investment landscape.

The Last Decade: An Evolving Landscape

By 2015, the adoption of the Sustainable Development Goals (SDGs) have marked a significant shift in the socio-political mindset towards ESG. The SDGs outlined 17 sustainability targets with specific indicators to track the progress, setting a global agenda for sustainable development by 2030. This framework ensured that ESG considerations were not merely discussed but were measured and integrated into corporate strategies worldwide.

Investor demands for climate related financial disclosures led to the establishment of the Task Force on Climate-related Financial Disclosures (TCFD) in 2015. This initiative aimed to standardize climate related disclosures for financial institutions and companies, reinforcing the importance of ESG transparency in investment decisions.

In 2017, the Compact for Responsive and Responsible Leadership was drafted by the World Economic Forum, with 140 CEOs committing to advancing the UN's SDGs. This pledge underscored the growing alignment between corporate leadership and global sustainability goals, further embedding ESG principles into corporate governance.

The COVID-19 pandemic tested corporate resilience, revealing that companies with strong ESG performance were better prepared to withstand economic shocks. This realization highlighted the value of ESG integration beyond ethical considerations, demonstrating its role in enhancing business continuity and long-term sustainability.

Today, the ESG data is instrumental in evaluating a company's performance across specific environmental, social, and governance metrics. From carbon emissions per unit of revenue to the employee turnover rates, ESG metrics provide insights into a company's operational efficiency and social impact. Regulatory frameworks continue to evolve, with initiatives like the European Union's Corporate Sustainability Reporting Directive (CSRD) and potential mandates from the Securities and Exchange Commission (SEC) in North America. These regulations aim to standardize ESG reporting practices, ensuring consistency and comparability across industries and regions.

ESG ratings and indices, such as those offered by Morgan Stanley Capital International (MSCI), have gained a huge popularity among investors seeking to integrate the ESG factors into their portfolios. These indices facilitate the identification and selection of the companies with strong ESG profiles, aligning investment strategies with sustainable development goals. As global challenges related to climate change and social issues intensify, ESG considerations are surely going to play an increasingly pivotal role in shaping corporate strategies and investment decisions. ESG is no longer a fringe concept but a fundamental framework for creating a resilient and responsible business environment, driving positive impact on both financial performance and societal outcomes.

3 Key Trends in ESG Investing

Investment choices considering environmental, social, and governance (ESG) issues have become really popular over the last decade. It can help you better represent your ideals in your investing decisions. Here are the few key sustainable ESG investing trends:

3.1 Increased Demand for Transparency

More revelation of ESG information is demanded by investors. Standardized reporting frameworks have developed like the ones set by the Global Reporting Initiative (GRI) and the Sustainability Accounting Standards Board (SASB) that are used to guide companies in a consistent and comparable manner of reporting their ESG performance. Third-party assurance techniques, such as audits and independent organizations' certifications, have also been increasingly used. These processes ensure the ESG data reported by companies is accurate, reliable, and trustworthy. More transparency does not only help investors make better decisions but calls on companies to account for their ESG practices, hence calling them to improve their sustainability performance.

3.2 Focus on Climate Risk

A focus on climate change as a central ESG investing issue has grown with the greater recognition of the far reaching consequences on economies, industries, and communities. Consequently, investors are placing more emphasis on assessing the risks and opportunities in their portfolios related to climate change. This involves the evaluation of companies' carbon footprints, an understanding of the exposure of companies to physical climate change risks, and therefore their resilience to such risks, as well as preparing for and achieving de-carbonization in atmospheric pathways in line with regulatory policy ambition. Another area investors are looking into is how exposed companies are to the global temperature increase limitation set by international agreements like the Paris Agreement, which seeks to limit global warming to well below 2 degrees Celsius. In order to report their climate plans, companies are expected to set scientific goals for reductions of emissions and set transition plans towards a low-carbon economy. A focus on climate risk is driving major changes in investment strategies as investors look to minimize losses and take advantage of opportunities that arise with the global shift towards sustainability.

3.3 Supply Chain Emissions Reduction

Supply chain emissions account for a significant portion of a company's overall carbon footprint. This has certainly made the abatement of supply chain emissions the most important priority for every company with a commitment to sustainable practices. Investors now care about how companies are grappling with, and reducing materials, manufacturing processes,

and transportation emissions along their supply chains. The technologies of digital transformation that companies are taking up will also ensure the ability to properly track and report supply chain emissions, including business networks and intelligent spending solutions. Key trends include transparent reporting and disclosure of supply chain emissions data to gain trust with stakeholders through demonstration of commitment to sustainability. Driving companies toward collaboration with suppliers in investment and practice the nature of commitment to supply chain cleanliness.

3.4 Social and Governance Considerations

Social and governance factors, when combined, are gaining more relevance in ESG investing, mainly because of diversity, equity, and inclusion (DEI). Investors understand the value creation through innovation from an inclusive workforce for corporate performance improvement and better decision-making. Shareholders are wading into DEI policies and looking at workplace demographics and efforts towards equal opportunity. Governance factors key to ensuring accountability, transparency, and long-term value include board diversity, independence, and shareholder rights. Companies with executive remuneration visible to the public and well aligned with long-term performance augmented by strong shareholder engagement are particularly attractive to investors who seek sustainable returns.

3.5 Deeper Integration with the Company Balance Sheet

With this wave of climate related financial disclosures, now spurred on by the new SEC rules on climate disclosures, many companies are linking ESG explicitly to their CFOs and controllers responsible for the company finance, and hence, the links between finance and sustainability have bound them to ESG. Carbon, which companies just a few years back were considering in forward scenarios, such as global carbon pricing or being forced to purchase carbon removal at an industrial scale, is now treated like an asset and a liability. It is a "liability-driven" approach that will make risks and financial obligations more visible on the balance sheet. For example, oil companies will need to forecast and price in emissions taxes, along with the financial impacts these will have on the fiscal side of fossil fuel production. In 2024, the ESG team and finance and risk management team will be working together closely, perhaps putting internal carbon pricing in place in preparation for stricter carbon regulations.

4 Challenges

ESG data – ESG ratings and disclosures – helps investors decide how they should invest in sustainability initiatives. However, there are some challenges that need to be addressed, which are:

- **No data standards:** The absence of consistent, verified, credible, and widely accepted data standards makes it difficult for investors to compare the ESG characteristics of a potential investment target company against another firm. Often times, data is missing for certain metrics and asset classes, leading to inaccurate investment analysis.

- **Inconsistencies across regions:** Certain regions have lesser number of ESG disclosures, which results in fragmented reporting. Moreover, ESG data is spread across multiple sources such as annual report, CSR report, company website, and regulatory filings.
- **Lack of data reliability:** When it comes to ESG data providers, there is lack of transparency with respect to methodology, scope of underlying data, and review mechanisms. Many firms are looking at developing proprietary, internal ESG ratings to ensure reliable data which is crucial to make sound investment decisions. This, however, may not be economically viable for small- or medium-sized asset managers.
- **Data variance:** ESG scores can vary from one ESG ratings provider to another due to differences in frameworks, measures, key indicators and metrics, data use, and qualitative judgement.
- **Materiality:** Firms can also capture any controversial information with potential reputation impact and financial materiality. Materiality, in the ESG context, refers to the effectiveness and financial significance of a specific measure as part of a company's overall ESG analysis.

Let's now delve deep into the challenges:

4.1 Investors are Confused by ESG

ESG funds are based on uncontrolled ESG ratings, which are not based on universal standards but rather on comparative evaluations of industry peers. Because of this, fossil fuel businesses sometimes have higher ESG scores than manufacturers of electric cars. The data that support ESG ratings are also frequently out-of-date, mostly unaudited, and incomplete. Even individuals in charge of this data lack trust in their own non-financial reporting; more than 70% of executives polled across a variety of businesses and countries reported having doubts about the accuracy of their own non-financial reporting. Despite numerous current initiatives to standardize ESG reporting, it will be difficult to attribute results or make impact claims for the foreseeable future since ESG investors lack access to comparable, precise indicators.

4.2 It Has No Significant Effects on the Environment or Society

ESG funds mostly invest in securities traded on secondary markets, making it impossible to assess the impact of ESG investing, even if planetary welfare is one of its primary goals. To determine whether a fund's investments have an impact, it is crucial to demonstrate additionality, which means that the measured outcome would likely not have occurred without the investment, thereby creating an impact. In a 2013 paper on secondary market equity purchases, Kelly Born of the Hewlett Foundation and Paul Brest, a retired professor of law at Stanford University, reported that "most economists agree that socially motivated investors cannot increase the beneficial outputs of a publicly traded corporation by purchasing its stock.

4.3 It Still Needs to Show That it Better Returns Are Delivered

ESG investment has the potential to produce higher financial returns, according to asset management companies. They list a number of explanations for possible outperformance, including the fact that high ESG enterprises have stronger managers, lower capital costs, produce greater margins, and are able to draw in and keep a more engaged workforce. The association between high ESG firms and stock returns has, however, been the subject of countless studies by academics and asset managers. In more than two-thirds of these research, the relationship between ESG and financial returns is at least non-negative. However, no research has demonstrated that ESG results in superior returns, and newer studies have questioned the association between ESG and outperformance.

4.4 It is Expensive

The costs associated with ESG goods are one of Wall Street's driving forces behind the frenzy of ESG product creation and overselling of planetary effect. Asset management revenues as a share of AUM have decreased by 4.6 basis points over the past five years, according to BCG, as passive funds have gained appeal. ESG funds are a timely response to the narrowing of asset management margins because their fees are often 40% higher than those of standard funds. These increased costs are frequently unjustified given that ESG funds frequently closely resemble "vanilla" funds. ESG U.S. Stock ETF, the largest and most established ESG fund offered by Vanguard, had a 0.9974 correlation with the S&P 500.

4.5 Maintaining the Illusion of Market-based Voluntarism

There is a misperception that the trillions of money required to finance the transition to a low carbon economy would soon be available due to the growth in ESG investing. This gives people a false sense of security and might lessen the need for the public-private partnerships and regulatory reforms that are essential to stop threats to the environment and social welfare. This postponement is consistent with the idea that private externalities can be regulated privately instead of publicly through market-based voluntary behavior. However, as seen by Coke's attempts to conserve water, this notion disregards the limitations of voluntary action.

4.6 Opposition to ESG Investing

ESG confusion has drawn criticism from the investment sector. ESG initiatives have drawn criticism from hedge fund manager Sir Chris Hohn, who claimed that "ESG for most managers is total greenwash and investors need to wake up to realize that their asset managers talk but don't actually do." Over 1,200 ESG funds with over \$1 trillion in assets under management had their ESG labels revoked early this year by Morningstar, a company that does investing research and advice services. This is as a result of the funds' failure to "integrate

[ESG factors] in a determinative way in their investment selection.” Following Tesla’s exclusion from the S&P 500 ESG index, Elon Musk also blasted ESG, calling it “the devil incarnate.” Even ESG’s skeptics are reconsidering its worth.

4.7 Greenwashing

It refers to the practice of presenting a company or investment as more environmentally friendly or socially responsible than it actually is. ESG skeptics argue that many companies engage in greenwashing by making superficial or misleading claims about their sustainability efforts in order to attract ESG-focused investors.

5 Impact of ESG on Financial Markets

We found a study about this topic by Tensie Whelan, Ulrich Atz, Tracy Van Holt and Casey Clark, CFA NYU Stern The authors of this report, NYU Stern Center for Sustainable Business and Rockefeller Asset Management, collaborated to examine the relationship between ESG and financial performance in more than 1,000 research papers from 2015 to 2020.

They found a positive relationship between ESG and financial performance for 58% of the “corporate” studies focused on operational metrics such as ROE, ROA, or stock price with 13% showing neutral impact, 21% mixed results (the same study finding a positive, neutral or negative results) and only 8% showing a negative relationship. For investment studies typically focused on risk-adjusted attributes such as alpha or the Sharpe ratio on a portfolio of stocks, 59% showed similar or better performance relative to conventional investment approaches, while only 14% found negative results. They also found positive results when they reviewed 59 climate change, or low carbon, studies related to financial performance. On the corporate side, 57% arrived at a positive conclusion, 29% a neutral impact, 9% mixed and, 6% negative. Looking at investor studies, 65% showed positive or neutral performance compared to conventional investments, with only 13% indicating negative findings. A detailed breakdown can be found in Fig.1.

Figure 1. Positive and/or neutral results for investing in sustainability dominate. Very few studies found a negative correlation between ESG and financial performance (based on 245 studies published between 2016 and 2020) .

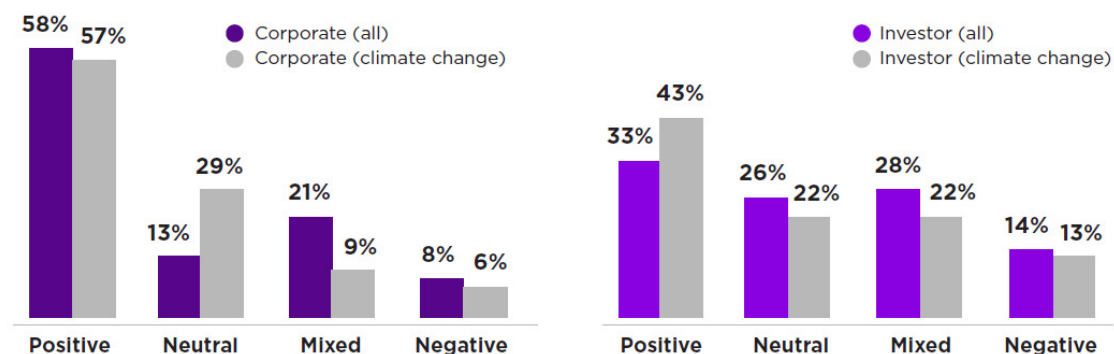


Fig. 1. Results for Investing in Sustainability

Many of the studies reviewed described a finding and tried to explain it through the lens of a social science derived model of the world. Several social science theories dominate the research:

- Stakeholder theory-Successful companies need to manage for a wide variety of stakeholders such as employees, civil society, suppliers and investors.
- Shared value-Companies that create shared value for all stakeholders do better financially.
- Legitimacy theory-a social contract between the corporation and society, which, if broken, leads to consumers reducing demand or governments imposing regulatory restrictions.
- Resource-based view-emphasizing internal resources such as employees and intangible assets for achieving a competitive advantage.

Some key takeaways we can see from the relation between ESG and financial performance are:-

- Improved financial performance due to ESG becomes more marked over a longer time horizon.
- ESG Integration as a strategy seems to perform better than negative screening approaches, and ESG momentum may cause improvers to outperform leaders.
- ESG investing appears to provide downside protection, especially during social or economic crisis.
- Sustainability initiatives at corporations appear to drive financial performance due to factors such as improved risk management and more innovation.
- Studies indicate that managing for a low carbon future improves financial performance.
- ESG disclosure on its own does not drive financial performance.

6 Analyzing ESG Reports

Analyzing ESG reports involves 5 key steps:

6.1 Material Assessment

This is the most important ESG issue for an organisation, considering both financial and environmental impact.

Steps-

- Select framework
- Narrow down material issues
- Group ESG issues with goals
- Risk rate ESG factors
- Build material map

6.2 Disclosures

Disclosures of ESG criteria's in the company-

6.2.1 Environmental

- GHG emissions
- Air quality
- Energy, water, waste management
- Biodiversity impact

6.2.2 Social

- Workforce diversity
- Worker health and safety
- Supplier worker safety
- Community relations

6.2.3 Governance

- Executive compensation
- Board composition
- ESG policies and ethics

6.3 Sustainability initiatives, efforts, and Progress

- Set sustainability goals and targets.
- Build initiatives to address material ESG issues.
- Analyze progress made towards achieving your sustainability goals.
- Discuss the challenges faced and lessons learnt.

6.4 Reporting Scope and Index

- **Clearly Define Boundaries:** Your scope should provide a transparent picture of your reporting coverage to avoid ambiguity for stakeholders.
- **Facilitate Navigation:** A well-crafted index acts as a roadmap, ensure clarity and logical organization in your index.
- **Align with Stakeholders:** Consider whether aligning your scope and index with your own corporate goals or relevant frameworks or standards such as UNGC or SDC to improves communication with key stakeholders.

6.5 Credibility & Assurance

While not mandatory, independent verification of your ESG data by a third party enhances transparency and credibility.

7 ESG Factors and Their Role in ESG Indices

Environmental, Social, and Governance (ESG) factors are used to evaluate the sustainability and moral effect of corporations. ESG indices, which include the MSCI ESG Index, Dow Jones Sustainability Index (DJSI), and FTSE4Good, are built based totally on a set of ESG factors that examine a organisation's overall performance in each of the three key domains. The contribution of every ESG thing in making these indices entails a multifaceted method that blends monetary evaluation with sustainability metrics.

Here's an in depth study 20+ key ESG elements and their position in shaping ESG indices:

7.1 Climate Change Policies (Environmental)

- **Contribution:** A company's efforts to mitigate weather trade, inclusive of greenhouse gasoline (GHG) emission reductions and commitments to carbon neutrality, play a imperative function in environmental scoring. Companies that actively pursue renewable electricity, strength efficiency, and weather resilience rank higher in ESG indices.
- **Weighting:** Indices frequently deliver full-size weight to climate change factors due to developing global interest on decarbonization efforts.

7.2 Carbon Emissions (Environmental)

- **Contribution:** Measures the total carbon emissions of a company. This factor includes both risk and opportunity assessments — emissions reductions mean that the fit is consistent with future regulations and market trends.
- **Weighting:** Heavily affects industries such as energy, manufacturing, and transportation.

7.3 Water Usage and Conservation (Environmental))

- **Contribution:** Measures a company's water efficiency and efforts to reduce water use and waste. In industries such as agriculture, beverages, and mining, this is very important.
- **Weighting:** Particularly relevant in water-constrained environments, where a company's performance in water management has a significant impact on its ESG score

7.4 Waste Management (Environmental)

- **Contribution:** Measures how a company handles its waste, including hazardous material reduction, recycling, and proper disposal. Companies with budgets that reduce waste and recycle score higher.
- **Weighting:** Important in all industries, but especially in manufacturing, engineering, and consumer goods.

7.5 Biodiversity Impact (Environmental)

- **Contribution:** A company's impact on the environment, including efforts to protect biodiversity and prevent deforestation, is increasingly being assessed in ESG indexes, particularly in the private sector te as miners, oil, and gas.
- **Weighting:** Loss of resources such as biodiversity is considered an important environmental issue.

7.6 Supply Chain Sustainability (Environmental/Social)

- **Contribution:** Determine whether a company ensures that its suppliers follow sustainable practices. This includes reducing the carbon footprint, implementing sound business practices and sourcing responsibly.
- **Weighting:** Increases in industries that rely on complex global supply chains, such as industrial, retail and automotive.

7.7 Renewable Energy Usage (Environmental)

- **Contribution:** The percentage of renewable energy used by a company. A company that switches from fossil fuels to solar, wind or hydropower gets more environmental scores.
- **Weighting:** Very important in heavy industry and power plants.

7.8 Human Rights (Social)

- **Contribution:** ESG indices assess a company's human rights standing, including its treatment of employees, workers' rights, and the prevention of forced labor or child labor.
- **Weighting:** This factor plays a key role in industries in the global supply chain, such as textiles and electronics, where human rights abuses can be prevalent.

7.9 Labor Standards (Social)

- **Contribution:** Assesses whether a company ensures fair wages, safe working conditions, and non-discrimination. Companies with strong employee protections and trade

unions score higher.

- **Weighting:** Labor relations are especially important in labor-intensive industries such as manufacturing, construction, and retail.

7.10 Employee Diversity and Inclusion (Social)

- **Contribution:** Companies are evaluated on their commitment to diversity, gender equality, and inclusion. A diverse and inclusive workforce can improve creativity, decision-making, and customer relations.
- **Weighting:** Important in all industries, but particular emphasis is placed on consumer-facing industries such as finance, technology, and healthcare.

7.11 Health and Safety (Social)

- **Contribution:** Examines how a company protects the health and safety of its employees, especially in high-risk industries such as construction, mining, and manufacturing.
- **Facilitate Navigation:** A strong safety culture reduces accidents and improves employee morale.
- **Weighting:** Heavy loads in jobs where worker safety hazards are most pronounced.

7.12 Community Engagement (Social)

- **Contribution:** Companies are identified based on how they engage with and support community stakeholders. This includes philanthropic efforts, volunteer programs, and creating community employment.
- **Weighting:** Moderate weight of local participation across sectors but particularly important for mining companies or those with significant local impact.

7.13 Corporate Governance Practices (Governance)

- **Contribution:** A company's governance structure, including board size, transparency, and shareholder rights, is critical to ESG indices. A well-structured and transparent board with independent directors enhances accountability.
- **Weighting:** Important across all sectors, with increased weight in sectors such as finance and pharmaceuticals, where governance inefficiencies have led to major scandals.

7.14 Anti-Corruption Policies (Governance)

- **Contribution:** An evaluation of anti-corruption policies, including bribery prevention and compliance with international anti-corruption conventions, is critical to assessing governance risk.
- **Weighting:** Heavily weighted in industries with government contracts, such as defense, infrastructure, and oil & gas.

7.15 Executive Compensation (Governance)

- **Contribution:** Evaluates whether a company's executive compensation plan is consistent with long-term performance and shareholder interests. Companies with excessive CEO compensation or unfair incentives may score lower.
- **Weighting:** An important element in governance, especially in public companies with close shareholder management.

7.16 Shareholder Rights (Governance)

- **Contribution:** Measures the extent to which shareholders influence board decisions, including the ability to vote on important issues such as mergers or executive compensation.
- **Weighting:** More important in public companies, especially in tech and finance where shareholder activity is common.

7.17 Transparency and Reporting (Governance)

- **Contribution:** Transparency in financial reporting, ESG metrics, and risk disclosure is central to good governance. Companies that are open and detailed in their ESG reports score higher.
- **Weighting:** Very important in all businesses, especially in finance, where transparency is needed for stakeholder trust.

7.18 Cybersecurity (Governance)

- **Contribution:** With growing concerns about data breaches and cyberattacks, a company's cybersecurity program is an emerging governance element. A strong cybersecurity program can mitigate significant reputational and financial risks.
- **Weighting:** Increases in technology, economy, and health.

7.19 Ethical Business Practices (Governance)

- **Contribution:** Assesses whether a company operates ethically in its business operations, including fair trade, fair pricing, and avoidance of harmful practices.
- **Weighting:** A key component in consumer-facing industries, such as pharmaceuticals, retail, and financial services.

7.20 Tax Transparency (Governance)

- **Contribution:** Measures a company's transparency in its tax practices, including disclosure of tax strategies and state taxes. A lower number of companies consider tax

avoidance.

- **Weighting:** Appropriate for multinationals, especially in industries such as technology, where tax practices have been scrutinized.

7.21 Product Safety and Quality (Social/Governance)

- **Contribution:** Examines how a company ensures the safety and quality of its products and services. Companies with robust quality and safety audit mechanisms score higher.
- **Weighting:** Important in industries such as pharmaceutical, food & beverage, and automotive, where safety and quality are important for customer confidence.

Weighting and Factor Aggregation in ESG Indices

Within ESG indices, each of these factors is weighted differently depending on:

- **Sector Sensitivity:** Certain factors, such as carbon emissions, are more important for industries such as energy and manufacturing, while labor opportunities and diversity may be more important in the service sector.
- **Geopolitical Context:** Factors such as human rights and governance practices vary from country to country and from region to region, and companies in emerging markets sometimes face greater scrutiny.
- **Materiality:** Indices generally prioritize the most important factors for a company's financial and risk profile. For example, a tech company's ESG score might emphasize cybersecurity, privacy, and a sustainable supply chain, while a mining company might focus on water consumption, waste management activity, and on greater community involvements

Aggregation Methodology

Indices such as MSCI or FTSE4Good often use scoring models to aggregate ESG factors into a single score for each company. This may require:

- **Data Collection:** From publicly available reports, disclosures, and third-party accounts.
- **Normalization:** Changing scores to account for different industry standards and regional factors.
- **Weighting:** Partial or total weights will be used to express physical properties.
- **Ranking:** Companies are then compared to a broader universe to create a final index.

8 ESG Report on Tata Motors & Tech Mahindra: A Comprehensive Review

This comprehensive 30-day report covers the performance of Tata Motors and Tech Mahindra, India's two largest companies in the automotive and IT sectors. The survey highlights

their sustainability practices, governance structures, and social responsibility policies, while comparing their performance to industry peers.

Automotive industry leader Tata Motors has made significant strides in curbing carbon emissions by combining electric vehicle production with renewable energy. Tech Mahindra, a prominent entrepreneur in the IT sector, has been equally active in environmental stewardship, promoting social welfare, and maintaining stringent governance standards.

This report seeks to:

- Look at the current ESG programs of Tata Motors and Tech Mahindra.
- Compare their performance with industry peers.
- Identify key challenges and opportunities for improvement.

Tata Motors is a major contributor to the Indian auto industry and has led efforts in the development of electric vehicles to reduce carbon emissions. On the other hand, Tech Mahindra has made great strides in adopting sustainable IT solutions, energy-efficient practices, and encouraging diversity and inclusion among its workforce.

8.1 Environmental Impact

Tata Motors

- **Electric Vehicle (EV) Production:** Tata Motors is leading India's transition to electric mobility with the successful launch of the Tata Nexon EV and other electric devices. By 2030, Tata aims for a larger share of its vehicle production to be electric, thereby reducing CO2 emissions.
- **Carbon Footprint Reduction:** Tata Motors has invested heavily in renewable energy, with more than 16% of its energy coming from solar and wind power. The company's Pune and Sanand plants are examples of areas where renewable energy has been adopted at scale.
- **Waste & Water Management:** Tata Motors has implemented Zero Waste to Landfill policy and uses wastewater recycling in various plants. These projects are part of their long-term sustainability strategy to reduce environmental impact.

Tech Mahindra

- **Energy-Efficient Data Centers:** Tech Mahindra data centers embrace and support green IT practices, including energy-efficient hardware, water cooling systems, and renewable energy that reduce the carbon footprint on the basis of their operations.
- **Carbon Neutrality Goals:** Tech Mahindra is committed to achieving carbon neutrality by 2030. This is supported by their Mission 2025 strategy, which aims to reduce overall energy consumption by 50% through energy efficient IT systems and wise use of energy.

- **E-Waste Management:** The company has a comprehensive e-waste recycling program, which promotes responsible disposal of old IT hardware and focuses on circular economic principles to save the environment influence has decreased.

8.2 Social Responsibility

Tata Motors

- **Employee Safety and Training:** Tata Motors is a pioneer in employee safety and welfare. Regular safety training and emergency drills are conducted at all manufacturing facilities. They also have programs focused on developing employee skills and creating career development opportunities.
- **Community Engagement:** Tata Motors contributes significantly to the community, especially in the areas of health, education, and rural development. In partnership with NGOs and government agencies, they have built roads, schools, and health facilities in underdeveloped areas, affecting the lives of thousands of people.
- **CSR Initiatives:** Tata Motors' CSR policy focuses on road safety awareness, employee training, and forestry initiatives. They are actively involved in improving the socio-economic conditions of underserved communities.

Tech Mahindra

- **Diversity and Inclusion:** Tech Mahindra has a diverse workforce with a strong focus on gender equality and women leadership. Several initiatives have been implemented, including the TechMHER program that empowers women in leadership and technical roles.
- **Skilling and Education:** Through its Tech Mahindra Foundation, the company provides job training and digital learning to underprivileged youth across India, with the aim of improving employment and closing the digital skills gap.
- **Healthcare and Well-Being:** The company's CSR initiatives focus on improving healthcare in rural areas through healthcare. In addition, they lead mental health programs for employees, balancing work and life.

8.3 Governance and Ethics

Tata Motors

- **Corporate Governance:** The company is committed to following strict principles of governance and corporate governance. The governance structure ensures openness, with its own appointment of audits, risk management and corporate responsibility. The company is committed to maintaining a majority of women on the board, and female representation has made some progress in recent years.
- **Ethics and Anti-Corruption:** It maintains strict ethical guidelines, with regular employee engagement on ethical practices, anti-corruption measures and compliance with

global and national laws.

Tech Mahindra

- **Governance Structure:** Tech Mahindra has created an ESG committee that drives entrepreneurship in the spirit of motivational power. The board places significant weight on ethical decision-making, risk management and business openness.
- **Data Security and Privacy:** As a technology company, Tech Mahindra invests heavily in data protection and cybersecurity measures, ensuring compliance with international standards such as ISO 27001 and GDPR for data protection.
- **Ethical Business Practices:** The company follows a strict anti-bribery policy and conducts regular ethical audits throughout the business. The focus on governance extends to supply chain ethics and ensures that all partners meet carrier standards.

8.4 Benchmarking and Comparison

Aspect	Tata Motors	Tech Mahindra	Industry Peers
Environmental	Leading in electric vehicle production, focus on renewable energy usage in plants.	Energy-efficient IT solutions, data centers with renewable energy focus.	Infosys (IT), Maruti Suzuki (Auto)
Social	Strong CSR programs, employee well-being, community engagement.	Diversity and inclusion, vocational training, mental health programs.	Wipro, Mahindra & Mahindra
Governance	Transparent, ethically driven, strong board oversight.	Ethical business practices, data security compliance.	Reliance, Ashok Leyland

8.5 ESG Ratings and Certifications

Tata Motors

- **CDP (Carbon Disclosure Project) Rating:** B for climate change.
- **Dow Jones Sustainability Index:** Tata Motors is listed on the DJSI Asia-Pacific for its performance in sustainable mobility and responsible manufacturing.
- **ISO Certifications:** Tata Motors holds ISO 14001 (Environmental Management) and ISO 45001 (Occupational Health and Safety).

Tech Mahindra

- **Sustainalytics Rating:** Tech Mahindra is ranked as a low-risk company in ESG.
- **Global Reporting Initiative (GRI):** The company follows GRI standards for its ESG disclosures and sustainability reporting.
- ISO 27001 (Information Security) and ISO 50001 (Energy Management).

8.6 Challenges and Recommendations

Tata Motors

- **Challenge:** Increase production of electric vehicles while maintaining infrastructure, such as charging stations and recycling.
- **Recommendation:** Increase collaboration with government agencies and the private sector to develop robust EV infrastructure and promote the use of sustainable batteries.

Tech Mahindra

- **Challenge:** Balancing digital service development with sustainability efforts in a dynamic media landscape.
- **Recommendation:** Accelerate the adoption of renewable energy powered data centers and integrate them with sustainable software development practices.

8.7 Conclusion

Both Tata Motors and Tech Mahindra demonstrate a strong commitment to ESG principles. Tata Motors is responsible for transforming the Indian automotive sector through electrification and sustainable manufacturing. Tech Mahindra seems to be active in promoting diversity, promoting inclusion and providing sustainable IT solutions.

While both companies perform well, there are opportunities to further scale its sustainability initiatives, improve supply chain transparency and integrate ESG into its business strategy if the extent of the. By continuously adapting to global ESG trends and following high standards, Tata Motors and Tech Mahindra are committed to nurturing their brands in responsible business practices.

9 Examining Criticisms and the Significance of Transparency in ESG Reporting

Criticisms of ESG Reporting

1. Inconsistent Standards:

- **Concern:** A major issue with ESG reporting is the absence of uniform standards, which leads to varied practices and challenges in benchmarking performance across different organizations.
- **Consequence:** This inconsistency makes it difficult for investors and other stakeholders to effectively compare ESG performance across companies, potentially leading to misinformed decisions.

2. Greenwashing Risks

- **Concern:** Companies may engage in “greenwashing,” where they present an exaggerated or misleading image of their environmental and social efforts.
- **Consequence:** This practice diminishes the reliability of ESG reports and can deceive stakeholders seeking genuine sustainable and ethical business practices.

3. Lack of Detail

- **Concern:** Many ESG reports provide broad overviews without delving deeply into the specifics of how objectives are met or progress is tracked.
- **Consequence:** Without detailed information, it becomes challenging to hold companies accountable and assess the real impact of their ESG initiatives.

4. Cost and Complexity

- **Concern:** Producing thorough ESG reports can be expensive and complicated, particularly for smaller organisations.
- **Consequence:** This financial and administrative burden might lead to either superficial reporting or discourage comprehensive ESG reporting altogether.

5. Short-Term Focus

- **Concern:** There is a tendency for ESG reports to highlight short-term achievements rather than addressing long-term sustainability issues.
- **Consequence:** This focus may result in companies prioritizing easily achievable goals over more substantial, long-term improvements.

Importance of Transparency and Disclosure in ESG Reporting

1. Enhancing Trust

- **Significance:** Transparent ESG reporting fosters trust among stakeholders, such as investors, customers, and employees. Open communication about practices and progress strengthens credibility.
- **Effect:** Building trust can lead to greater investor confidence, improved customer loyalty, and higher employee morale.

2. Supporting Informed Choices

- **Significance:** Detailed and transparent ESG disclosures provide the necessary information for stakeholders to make well-informed decisions regarding investments, purchases, and career choices.
- **Effect:** This transparency helps in fostering responsible investing and consumer behavior, benefiting the market and promoting ethical practices.

3. Promoting Accountability and Progress

- **Significance:** Clear reporting holds companies accountable for their ESG commitments and allows them to monitor their progress and make necessary adjustments.
- **Effect:** This can lead to ongoing improvement in ESG practices and help achieve long-term sustainability objectives.

4. Ensuring Regulatory Compliance

- **Significance:** With increasing regulations around ESG disclosures, transparent reporting ensures that companies meet legal requirements and avoid potential penalties.
- **Effect:** Compliance helps in mitigating regulatory risks and bolstering the company's reputation as a responsible corporate entity.

5. Differentiating in the Market

- **Significance:** Effective ESG reporting can set a company apart by demonstrating its dedication to sustainable and ethical practices.
- **Effect:** This differentiation can attract investors, customers, and talent who value corporate responsibility, potentially leading to competitive advantages.

6. Fostering Stakeholder Engagement

- **Significance:** Transparency in ESG reporting enhances engagement with stakeholders by providing clear insights into how the company is addressing key issues.

- **Effect:** Engaged stakeholders are more likely to support the company’s initiatives and contribute to its long-term success.

Summary

While there are notable criticisms regarding ESG reporting—such as the lack of standardised metrics, green-washing, and short-term focus—the importance of transparency and disclosure cannot be overstated. Effective ESG reporting builds trust, supports informed decision-making, promotes accountability, ensures regulatory compliance, differentiates companies in the marketplace, and fosters stakeholder engagement. Addressing these criticisms and improving the quality of ESG reports can enhance their effectiveness and credibility, driving more sustainable and ethical business practices.

10 Contribution

- **Kushagra Bothra:** Introduction, Evolution of ESG Investing Strategies, Key Trends in ESG Investing , ESG Factors and Their Role in ESG Indices & ESG Report on Tata Motors & Tech Mahindra: A Comprehensive Review
- **Dushyant Singh Charan:** Challenges in ESG Investing, Analyzing ESG Reports & Examining Criticisms and the Significance of Transparency in ESG Reporting
- **Aryan Biswas (Till Mid-Term Report):** Impact of ESG on Financial Markets

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