

## **What Is ESG Investing?**

ESG stands for Environmental, Social, and Governance. Investors are increasingly applying these non-financial factors as part of their analysis process to identify material risks and growth opportunities. ESG metrics are not commonly part of mandatory financial reporting, though companies are increasingly making disclosures in their annual report or in a standalone sustainability report. Numerous institutions, such as the Sustainability Accounting Standards Board (SASB), the Global Reporting Initiative (GRI), and the Task Force on Climate-related Financial Disclosures (TCFD) are working to form standards and define materiality to facilitate incorporation of these factors into the investment process.

### **ESG Investing Trends**

As ESG investing accelerates in demand, several key trends are emerging – from climate change to social unrest. The coronavirus pandemic, in particular, has intensified discussions about the interconnectedness of sustainability and the financial system.

### **What Is Sustainable Investing?**

Traditional investing delivers value by translating investor capital into investment opportunities that carry risks commensurate with expected returns. Sustainable investing balances traditional investing with environmental, social, and governance-related (ESG) insights to improve long-term outcomes.

In many ways, sustainable investing can be seen as part of the evolution of investing. There is a growing recognition among industry participants that some ESG factors are economic factors, especially in the long term, and it is, therefore, important to incorporate material ESG factors.

#### **There are three critical elements of sustainable investing:**

1. Sustainable investing is additive to asset management theory and does not mean a rejection of foundational concepts.
2. Sustainable investing develops deeper insights about how value will be created going forward using ESG considerations.
3. Sustainable investing considers diverse stakeholders, consistent with how companies are developing.

### **Why Is Sustainable Investing Important?**

Interest in sustainable investing continues to grow, and the pressure is on for investment organizations to move toward the sustainable investing model. In an era when the investment industry is challenged by rising end-client and regulatory expectations and challenging economics, the alternative of maintaining the status quo leaves the industry vulnerable to decline.

The next stage of development will depend heavily on industry leadership and innovation in investment thinking and practice, as well as data management. If these are present, the future is exceptionally bright.

### **Climate change impact**

- Around 50% of investors in Asia-Pacific countries, excluding Australia, New Zealand and Japan, consider climate change metrics for decision-making compared with the global average of 42%, the MSCI report showed.
- The reality is, climate change links to a rapidly shifting social context that in turn drives changes to investor demands, all within a very dynamic regulatory environment. These trends are amplified by technology innovation, adding significant cost and time pressure. Quite simply, investing has never been a more complex ecosystem.

### **Climate Change Analysis in the Investment Process**

#### **Economic And Market Implications Of Climate Change**

Estimates of the costs of climate change have a wide range, but all contain bad news. A 2015 report by The Economist Intelligence Unit estimated the net present value costs of climate change at US\$4.2 trillion. That estimate tends to be on the low end, however. If no action is taken to mitigate climate change, losses could be between US\$4 trillion and US\$20 trillion. The cost of adapting to climate change in developing countries could rise to between US\$280 and

US\$500 billion per year by 2050, according to a recent United Nations Environment Programme (UNEP) report.

The Fourth National Climate Assessment, published in 2018 by the US Global Climate Change Research Program, noted that climate change could slash up to a tenth of US gross domestic product annually by 2100. That figure is more than double the losses of the Great Recession of 2008.

## **Climate Analysis Takes Imagination and Better Data**

Climate change is already affecting economies and financial markets, and by its nature, it will do so with more frequency in the future. To exacerbate the matter, today's financial professionals generally have a limited understanding of the issue and few tools for including climate change metrics into their financial models.

Global regulators and standard-setting bodies are increasing their attention to climate change. The European Commission is in the process of creating a taxonomy for sustainable financial activities that aims to place an environmental, social, and governance (ESG) or sustainability framework on the investment industry's activities. This approach places some of the burden of climate change mitigation on the financial profession, although we will need better data from companies in order to adequately meet this challenge. China, Japan, and Canada are in the early stages of developing similar taxonomies. More government intervention on the issue is inevitable.

### **What Investors Can Do**

Investors need to educate themselves on the economics of climate change and understand the implications of a heating world on their investments. As we explore in the next section, this includes understanding the risks as well as opportunities that may arise. To perform this analysis, investors need better data and better reporting standards around climate related data. They should therefore engage with corporate issuers and policymakers to help inform best practices and standards for climate change

### **ESG Metrics**

ESG Metrics is a tool designed to give institutional investors a broad set of standardized ESG data and simple flagged metrics that are comparable across a broad universe of 8,500 companies in the MSCI ACWI Investable Market Index (IMI) coverage universe. Developed based on 40 years of experience collecting, standardizing and modeling ESG metrics, the data can be used as inputs for in-house analytical models or to develop proprietary investment strategies.

### **ESG METRICS DATASET:**

**Risk Exposure** A new risk exposure dataset that leverages MSCI ESG Research's proprietary ESG risk models, mapping over 50,000 individual business and geographic segments to 22 macro risk factors, such as carbon regulation, water stressed regions, and corruption risks.

Exposure scores (ranging from 0-10) measure to what extent a company's business is vulnerable to a particular ESG risk. Higher scores on exposure indicate greater risk on the issue. The 8 scores below are available for all companies in the MSCI ACWI IMI coverage universe.

### **Practices**

The practices dataset offers insight into a company's capabilities to manage ESG risks or capitalizing market ESG opportunity such as policy commitments, certifications, risk mitigation initiatives and programs, and targets to improve performance.

### **Performance**

The performance dataset evaluates the company's historical track record on managing the specific ESG risk. Performance data involves collecting, standardizing, and benchmarking a range of quantitative indicators where applicable.

### **Controversies**

The controversies dataset offers insights into a company's involvement in notable environmental, social and governance controversies (e.g. lawsuits, disputes, regulatory actions) related to the company's operations and/or products, possible breaches of international norms and principles.

### **Unique Risk Exposure Dataset**

The new risk exposure dataset that leverages MSCI ESG Research's proprietary ESG risk models, mapping over 50,000 individual business and geographic segments to 22 macro risk factors, such as carbon regulation, water stressed regions, and corruption risks. The risk exposure metrics and underlying data indicate the level of exposure that each company faces to a given risk based on the nature of its business and where it operates. Risk exposure metrics combine company-specific operational data with macro-level data relevant to each ESG issue.

**22**

Exposure  
Metrics

**8**

Exposure  
Scores

**79**

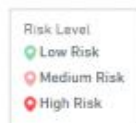
Raw Data  
Points

**50,000**

Mapped business  
and geographic  
segments

**8,500**

All companies  
in the ACWI IMI  
Index covered



### Example Of Risk Exposure Underlying Data: Business And Geographic Segment Risk Exposure Underlying Data

Business Segments	Business Segment Asset Percentage (%)	Business Segment Exposure to Carbon-Intensive Operations (High, Medium, Low)
Asphalt Paving Mixtures and Blocks	5.2	Medium
Gum and Wood Chemicals	2.1	High
Asphalt Paving Mixtures and Blocks	8.4	Medium
Cement, Hydraulic	27.9	High
Ready-Mixed Concrete	18.7	Medium
Construction Sand and Gravel	37.7	Medium

Geographic Segments	Geographic Segment Asset Percentage (%)	Geographic Segment Exposure to Carbon Regulation (High, Medium, Low)
United States of America	98.7	High
All Countries	1.3	Medium

#### 56 FLAGGED METRICS

- Simple flagged metrics comparable across all 8,500 companies in coverage.
- Covering risk exposure, controversies, performance and practices.
- Available in both numeric (1,0) and non-numeric (yes, no) outputs.



Climate change	Natural Capital	Pollution & waste	Environmental Opportunities	Human Capital	Product Liability	Stakeholder Opposition	Corporate Behaviour
Risk Exposure	Risk Exposure	Risk Exposure	Practices	Risk Exposure	Risk Exposure	Controversies	Risk Exposure
•Geographic Exposure to Carbon Regulation (-1,0)	•Business Exposure to Operations with Land or Ecosystem Disturbance (-1,0)	•Business Exposure to Operations Producing High Levels of Packaging Waste (-1,0)	•Alternative Energy Products and Services (1, 0)	•Business Exposure to Injury-Prone Operations (-1,0)	•Geographic Exposure to Chemical Safety Regulations (-1,0)	•Social Impacts on Communities Controversies (-1, 0)	•Geographic Exposure to Corruption & Instability (-1,0)
•Business Exposure to Carbon-Intensive Operations (-1,0)	•Geographic Exposure to Fragile Ecosystems (-1,0)	•Business Exposure to Operations Producing High Levels of Toxic Emissions and Waste (-1,0)	•Energy Efficiency Products and Services (1, 0)	•Geographic Exposure to Poor Workplace Safety Standards (-1,0)	•Involvement in Business Commonly Reliant on High Concern Chemicals (1, 0)	•Social Impacts of Raw Materials Controversies (-1, 0)	•Geographic Exposure to Corruption & Instability (-1,0)
•Geographic Exposure to Climate Vulnerable Regions (-1,0)	•Geographic Exposure to Water Stressed Regions (-1,0)	<b>Controversies</b>	•Green Building Products and Services (1, 0)	•Reliance on Highly Skilled Workforce (-1, 0)	•Exposure to Business Prone to Data breaches or Handles High Volumes of Customer Data (-1,0)	•Human Rights Concerns Controversies (-1, 0)	•Business Exposure to Operations Commonly Associated with Corrupt Practices (-1,0)
•Reliance on Carbon-Intensive Supply Chain (-1, 0)	•Business Exposure to Water-Intensive Operations (-1,0)	•Toxic Emissions & Waste Controversies (-1, 0)	•Pollution Prevention and Control Products and Services (1, 0)	•Business Exposure to Labor-Intensive Operations (-1,0)	•Geographic Exposure to Privacy Regulations (-1,0)		•Performance
<b>Controversies</b>	<b>Controversies</b>		•Sustainable Water Products and Services (1, 0)	•Geographic Exposure to Frequent Work Stoppages (-1,0)	•Exposure to Business with Product Safety Risks (-1, 0)		•Tax Gap Greater Than 20% (-1, 0)
•Climate Change Controversies (-1, 0)	•Environmental Impacts on Communities Controversies (-1, 0)			•Controversies	•Controversies		•Foreign Market Revenue Greater Than 20% (-1, 0)
<b>Performance</b>	•Operational Impacts on Ecosystems Controversies (-1, 0)			•Controversial Workplace Accidents Controversies (-1, 0)	•Chemical Safety Controversies (-1, 0)		•Controversies
•Three-year trend of average carbon emissions intensity (-1, 0, 1)	•Environmentally Controversial Investments Controversies (-1, 0)			•Discrimination and Diversity Controversies (-1, 0)	•Data Security Breaches Controversies (-1, 0)		•Anti-Competitive Behavior Controversies (-1, 0)
•Three-year trend of average carbon emissions intensity (-1, 0, 1)	•Operational Impacts on Ecosystems Controversies (-1, 0)			•Controversial Working Conditions Controversies (-1, 0)	•Customer Fraud Controversies (-1, 0)		•Bribery and Corruption Controversies (-1, 0)
•Three-year average carbon emissions intensity (tCO2e / USD million sales) relative to GICS Industry peer median (-1,0,1)	•Environmentally Controversial Investments Controversies (-1, 0)			•Discrimination and Diversity Controversies (-1, 0)	•Discriminatory Access to Basic Services Controversies (-1, 0)		•Business Ethics Controversies (-1, 0)
	•Raw Material Impact Controversies (-1, 0)			•Controversial Working Conditions Controversies (-1, 0)	•Marketing Controversies (-1, 0)		•Taxes and Subsidies Controversies (-1, 0)
	•Water Stress Controversies (-1, 0)			•Collective Bargaining and Union Labor Controversies (-1, 0)	•Product Safety & Quality Controversies (-1, 0)		
				•Supply Chain Labor Controversies (-1, 0)			

## ITC

### Better than peers:

ITC is rated AA by MSCI on ESG, the highest among global tobacco players and better than most Indian FMCG companies. This is backed by its strong credentials — ITC has been carbon positive for 15 years, water positive for 18 years and solid waste recycling positive for 13 years.

### Carbon footprint:

ITC focuses on both reducing own carbon footprint and increasing sequestration through afforestation. c.41% of its energy use comes from renewable sources and efficiency is engrained in all its offices, hotels and even data centers. It works with local communities to drive afforestation — 820,000 acres of forest have been created till date leading to 150 million days of employment. ITC sequesters 2x the amount of carbon dioxide it emits, with a target to reach 4x by 2030.

### Water usage:

Apart from reducing its own consumption, ITC has created 19,000 rainwater harvesting structures, covering 1.2 million acres. In fact, it harvests 3x its net water consumption, which should increase to 5x by 2030. ITC also works with farmers to improve water efficiency in agriculture. Started a year ago, the program has covered c.200,000 acres and substantial water savings have been achieved.

### Waste:

ITC runs a 'Well-being out of waste (WOW)' program, which covers 12.5 million citizens and provides livelihoods to 16,200 waste collectors. Its R&D is also working on new-age bio-degradable and recyclable boards and sustainable packaging materials.

### E-Choupal:

ITC's E-Choupal platform, through its 6,100 centers, focuses on improved market access and productivity for c.4 million farmers across 35,000 villages.

### Social initiatives:

Some of ITC's social initiatives include; i). Supplementary education provided to 781,000 children; ii). Sustainable livelihood opportunities for 76,000 women; iii). 86,000 youth trained through vocational training program; and, iv) 37,700 sanitation units created. ITC promotes greater women participation, even in its manufacturing facilities - for example, 60% of the workforce in its Nanjangud unit are women.

### Governance:

Independent directors have a 50% representation on ITC's board. It follows a 3-tiered management structure, which allows each business to function independently and yet ensure synergies across the business are tapped. Policies on sustainability and other aspects of corporate governance are clearly defined.

### Aggressive future targets:

By 2030, ITC intends to increase the share of renewable energy to 50% (vs. 41% now), reduce specific energy consumption by 30%, specific GHG emission by 50% and specific water consumption by 40% over FY19 levels. It would also move to 100% recyclable, reusable or compostable plastic packaging by 2030.

### View:

Increase in consumer prices should more than offset tax hikes, although at the cost of lower volumes. The agri, paperboard and hotel businesses, after seeing a decline in FY21 on account of Covid-19, are expected to see a sharper recovery in FY22.

However, given the Covid-19 related concerns, we find consumer staple firms relatively better placed given the defensive nature of the business. Businesses with strong cashflows and robust balance sheets may be preferred during a period of disruption.

## **Conclusion**

Esg has helped investors in identifying companies having corporate governance issues before investing.

Data privacy has been recently included in 2014 under ESG metrics.

Example. Equifax has been downgraded by MSCI ESG due to data security issues and they have announced " data breach" 18-24 months later and stock fall by as high 30-35 pc post this announcement.

Facebook has been avoided by ESG funds due to data privacy issues and they have been rated poorly than other tech companies in the sector.

India: In India companies like ITC, Vedanta, Coal India, Bharat Electronics, Delta Corp, United spirit's are the companies which are avoided under ESG metrics. The stocks in sectors like mining, paper, Energy, Energy ( non renewables), Tobacco, Defence, liquor, Gambling etc. are considered as sin stocks under ESG metrics.

In India 4 AMCs are offering ESG funds including SBI, Axis, ICICI & Quantum and we believe few more AMCs are in pipeline. ESG in India is in niche segment and it may be much bigger in next 10-15 years.

Lot of fund managers have started looking ESG score as important criteria for investing. So companies with good financial metrics with good ESG scores would get premium valuations.

### **Cons of ESG**

Investing ESG investing is important but we cannot ignore completely non ESG compliant stocks. Sectors like Mining, Defence, Paper cannot be ignored completely.

Even in sin Industries like Gambling, Liquor, Tobacco offer large employment, pay taxes. ESG is quality related issue and quite subjective one.

For an example YES Bank under new management can be completely different ESG score than under previous fund.