THE ‘S’ IN ESG IS NOT SILENT

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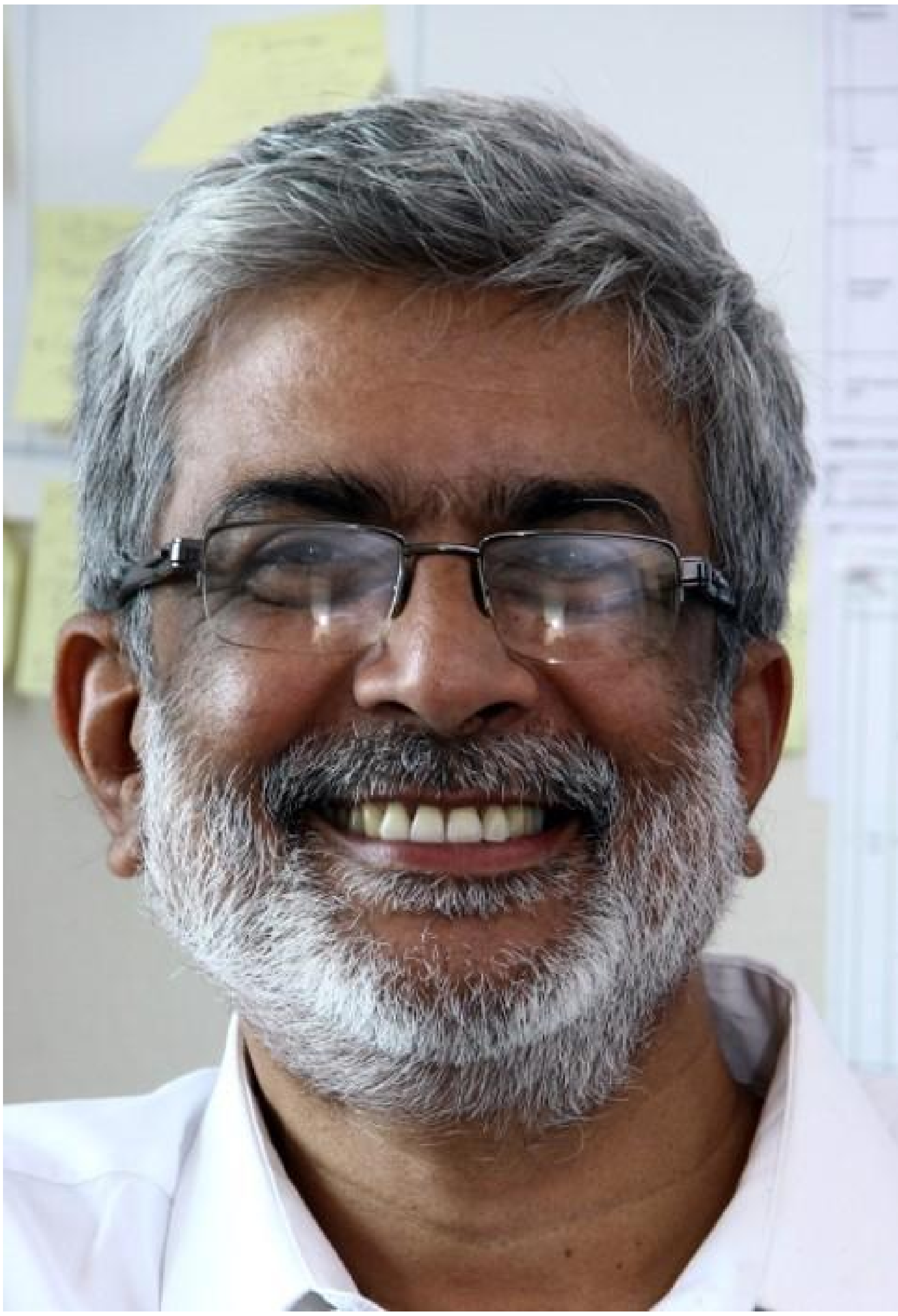

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A term that many people in the financial world are talking about (and even more so post COVID) is ESG—focusing on environmental, social and governance issues. This is investor-speak for “Sustainability”, a term that has been around since 1987. Yes, it is good news that the financial world has embraced the idea, but it is a term that reminds me of the blind men encountering different parts of the proverbial elephant. All seize different bits—and all have very different mental images of what they are encountering.

Discussions on ESG seem to follow a similar pattern. The three components tend to be seen separately in silos, their complex interrelations too often overlooked. Also, within a few minutes, ESG discussions tend to converge into one overarching theme: climate change mitigation - that is, reducing greenhouse gases (GHGs) emissions through renewable energy, electric vehicles and wider net-zero strategies.

Read—or listen—between the lines of these exchanges and typically you will find only a fleeting discussion on the “S” part of the formula. This usually grinds to a halt around diversity. And if you’re in India, the conversation rarely goes beyond gender. That, sadly, seems to be the be-all and-end-all of ESG!

But anyone who has watched the ESG agenda evolve from early discussions about the triple bottom line will know that there is far more to it than that, especially in emerging economies like India. As companies outsource their activities, their dependence on supply chains increases and this is where they become extremely vulnerable to the “S” agenda.

Achilles’ heel

That was true before COVID, of course, but the pandemic harshly spotlighted the plight of informal workers—many of them migrant—who make up the base of the economic and (not coincidentally) social pyramid, mired via exclusions on account of gender, caste, identity, disability and so on.

Such people make a massive contribution to India’s wealth, generally by working in MSMEs (micro-, small and medium-sized enterprises), which are themselves an integral part of supply chains of large companies, in construction (at building sites, most obviously, but also in the production of red bricks, stones, sand, aggregates), in the gig economy and as contract and casual labour.

What characterises their terms of employment is precisely the lack of terms of employment. Human rights violations are the norm, be it in wages, working and living conditions, and safety—with scant, if any, investment made in training. This is the Achilles’ heel of most companies in India, which have little visibility on human rights issues beyond their tier 1 suppliers.

Another critical “S” component focuses on communities around production sites. Many of these people, most likely involuntarily, gave up the land on which a factory or other facility has been built. Apart from any (and very likely inadequate) compensation they may have received at that time, they now get very little benefit from the development. India’s government may mandate that 2 percent of company profits goes to CSR projects, but even if that money filters through it is unlikely to compensate for the huge costs of pollution, water use and other disruptions.

Worse, COVID-19 has driven huge numbers of people back to their villages. With employment opportunities severely limited, communities are increasingly expecting more from companies that have plants in their midst. And since it is now communities that provide the “license to operate”, at least some companies are waking up to the need to respond proactively and positively to community needs and aspirations to ensure business continuity.

A third “S” is safety. While most established companies invest in safety training, processes and equipment, much of this is restricted to their own workforce. What is less clear is the extent to which these investments cover contract and casual labour working in their plants. And too often firms also fail to track related investments made by suppliers, despite the fact that accidents and casualties in supply chains can disrupt their own operations. Thus, it is in the interests of companies that they continuously expand the scope of safe operations.

Where “E” meets “S”

Many “E” issues have “S” impacts, of course, though these too are often ignored. The linkage between air and water pollution and human health and survival is better understood than it once was. But the linkage between climate change mitigation concerns and its impact on people is less so—which brings us to the Just Transition agenda.

So, for example, while coal-fired power plants must be replaced with renewables, in the emerging economies this requires a period of transition—because bringing an abrupt end to coal mining will put millions of people out of work and adversely impact public finances used to fund public good. The transition to EVs, meanwhile, which typically have far fewer parts than current petrol/diesel/CNG vehicles, will hit people employed across the sector.

So what is the takeaway from all this? It is not that GHG emissions and gender diversity are not important—they certainly are. But so are a host of other issues, among them resource scarcity, pollution, biodiversity loss, inequality, human rights, the provision of decent work and so on. If the necessary economic transitions are to succeed, the financial sector must understand all the relevant E, S and G issues and recognise their interrelationships, and forcefully nudge their investees and borrowers to move in the right direction.

Where they fail to do so, the “S” in ESG will be very far from silent.

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