ISSN–2278-5655

Aarhat Multidisciplinary International Education Research Journal

Volume–XII, Issue– VI(Special Issues-I) *Nov – Dec, 2023*

OPEN ACCESS

Original Research Article

A STUDY OF ESG REGULATORY FRAMEWORK IN INDIA

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Introduction:

Environmental, Social, and Governance is referred to as ESG. ESG goes beyond environmental issues.

The best way to describe ESG is as a framework that aids stakeholders in comprehending how a company manages opportunities and risks associated with environmental, social, and governance standards.

Environmental:

The first pillar of ESG focusses on the effects on the physical, natural environment. Across the globe, how we produce, consume and discard has a significant adverse impact on the natural world. In the context of ESG (Environmental, Social, and Governance) criteria, "Environment" refers to the set of considerations and practices related to a company's impact on the natural world. ESG is a framework used by investors, analysts, and other stakeholders to evaluate the sustainability and ethical practices of a business. Environmental criteria in ESG typically focus on aspects such as a company's.

Carbon footprint:

The amount of greenhouse gas emissions a company produces directly or indirectly through its operations.

Resource usage:

This includes the responsible use of natural resources, such as water, land, and raw materials.

Waste management:

How a company handles waste, whether it's through recycling, reduction, or responsible disposal.

Biodiversity:

The impact of a company's operations on local ecosystems and biodiversity.

Energy efficiency:

The efficiency with which a company uses energy in its operations.

Environmental policies and practices: The existence and effectiveness of policies and practices aimed at minimizing negative environmental impacts.

Investors and stakeholders interested in sustainable and responsible investing consider a company's environmental performance alongside social and governance factors to assess its overall impact and long-term viability. Companies that prioritize environmental sustainability are often seen as more resilient in the face of environmental challenges and regulatory changes.

Social:

It's not only nature that is needed to be considered. How employees and local communities are affected also must be taken into account. In the context of ESG (Environmental, Social, and Governance) criteria, "Social" refers to the set of considerations and practices

ISSN–2278-5655

AMIERJ Aarhat Multidisciplinary International Education Research Journal

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related to a company's impact on society and its relationships with various stakeholders. The social component of ESG encompasses a wide range of factors that reflect a company's commitment to ethical and socially responsible business practices. Some key aspects of the social criteria in ESG include:

Labor Practices:

This involves how a company treats its employees, covering aspects such as fair wages, working conditions, diversity and inclusion, and employee well-being.

Human Rights:

Companies are assessed on their respect for human rights, both within their operations and along their supply chains. This includes efforts to prevent and address issues such as forced labor and child labor.

Diversity and Inclusion:

This involves promoting diversity in the workplace, including gender, race, ethnicity, and other dimensions. Companies are evaluated on their efforts to create inclusive environments and equal opportunities for all employees.

Community Engagement:

Companies are assessed on their relationships with local communities, including initiatives to support community development, charitable activities, and efforts to minimize negative impacts on communities where they operate.

Customer Relations:

Companies are evaluated on their interactions with customers, including the quality and safety of products and services, customer privacy, and responsible marketing practices.

Product Safety and Quality:

Ensuring the safety and quality of products is a critical aspect of the social criteria in ESG.

Employee Relations:

This involves how a company manages relationships with its workforce, including employee satisfaction, communication, and conflict resolution.

Investors and stakeholders use social criteria to gauge how well a company is managing its impact on people and communities, and whether it is fostering a positive and sustainable societal contribution. Companies that prioritize social responsibility are often seen as more attractive to investors and better positioned for long-term success.

Governance:

Governance is to do with making sure there are systems in place to ensure accountability within a corporation. So that Governance refers to the systems and practices that a company has in place to ensure its accountability, transparency, and ethical behavior in its operations. Governance is a critical component of ESG because it reflects how well a company is managed and how it considers the interests of various stakeholders, including shareholders, employees, customers, and the broader community. Key aspects of governance in ESG include:

Board Composition and Structure:

This involves the composition of a company's board of directors, including the independence of directors, diversity, and the balance of power between executives and non-executives.

Executive Compensation:

How a company determines and discloses executive pay, and whether it aligns with the company's performance and long-term sustainability.

Shareholder Rights:

The rights and protections afforded to shareholders, including voting rights and the ability to influence important decisions.

Audit and Internal Controls:

The effectiveness of a company's internal audit processes and controls, ensuring accuracy and reliability of financial reporting.

Anti-Corruption Policies:

The existence and effectiveness of policies and

ISSN–2278-5655

AMIERJ Aarhat Multidisciplinary International Education Research Journal

Volume–XII, Issue– VI(Special Issues-I) Nov – Dec, 2023

OPEN ACCESS Original Research Article

practices aimed at preventing corruption and bribery.

Ethical Business Practices:

This involves a company's commitment to ethical behaviour, including the enforcement of a code of conduct, anti-discrimination policies, and mechanisms for addressing unethical behaviour.

Risk Management:

The processes a company has in place to identify, assess, and manage risks, including those related to ESG factors.

Corporate Governance Structure:

The overall governance framework, including how decisions are made, transparency in communication, and adherence to legal and regulatory requirements.

Good governance practices contribute to the long-term sustainability and success of a company. Investors and stakeholders use governance criteria to evaluate the overall quality of a company's management and to assess the risks associated with its business practices. Companies with strong governance structures are often considered more attractive to investors and are better positioned to navigate challenges and capitalize on opportunities in a changing business environment.

In nut shell, the main objective of ESG norms ensures that businesses are conducted responsibly. The business enterprises are accountable not merely to their shareholders but also to the larger society which is also its stakeholder. Hence, adoption of responsible business practices by companies to cover the ESG aspects are as vital as their financial and operational performance. Compliance with ESG norms essentially requires every business to be accountable for the responsibility it has towards the environment as well as the people who make up the entire ecosystem either as employees or customers or other stakeholders.

ESG REGIME IN INDIA:

Though ESG is gaining more and more importance in the corporate/business ecosystem, unfortunately, there is no single piece of legislation laying down the ESG compliance. ESG compliance comes from various sources of laws enforced in India, some of which are as follows:

a) COMPANIES ACT, 2013:

i. **Section 134(3)(m**) of the Companies Act mandates the board’s report to contain details on conservation of energy

ii. **Section 135** of the Companies Act read with the Companies (Corporate Social Responsibility Policy) Rules, 2014 makes it mandatory for companies with specified net worth, turnover or net profit to constitute a Corporate Social Responsibility (CSR) committee to oversee the CSR policy and activities.

iii. **Section 149** of the Companies Act read with Rule 3 of the Companies (Appointment and Qualifications of Directors) Rules, 2014 stipulates for having Woman directors for certain classes of companies.

iv. **Regulation 17(1)(a) of SEBI** (Listing Obligations and Disclosure Requirements) Regulations, 2015 requires the top 1,000 listed entities to have an independent, Woman director on their boards.

v. **Regulation 17(1)(b) of SEBI** (Listing Obligations and Disclosure Requirements) Regulations, 2015 stipulates that one-third of the board of a listed entity shall be composed of independent directors in case the chairperson is a non-executive director and not a promoter or related to a promoter or a person occupying a management position; otherwise, at least half of the board should be composed of independent directors.

vi. **Regulation 17(1)(b) of SEBI** (Listing Obligations and Disclosure Requirements) Regulations, 2015 provides that, with effect from 1 April 2022, the chairperson of the board of the top 500 listed entities (except those that do not have any identifiable promoters) shall be a non-executive director and not related to the managing director or chief executive officer.

vii. **Section 177** of the Companies Act requires the board of every listed company and certain classes of public companies to constitute an audit committee consisting of a minimum of three directors, with independent directors forming a majority.

viii. **Regulation 18 of SEBI** (Listing Obligations and Disclosure Requirements) Regulations, 2015 requires that at least two-thirds of a listed entity's audit committee members are independent directors;

ix. **Section 178** of the Companies Act requires the board of every listed company and certain classes of public companies to constitute a nomination and remuneration committee (NRC) consisting of three or more non-executive directors, out of which not less than one-half shall be independent directors. X

x. **Regulation 19 of SEBI** (Listing Obligations and Disclosure Requirements) Regulations, 2015 requires that in case of a listed entity having outstanding SR equity shares, two-thirds of the NRC shall be composed of independent directors. It also requires that the chairperson of the NRC shall be an independent director.

xi. **Regulation 34(2) (f) of SEBI** (Listing Obligations and Disclosure Requirements) Regulations, 2015 and its circular dated 10 May 2021 on 'Business responsibility and sustainability reporting by listed entities' (BRSR Circular) made it mandatory for the top 1,000 listed entities by market capitalisation to include, in their annual report, a BRSR describing the initiatives taken by the listed entity from an ESG perspective.

b) ENVIRONMENTAL LAWS:

i. **Environment (Protection) Act, 1986** entails rules in relation to e-waste management, bio-medical waste, solid waste, ozone depleting substances, construction and demolition waste, hazardous waste, hazardous chemicals, plastic waste, batteries and rules to assess environmental impact of establishment of any industry.

ii. **Water (Prevention and Control of Pollution) Act, 1974** and **Air (Prevention and Control of Pollution) Act, 1981**, imposes obligations on companies for prevention, control and abatement of water and air pollution.

iii. **Wildlife (Protection) Act, 1972, the Forest (Conservation) Act, 1980** and the Biological Diversity Act, 2002 ensures that companies do not interfere with the natural ecosystems of their area of operations.

c) LABOUR LAWS:

i) **Code on Social Security 2020**, To ensure security for all workers, the Central Government has amalgamated 9 Labour Laws into the Social Security Code in order to secure the right of workers for insurance, pension, gratuity, maternity benefit etc

ii) **Occupational Safety, Health and Working Conditions Code 2020**, For providing better and safe environment along with occupational health and safety to workers at the work place, 13 existing Labour Laws have been subsumed in the Occupational, Safety, Health and Working Conditions Code, 2020. In this Code, the security of interests of workers engaged in factories, mines, plantations, motor transport sector, bidi and cigar workers, contract and migrant workers has been ensured.

iii) **Industrial Relations Code 2020,** By amalgamating 3 Labour Laws into the Industrial Relations Code the Central Government has taken steps for safeguarding the interests of Trade Unions as well as the workers. In this Code, all possible steps have been taken for industrial units and workers so that disputes do not arise in future

iv) **Code on Wages 2019** Four Labour Laws have been amalgamated into the Minimum Wages Code. Due

ISSN–2278-5655

AMIERJ Aarhat Multidisciplinary International Education Research Journal

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to this, for the first time, all the workers have got the Right to Minimum Wages.

SEBI'S Disclosure Requirements:

SEBI recently came out with a circular on Business Responsibility and Sustainability Reporting by listed entities. However, the same is applicable only to the top 1000 listed companies by market capitalization. This is a transition from the erstwhile Business Responsibility Reporting ("BRR") regime to Business Responsibility and Sustainability Report ("BRSR") reporting regime.

The Securities Exchange Board of India (SEBI)—the regulatory body for securities markets in India—has now designed the new BRSR to be interoperable with other internationally accepted reporting frameworks such as the Global Reporting Initiative (GRI), Sustainability Accounting Standards Board (SASB) and the Task Force on Climate-Related Financial Disclosures (TCFD).

" Reporting under the BRSR format is divided into three parts: general disclosures; management and process disclosures; and, principle-wise, performance disclosures. The key features of the circular are discussed below:

1. **General disclosures** encompass basic company information**.**
2. **Management and process disclosures** provide evidence that companies are adhering to the structures, policies and processes specified in the National Guidelines on Responsible Business Conduct (NGRBC).
3. **Principle wise performance disclosures** are focused on more quantitative data relating to 9 basic principles of the National Guidelines on Responsible Business Conduct (NGRBC)

This set of disclosures within the BRSR is aimed at helping organizations demonstrate how their operations impact environmental and social metrics

A**n overview of the 9 principles of BRSR:**

P1. Businesses should conduct and govern themselves with integrity, and in a manner that is Ethical, Transparent and Accountable

P2. Businesses should provide goods and services in a manner that is sustainable and safe

P3. Businesses should respect and promote the well-being of all employees, including those in their value chains

P4. Businesses should respect the interests of and be responsive to all its stakeholders

P5. Businesses should respect and promote human rights

P6. Businesses should respect and make efforts to protect and restore the environment

P7. Businesses, when engaging in influencing public and regulatory policy, should do so in a manner that is responsible and transparent

P8. Businesses should promote inclusive growth and equitable development

P9. Businesses should engage with and provide value to their consumers in a responsible manner

Relevance of ESG Disclosure:

ESG disclosures are highly relevant for all stakeholders involved in a business process:

a) Investors- ESG disclosures are highly consequential for investors for the following reasons:

i) including climate-related considerations in asset valuation and finance allocation processes;

ii) determining the environmental and social impact of a company's business processes; and

iii) assessing how climate change could affect a company's financial stability in the future.

b) Businesses – ESG disclosures allow companies to identify potential transition risks, self- assess its ability to sustain in the future, and undertake necessary steps to adapt to the likely future changes. In case companies are not conscious of this exercise, they not only stand the risk of losing profit-making capacity, but also market reputation.

ISSN–2278-5655

AMIERJ Aarhat Multidisciplinary International Education Research Journal

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c) Consumers – ESG disclosures aid consumers in identifying responsible businesses, which not only concentrate on maximizing profits, but also on growing in a responsible manner. Businesses can also use these disclosures as part of their marketing strategy to attract more consumers.

This demonstrates that ESG disclosures are significant from the perspective of all stakeholders involved in the business processes.

ESG Regulators:

In India, the principal regulators with respect to ESG are MCA, which supervises corporates incorporated under the Companies Act, and SEBI, which supervises publicly listed companies as well as asset managers.

SEBI's BRR goes the furthest in promoting ESG disclosures on a mandatory basis. Separately, MCA has imposed mandatory reporting on CSR under the Companies Act. In addition, enforcement authorities under labour laws and environmental laws (including the Ministry of Environment, Forest and Climate Change and the Central and State Pollution Control Boards) play a meaningful role in ESG compliance in their respective spheres.

The Ministry of New and Renewable Energy plays an important role in establishing goals and benchmarks for the renewable energy business in India.

In order to coordinate efforts with other national and international agencies on climate change-related issues, the Reserve Bank of India (RBI) established the "Sustainable Finance Group" (SFG) in May 2021. The group's goal is to propose strategies and introduce a regulatory framework, which may include appropriate ESG disclosures, that could be required of banks and other regulated entities in order to promote sustainable practices and reduce risks associated with climate change in the Indian context.

Furthermore, the RBI noted in a paper published in 2021 that "green finance" is becoming a priority for public policy and that improved stakeholder coordination and the use of information management systems to reduce asymmetric information about green projects could open the door to sustainable economic growth. Moreover, SEBI has mandated that the new BRSR format be used starting in 2022–2023.

In India, the judiciary also has a significant influence on environmental matters. The established doctrine of locus standi allowed the Apex Court of India to pioneer public interest litigation (PIL), facilitating easier access to the legal system. PIL gives altruistic individuals or social action groups the ability to bring up issues of shared concern or mobilize judicial concern before the Supreme Court and High Courts on behalf of marginalized communities. Additionally, there is a constitutional foundation for the courts to investigate environmental matters; specifically, Article 21 has been interpreted by the courts over time to encompass, among other things, the right to a healthy and pollution-free environment. Additionally, the National Green Tribunal was established by the government in 2010.

ESG Investors:

Simply put, ESG investing is the practice of making investments that take into account non-financial environmental, social, and governance (ESG) concerns in addition to traditional financial ones. ESG investing, a significant component of the current shareholder versus stakeholder capitalism debate, is gaining traction as more institutional investors—and their clients, in particular—aim to balance financial returns with moral and other non-financial considerations. Increased empirical evidence of a positive association between rates of return and higher ESG scores, along with regulatory and policy efforts by governments and regulators targeting the fight against economic and social inequality and climate change, further reinforce this momentum

ESG investors, like most investors, look for and rely on trustworthy information when deciding where and how to put their money. This explains why governments and regulators, in addition to lenders and investors, are currently placing a strong emphasis on ESG disclosure and reporting.

Due to the growing significance of Environmental, Social, and Governance (ESG) issues on a global scale, investors, particularly those from outside the country, have the right, under the terms of the transaction agreements, to inspect and obtain information about the ESG report and any significant incidents involving death, significant environmental impact, or material legal violations from the target company.

(a) environmental and social criteria, including risk assessment and management for the environment and society, labour rights and working conditions, and the provision of a grievance mechanism for its employees; and

(b) requirements for business integrity, such as putting in place anti-corruption and anti-bribery policies, properly recording, reviewing, and reporting financial and tax data, adhering to applicable government norms, rules, and regulations, including international laws, and putting in place whistleblowing policies.

Conclusion:

The increasing global recognition and significance of ESG reporting among international investors may prompt Indian companies to undertake ESG due diligence and develop an ESG action plan. This plan would encompass obtaining relevant licenses, drafting policies on anti-corruption, environment, and social issues, managing the waste disposal process, preserving a healthy work environment for employees, and implementing fire safety and precautionary measures, among other things.

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Cite This Article:

CA Kadyan S. & Dr. Bhakkad D.D. (2023). A STUDY OF ESG REGULATORY FRAMEWORK IN INDIA. In Aarhat Multidisciplinary International Education Research Journal: Vol. XII (Number VI, pp. 338–345). AMIERJ. https://doi.org/10.5281/zenodo.10540362