

ESG can bridge the growth-capital gap



When the NIP was drawn up, the government had expected the domestic corporate bond market to contribute Rs 7-9 lakh crore, or 6-8%⁴, of the Rs 111 lakh crore infrastructure investments needed between fiscals 2021 and 2025.

Then came the Covid-19 pandemic, which crushed economic activity even as government expenditure soared to offset its aftermath. The result is impaired fiscal positions of both, the Centre and the states.

That means contribution from the corporate bond market and private sector will have to increase materially.

CRISIL's analysis shows that over the next five fiscals, corporate bond issuances outstanding can more than double from ~Rs 33 lakh crore⁵ at the end of fiscal 2020 to Rs 65-70 lakh crore⁶ by the end of fiscal 2025.

But a demand-side analysis shows outstanding issuances could touch Rs 60-65 lakh crore by fiscal 2025.

That would leave a gap of ~Rs 5 lakh crore.

As a result, tapping all potential pools, including large chunks of 'patient capital', or long-term investors from the developed economies, especially the sustainability-conscious ones, becomes critical.

On their part, global asset managers have been actively integrating ESG, factors into their investing process.

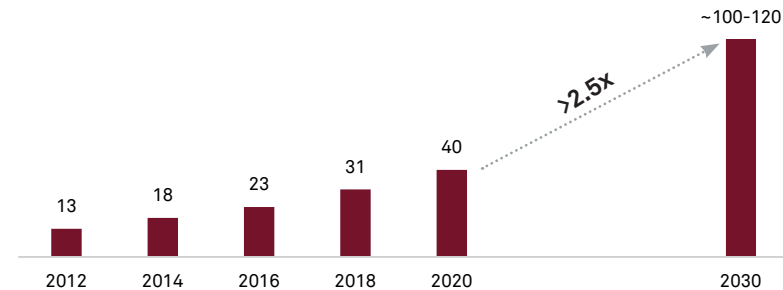
Clearly, ESG is increasingly influencing the flow of global capital.

Put another way, foreign investor demand can increase if domestic corporate issuers embrace ESG practices.

ESG is galloping ahead worldwide

Globally, ESG-mandated AUM totalled \$40 trillion⁷ as of December 2020, and are expected to triple to \$100 trillion⁸ by fiscal 2030.

Global AUM under ESG investing on the rise (\$ trillions)



Source: Global Sustainable Investment Alliance 2018 report, ESG Data Integration by asset manager by Opimas, Climate Change and Corporates by Deutsche Bank,

The reasons for this trend are not far to seek. ESG factors help investors assess the long-term sustainability of a company or investment.

- Environmental factors determine a company's stewardship of the environment and focus on waste and pollution, resource depletion, greenhouse gas emissions, deforestation, and climate change
- Social factors examine how a company manages relationships with all its stakeholders – employees, suppliers, customers, and the communities it operates in
- Governance factors take a look at corporate policies and how a company is governed, i.e. performance of the board, ownership concentration and shareholder rights, and disclosure levels

Global funds have started integrating these non-financial factors into their investment decisions – apart from the traditional analysis

⁴As per NIP, sources of funds

⁵SEBI outstanding corporate bonds data

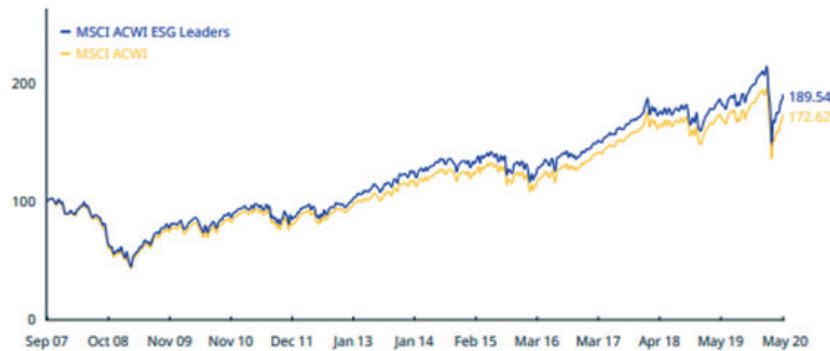
⁶CRISIL estimates

⁷Report on 'ESG Data Integration by asset manager' by Opimas

⁸Report on 'Climate Change and Corporates' by Deutsche Bank

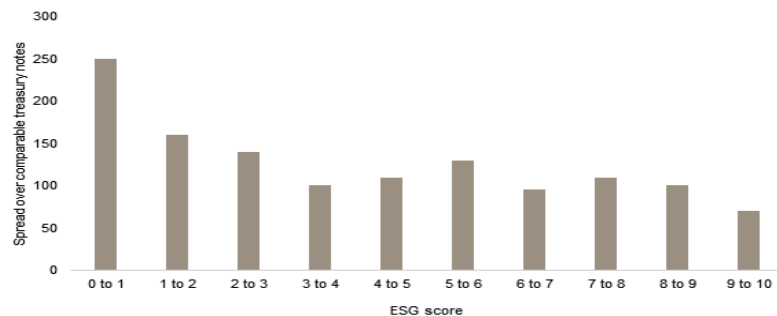
of business, and financial and management aspects. Investments in companies that score well on ESG have generated higher value over the long term. As the charts below show, ESG investing has generated superior returns, and ensures low exposure to risk as reflected in the lower cost of capital.

ESG investments promise superior returns



Source: MSCI ACWI ESG Leader Index Factbook

Relationship between spread over risk-free rate and ESG scores of S&P 500 companies



Source: BofA-Merill Lynch study

¹⁰A study conducted by Japan Sustainable Investment Forum (JSIF)
¹¹Global Sustainable Investment Alliance 2018 report

Emerging economies expected to drive ESG growth

Initially concentrated in Europe and the US, ESG investing has now spread to Canada, Australia and Japan. In Japan, assets invested according to sustainable investment principles rose 45% on-year to ¥336 trillion in 2019¹⁰. In Australia and New Zealand, it has clocked a CAGR of 49%¹¹.

The next phase of growth is expected to be in the emerging economies. ESG-screened emerging market funds are expected to grow to \$15-20 trillion and comprise 15-20% of the global ESG-linked AUM by 2030.

To tap this growing pool of growth capital, domestic companies need to adapt and embed ESG considerations into their business philosophy, and ensure high transparency through non-financial disclosures.

That will help partially bridge the demand-supply gap of ~Rs 5 lakh crore.

A constraining factor for global investors is the lack of clarity on how ‘green’ the opportunities in India are.

The good part is, there are signs of change. Today, all the 50 companies in the National Stock Exchange Nifty index have a board-level committee on corporate social responsibility, while nearly a third have a committee that deals with sustainability and ESG-related aspects.

About 70% of them have delineated the financial and non-financial capital available, and have identified human, social and natural as the areas of focus along with metrics related to each.

ESG adoption should also speed up with the Securities and Exchange Board of India proposing expansion of non-financial disclosures and rechristening Business Responsibility Reporting as Business Responsibility and Sustainability Reporting (BRSR). This would be applicable to the top 1,000 listed companies.

Given the milieu, a crucial facilitator of global capital will be independent assessment of ESG credentials that lend credibility and make instruments attractive to ESG-conscious global funds.

A concomitant here would be higher disclosure and data standards that give a clear picture on the sustainability quotient of available products. Regulatory oversight is ensuring this and adoption of global best practices in the disclosure of non-financial performance will enhance foreign investor confidence in domestic corporate bonds.

The task is clearly cut out.

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