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THE LINK BETWEEN ESG TARGETS AND FINANCIAL PERFORMANCE

2022

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INTRODUCTION

As concern about the ethical status of companies is increasing, both investors and customers have started keeping environment, social and corporate governance as the central factors to ensure sustainability of investment in the company. In order to make a safe and profitable deal, investors are now making their decision on the basis of company's adherence with its norms laid down for environmental, social, and governance (ESG) factors. We should see that corporate governance, environment and society are not treated as three separate entities, but should be seen under interwoven inclusive set of sustainability and impact.

ESG investing has gained good momentum in India for past 5 years. India is warming up towards ESG disclosures with the BRSR standards being mandated for listed companies. Initially incorporating and streamlining this reporting regime might be difficult for the companies. The stakeholders are becoming more cautious about where to invest. The workforce in the market prefer working in an employee-friendly environment than a purely profit-motivated business. Therefore those stakeholders who prioritize the longevity and growth in their business prefer to consider and know ESG strategies and goals of the business.

IDENTIFYING ESG RELATED ISSUES IS CRUCIAL FOR A BUSINESS

Despite of augmented attention given to ESG issues, only few companies are really committed to such targets and make meaningful progress towards ESG targets. This is because most of the companies are not integrating ESG factors into internal strategy and operations and they are not providing the investors with adequate information and explanation on how the improvising ESG performance will help increasing corporate earnings and capital. This problem can be solved by identifying ESG material issues to the business. After identifying, such issues can put forth in front of all stakeholders and decisions can be made such that it will help in uplifting the business operations and strategies.

If companies want to move beyond posturing, the internal stakeholders must confront the contradictions and drive the synergies between environmental and societal benefits and make changes into the operations such that it caters to needs of achieving Paris Agreement Goals and United Nations Sustainable Development Goals (SDGs).

PROCESS TO ACHIEVE ESG TARGETS

To achieve ESG targets, an entity must follow the six step process mentioned as follows:

01 Identify the ESG issues material to the company

Consider these three factors while identifying the issues - governance, sustainability or societal and map how will they affect the financial condition or operating performance of businesses.

02 Focus on your strategy, not on reporting:

Address the issues first and focus on changes that can be made. Create strategies that will pursue financial benefits along with societal benefits.

03 Optimize impact intensity of profits:

Impact intensity of profits-relationship between a company's profit and its positive and negative effect on ESG issues. Product design, product access and operational footprint are three main domains wherein companies must change their internal decision making process.

04 Collaborate to avoid trade-offs between profit and societal benefit:

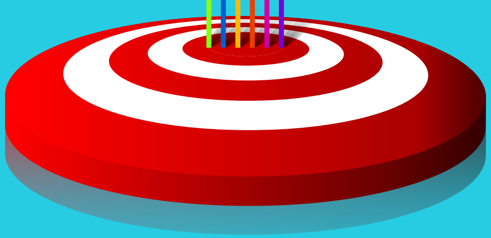
Most companies do not sacrifice profits for improved social and environmental performance, for better financial returns. Companies should try to involve or collaborate with external stakeholders along with the internal stakeholders to rectify the problems which can have direct implications on the finances of the company.

05 Redesign organizational roles:

The CSR departments focus primarily on stakeholders and government relations, philanthropy and ESG reporting. For implementing ESG criteria into key decisions, sustainability expertise or subject matter experts are required to make strategic and operational decisions.

06 Bring investors along:

Companies need to explain their investors about improving impact intensity of their profits, commitments to achieve goals, report publicly on their progress. Spelling positive societal benefits can carry more weight with investors that care about climate targets and SDGs than flawed and inconsistent ESG rankings. (Kramer & Pfitzer, 2022)



INVOLVEMENT OF PRIVATE EQUITY FIRMS IN SUSTAINABILITY RELATED MATTERS

To tackle the problem of climate change, it is necessary for Private Equity (PE) to participate in sustainability related matters. PE business model gives private equity clear advantages over investors in public companies when it comes to promoting a sustainability agenda. PE firms can integrate their ESG considerations into the deal-making and can be transparent about their efforts.

Private equity firms are taking initiatives for inculcating ESG strategies in business however there are four initiatives that can help in improving ESG integration which are as follows:

01 **Standardize ESG reporting:**
Firms can adopt a mechanism for simplifying and harmonizing ESG data report, reported by theirportfolio companies to GPs and LPs.

02 **Make net-zero commitments:**
All financial institutes are making net zero commitments and target to achieve it by 2050.

03 **Improve diversity:**
More-diverse workforce leads to better performance.

04 **Spread the wealth:**
The PE industry needs to directly confront the fact that the tremendous wealth it has created has been evenly distributed. (Eccles, et al., 2022)

HOW TO INTEGRATE ESG INTO REGULAR OPERATIONS?

THE EXPERTISE CAN USE THREE WAYS TO INTEGRATE ESG IN THE SYSTEM:

01- Integrating ESG:
Each target of the company is assessed on the critical ESG issues that will affect value creation.

02- A standard set of KPIs (Key Performance Indicators) :
Which includes ESG issues that are material to the company's financial performance.

03- Increasing transparency:
ESG performance contributes to financial performance. They collect Improving ESG performance. The PE business model puts general partners in a good position to help portfolio companies improve their ESG integration and reporting practices in a number of ways.

CONCLUSION

ESG integration, broadly speaking as an investment strategy, seems to perform better than negative screening approaches. ESG investing appears to provide downside protection, especially during a social or economic crisis. While environmental, social, and governance (ESG) issues increasingly dominate the executive agenda, not all three elements receive equal attention. Therefore, businesses should make a point to involve ESG related matter into their operations and strategies right from beginning to maintain the flow of business as well as avoid trade-offs between finance and environmental and social matters.

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