



# A LEGAL PERSPECTIVE ON CORPORATE GOVERNANCE AND ESG COMPLIANCE.

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## **Abstract**

Adopting Environmental, Social, and Governance (ESG) principles in corporate governance has become the key to guaranteeing sustainability, transparency, and ethical business conduct. Compliance with ESG is now a regulatory and stakeholder-driven requirement that affects investment strategies, risk management, and corporate policies. The historical development of ESG from Environmental, Health, and Safety (EHS) standards to Corporate Social Responsibility (CSR) and today's form proves that it is increasingly playing a vital role in the financial markets. This essay discusses the legal environment around ESG compliance, including in India, where the Companies Act 2013, Securities and Exchange Board of India (SEBI) regulations, Business Responsibility and Sustainability Reporting (BRSR), and Listing Obligations and Disclosure Requirements (LODR) have a fundamental role in promoting corporate responsibility and ethical leadership.

The convergence of corporate governance and ESG is discussed, emphasizing how firms can align business strategy with sustainability objectives to increase accountability, investor trust, and long-term value creation. Although applying ESG is challenging, e.g., data gathering, regulatory requirements, balancing financial returns with sustainability, and stakeholder engagement, firms implementing ESG effectively in their governance structures can generate innovation, competitive edge, and resilience. The report presents the ESG's disruptive influence in shaping corporate choices, sustainable investing, and values-driven leadership as an essential framework for corporate sustainability and long-term business success.

**Keywords:** ESG compliance, corporate governance, sustainability, ethical business practices, regulatory framework, SEBI, Companies Act 2013, BRSR, CSR, investment strategies, risk management, financial markets, stakeholder engagement, transparency, accountability, corporate responsibility, ethical leadership, innovation, competitive advantage, resilience.

## **Introduction**

Environmental, social, and governance (ESG) is a framework to assess an organization's business practices and performance on various sustainability and ethical issues. It also provides a way to measure business risks and opportunities in those areas. In capital markets, some investors use ESG criteria to evaluate companies and determine their investment plans, a practice known as ESG investing<sup>1</sup>. In today's business environment, particularly in India, the relationship between corporate governance and Environmental, Social, and Governance (ESG) compliance has become increasingly important. Integrating ESG principles into corporate governance

<sup>1</sup> <https://www.techtarget.com/whatis/definition/environmental-social-and-governance-ESG>

frameworks is crucial for sustainable business practices as stakeholders continue to demand responsibility and transparency from corporate entities.

ESG marked a turning point in the evolution of the financial system, as it rapidly became an international movement of investors.<sup>2</sup> This article mainly speaks about the legal dimensions of corporate governance concerning ESG compliance. The “environmental” factor is composed of a company’s operations’ long-lasting environmental impacts and what that company is doing to positively steward the natural world.<sup>3</sup> It also draws attention to the legal framework that directs the business to embrace moral behavior that upholds professional integrity and benefits the environment and society. Companies are now required to connect their strategy with the ESG Standards for long-term sustainability and stakeholder trust, thanks to the Security and Exchange Board of India (SEBI) and the Company Law of 2013.

## History and Evolution of ESG

From what was initially known as Environmental, Health, and Safety (EHS) standards to the "Corporate Sustainability" movement in the 1990s, the Corporate Social Responsibility (CSR) revolution in the early 2000s, and finally, the emergence of ESG in the late 2010s and into the present, environmentally and socially responsible factors have developed together. Traditionally, investors viewed companies’ efforts to engage in positive social responsibility efforts with a critical lens because they believed the initiatives were “risks that would eat into profits” and provided little to no economic benefit.<sup>4</sup> Furthermore, some investors believed that it was illegal or a breach of fiduciary duty for pension funds and other financial institutions and intermediaries to consider ESG when making investment decisions.

These conventional investors were known to claim that the sole reason why companies engaged in ESG-focused reporting was to deliberately create a false sense of social consciousness by making promises they never intended to keep and inventing positive environmental and social responsibility initiatives. All of this is done to improve their standing as decent members of the community. However, this pessimistic outlook appears to be mostly over given recent financial industry disruptions and uncertainty. According to some research, investors are once again more skeptical and pessimistic about environmental, social, and governance (ESG) investing than they were a year ago. ESG, as a term, was first used in 2004 by the United Nations (UN) to develop guidelines to integrate environmental, social, and governance concerns into the financial reporting sphere.<sup>5</sup> In the year 2006, the UN integrated ESG criteria into their Principles for Responsible Investment (PRI) Report, and required that it has to be incorporated into the financial evaluation of all companies. At the time it was incorporated, there were only sixty-three investment companies (with assets of \$6.5 trillion) who have signed on to the proposition and agreed to incorporate ESG evaluations in their reporting structures. In 2017, a global survey of 475 institutions, reported by Business Wire, found that 68% of respondents indicated that incorporating ESG reporting and emphasis in their business models actually improved their returns.<sup>6</sup> In addition, 77% reported that they have invested in ESG strategies because of their positive impact on companies’ financial performance.

## Significance of ESG

Environmental, Social, and Governance (ESG) Compliance is a set of guidelines the regulatory bodies mandate. For a company to be called an ESG complaint, it has to work in these three main dimensions: environmental criteria like practices to address climate change, usage of harmful chemicals, and sustainability efforts that make

<sup>2</sup> JOHN HALE, A Broken Record: Flows for U.S. Sustainable Funds Again Reach New Heights, Morningstar, (21-jan.-2021) referring \$51 billion in 2020 of sustainable funds in the US in contrast to \$5.4 billion in 2018.

<sup>3</sup> David McSweeney & Lisa Shelton, *Corporate Financial Disclosures and Environmental, Social, and Governance Concerns: Evolving Issues*, Nat. Res. & Env't, Summer 2020, at 23.

<sup>4</sup> See Meyerson, *supra* note 15.

<sup>5</sup> See R. Krishnamoorthy, *Environmental, Social, and Governance (ESG) Investing: Doing Good to Do Well*, Open J. Soc. Scis., July 2021, at 189, 191. At the time, it was mostly voluntary for organizations to report or market what we now call ESG initiatives, and it was primarily regarded as an effort to “do good to be seen as good” rather than as a rigorous legislative movement or to avoid financial consequence or enforcement. *Id.* at 191. In conjunction with this laissez-faire ESG attitude, ESG reporting remained largely a secondary focus and not seen as a financial benefit. *Id.* at 190–91.

<sup>6</sup> *Id.* Defiantly, in May 2017, ExxonMobil shareholders thwarted company management and passed a vote to require the world’s largest oil and gas company to provide ESG disclosures in the form of a report on the impacts climate change has on its business, in the wake of the Paris Climate Agreement. *Id.*

up its business and supply chains. Social ESG considerations consider the relationship between the employer, employee customers, stakeholders, suppliers, and communities. And about the working culture and environment. It also focuses on racial discrimination, Equality, and Work ethics. Governance in terms of ESG means the overall performance of the company and the positive change. It includes executive pay, shareholders' rights observance, and internal controls to promote transparency. Thus, ESG compliance is essential for publicly traded companies as investors and stockholders are responsible and opt for socially responsible investments.

## The intersection of Corporate Governance and ESG

Corporate Governance and Environmental, Social, and Governance (ESG) intersection represents how companies operate. An increasing recognition of the interconnectedness between business success and societal well-being drives this shift. ESG considerations are no longer supplementary to traditional business metrics but integral to long-term corporate strategy and risk management. Integrating ESG factors into corporate governance is driven by several critical imperatives highlighting aligning business practices with sustainable and ethical principles. Successfully integrating ESG factors into corporate governance requires a strategic approach and commitment from leadership. Here are key strategies for effective ESG integration, such as establishing clear ESG frameworks and integrating ESG considerations into corporate strategy to ensure that sustainability and ethical practices are central to business decision-making. Reputational concerns also come into play when adopting ESG investment criteria – namely, the younger generation of investors takes ESG more seriously.<sup>7</sup> Building a culture of responsibility involves promoting ESG values and practices throughout the organization and by the year 2018 the world saw a drastic increase in the ESG having around \$18 trillion as an asset. ESG management, in particular, has come under fire, with the pandemic highlighting how global recovery actions taken by companies should be in alignment with whatever ESG principles they purport to have in place.<sup>8</sup>

## Legal Framework in Promoting ESG Principles

Every new set of regulations and procedures needs a suitable legal foundation in order to be implemented in a way that is better for society. There isn't a single law or statute that addresses ESG compliance. However, the Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015 (Listing Regulations), the Companies Act 2013, and other laws govern it.

The Companies Act permits some businesses with a specific net worth and value level to establish a committee to oversee Corporate Social Responsibility (CSR) initiatives. Furthermore, Section 149 of the Act discusses the specific kind of businesses that require a female director.

To evaluate the ESG criteria, SEBI made the top 100 listed businesses by market capitalization submit the Business Responsibility Report (BRR) in 2012. Business Responsibility and Sustainability Reporting (BRSR), which built upon the previous Business Responsibility Report, took its place in 2021. The United Nations Sustainable Development Goals (UNSDG) and the nine principles of the national rules for responsible corporate conduct are both embraced by the data-heavy BRSR framework.

Regulation 34(2) of the LODR regulations was modified by SEBI 2023, and a framework known as "BRSR Core" and "BRSR Core for the company's value chain" was introduced. ESG policies and practices were required to be disclosed by the top 1,000 listed companies based on market capitalization. The Securities and Exchange Board of India (SEBI) improved the framework for corporate governance and sustainability reporting in 2023 by amending Regulation 34(2) of the Listing Obligations and Disclosure Requirements (LODR) Regulations. This amendment emphasizes the significance of Environmental, Social, and Governance (ESG) compliance and

<sup>7</sup> AFDHEL AZIZ, Playing for the Planet: How Playmob Helped the UN Conduct the Largest Climate Chance Survey Ever Using the Power of Gaming, *Forbes* (Jan. 28, 2021); ALEX EDMANS, Grow the Pie, (2020), 35-36; SERGIO GRAMITTO RICCI / CHRISTINA M. SAUTTER, Corporate Governance Gaming, *Nevada Law Journal*, Vol. 22 (2021), 23-25; MICHAL BARZUZA / QUINN CURTIS/ DAVID WEBBER, Shareholder Value(s): Index Fund ESG Activism and the New Millennial Corporate Governance, 93 *Southern California Law Review* (2020), ECGI Law Working Paper 545/2020 (2020) 1283-1312; ID., The Millennial Corporation (2021), SSRN 3918443.

<sup>8</sup> See Marc S. Gerber et al., *The New Normal: ESG Drivers and the COVID-19 Catalyst*, Skadden (Nov. 12, 2020), <https://www.skadden.com/insights/publications/2020/11/the-new-normal> [<https://perma.cc/XQK4-WJ5T>].

requires listed businesses to produce a Business Responsibility and Sustainability Report (BRSR) in a format determined by the board, with effect from July 14, 2023.

In India, ESG is still in its infancy. Nonetheless, businesses like Asian Paints and Tata Consultancy Services (TCS) have implemented and embraced strategies for the same. These include Asian Paints' choice to employ environmentally friendly production ingredients and Havells' reduction in the use of radioactive isotopes. To encourage education among people in rural India, TCS also runs an Adult Literacy Program. SEBI introduced Listing requirements for businesses that require ethical governance procedures. To adopt international patterns in India, the Ministry of Corporate Affairs (MCA) and SEBI will be essential. Additionally, it assists businesses in generating value and drawing in investments.

## Challenges and the path forward

While integrating ESG principles into corporate governance offers significant benefits, some challenges remain. Measuring and reporting on ESG performance can be a bit complicated, and there is always a need for standardized frameworks to ensure consistency and comparability. Additionally, companies might face short-term costs associated with implementing sustainable practices, which could impact profitability. There are several challenges in ESG compliance with corporate governance, like data collection, where companies may struggle to keep track of appropriate data, especially for companies with diverse operations. It can be challenging to balance ESG factors, financial performance, and other corporate goals. Businesses need to strike a balance between ESG objectives, overarching strategy, and stakeholder expectations. To make sure that sustainability and profitability reinforce one another, this entails incorporating ESG considerations into risk management, financial planning, and investment choices.

Another major challenge the company faces is the constant market pressure from investors, activists, and customers to improve ESG performance. Businesses should proactively interact with stakeholders, respond to their issues, and show their dedication to ESG by being open and honest in their reporting and activities. One of the best examples of a business incorporating ESG factors into its governance structure is Unilever. The company's Sustainable Living Plan sets ambitious goals for reducing environmental impact, improving social outcomes, and enhancing governance practices.<sup>9</sup>

## Conclusion

A strategic approach is necessary for effective ESG integration, ensuring that sustainability and ethical issues are at the forefront of business decision-making by coordinating ESG objectives with overarching corporate strategy. Setting specific, quantifiable goals and incorporating ESG considerations into risk management, investment choices, and business planning are all part of this alignment. Executives and board members must support ESG initiatives and guarantee that these factors are incorporated into all facets of governance, therefore leadership commitment is essential. Additionally, including ESG factors promotes innovation and strengthens corporate resilience. Businesses that prioritize sustainability and moral behavior need to create new goods, services, and business plans that tackle social and environmental issues. This creative strategy boosts the company's competitive advantage and long-term sustainability while opening up new market prospects. Businesses that invest in renewable energy, for example, can reduce the risks brought on by fluctuating fossil fuel prices and regulatory changes while promoting a culture of accountability that will increase employee engagement and strengthen stakeholder connections. It takes effort, strategic alignment, and a desire to continual improvement to integrate ESG considerations into corporate governance. Businesses that adopt ESG principles and incorporate them into their governance structures will satisfy stakeholders and set themselves up for long-term success in a world that is becoming more connected and conscientious. Businesses may successfully negotiate the intricacies of the contemporary business climate, spur innovation, and guarantee long-term resilience by giving ESG factors top priority. This will ultimately help create a more sustainable and just future. ESG namely shows that there can

<sup>9</sup> <https://www.directors-institute.com/post/the-intersection-of-corporate-governance-and-environmental-social-and-governance-esg-factors-in>

be an alignment between investor value and stakeholder value – what MARK CARNEY coins as the ‘divine coincidence’.<sup>10</sup>

Corporate governance has always been considered an organizational tool for a better future. In the ESG context, this can be manifested in a very tangible sense. Indeed, ESG is ultimately a vehicle for boosting climate, social, and governance-based decisions. As we have seen, the intersection of corporate governance and ESG is apt to produce a ‘cascade effect.’ We have defined the ESG cascade effect as the potential aptitude for companies to engage in ESG-based decisions and systemically influence others. Such is a metric with effects and consequences that can be assessed at the investors’ level, the invested companies’ level, the supply chain level, and the community at large. In any of these levels, ESG potential impact is systemic, and its degree of influence is variable and depends upon the ESG policies and product-specific arrangements in place. Incorporating Environmental, Social, and Governance (ESG) considerations into corporate governance is a significant step toward more ethical and sustainable company operations. Businesses are changing their governance frameworks to meet the rising demands of stakeholders, reduce risks, and seize new growth opportunities as they realize the significance of ESG issues.



<sup>10</sup> MARK CARNEY, Value(s). Building a better world for all, cit., 426, 432, 453. See also LUCA ENRIQUES, Chapter 6 in this book. Regarding shareholder alignment paved through green financing, see also JULIAN NYARKO/ ERIC TALLEY, Corporate Climate: A Machine Learning Assessment of Climate Risk Disclosures, in ANDREAS ENGERT / LUCA ENRIQUES/ WOLF-GEORG RINGE/ UMAKANTH VAROTTIL/ THOM WETZER, Business Law and the transition to a Net Zero Economy, (2022), 3-5.