



ESG Insights for Corporate India

Controversies in the ESG space

May 2022

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About Us

ESG Risk Assessments and Insights (ESGRisk.ai), is a wholly owned subsidiary of Acuité Ratings & Research Limited and is India's first ESG rating company with an India specific assessment framework.

ESGRisk.ai's rating, second party opinions and gap assessment is an objective, independent and unbiased opinion on a company's ability to mitigate future/emerging risks associated with Environment, Social, and Governance issues that have material financial impact based on publicly available data.

To actively contribute to and be aligned with the worldwide ESG movement and policy dialogue, we are signatories of various global frameworks. Being a member of the GRI community, ESGRisk.ai actively contributes to advancing sustainability reporting. Acuité Ratings & Research Ltd together with ESGRisk.ai are also signatories to the UN Principles of Responsible Investment (PRI). Moreover, Acuité is the first credit rating agency from India to become a signatory of PRI's ESG in Credit Risk and Ratings Statement to enhance the systematic and transparent consideration of financial material ESG factors in the assessment of creditworthiness.

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Introduction

Controversies are defined as any kind of adverse information that affects the reputation of the company in a negative manner. The financial impact of corporate scandals can range from legal penalties to consumer boycotts, depending on the nature of the scandal. From bribery or corruption to workplace discrimination and environmental issues, corporate controversies can be devastating. These incidents have the power to affect negatively both the companies and their stakeholders. They are unfailing indicators of the gaps in an issuer's ESG risk management framework. The inability to foresee and manage a risk is starkly evident when the company faces controversies arising from its inability to address adverse events when they are encountered in the normal course of business.

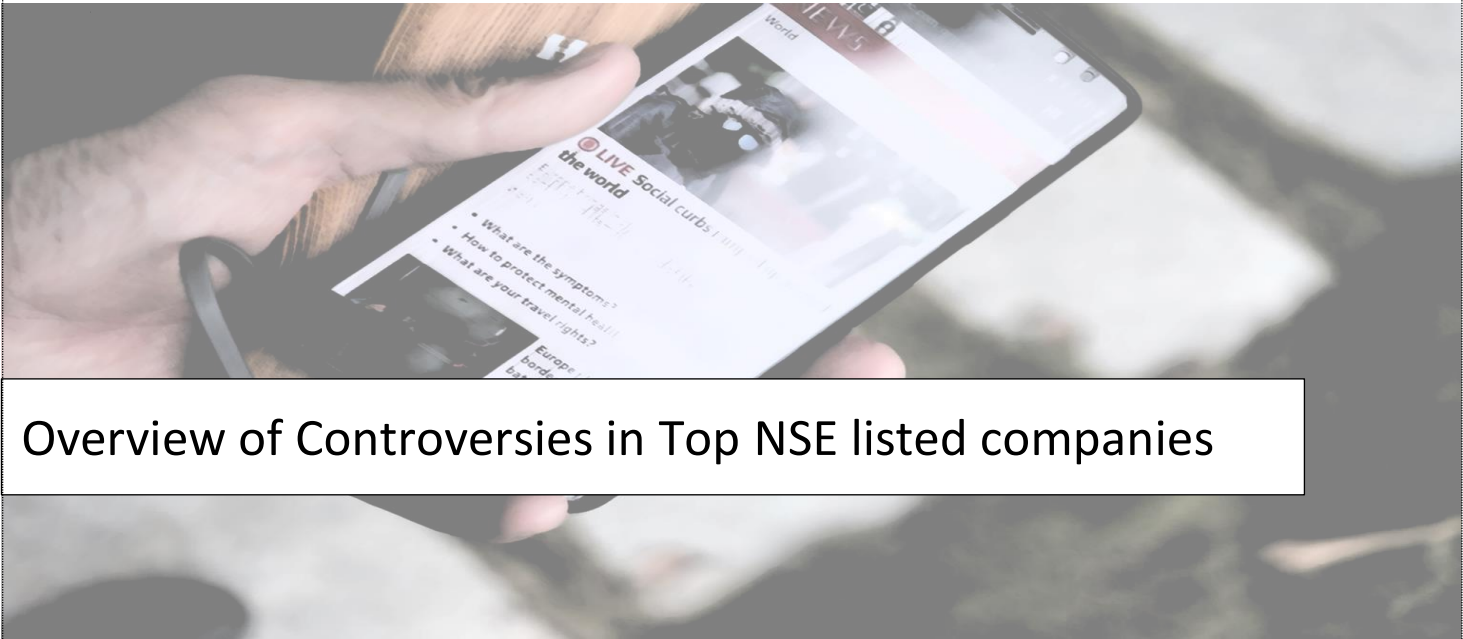
This paper offers a detailed overview of ESG controversies across top NSE 600 listed companies. While corporates are taking measures for sustainable business practices, ESGRisk.ai has observed significant failures in managing ESG risks. Some of the recent negative news are across the following ESG themes:

Corporate Governance	Environmental	Social
Board & Committee Functioning	Biodiversity	Community
Business Ethics	Emission	Product/Service Accountability
Financial Audit & Control	Energy	Social Supply Chain Management
Management Structure and Compensation	Water	Workforce
Shareholders Rights	Environmental Supply Chain Management	Data Privacy and Security
	Material Efficiency	

Controversy Methodology

Negative news/controversies have varied levels of impact on the companies' operations and the companies themselves have varying approaches to manage adverse events. ESGRisk.ai's model evaluates the fragility of the ESG risk management framework by the magnitude of the controversy's impact, management abilities and potential for future liabilities.

ESGRisk.ai assess controversies based on their impact – very high, high, medium, and low, across 35 Key issues (KI). In some cases, we carry forward the controversy to next year if no action has been taken by the company. In such cases, the impact of the controversy is lowered/ reassigned to account for the time elapsed since its occurrence. ESGRisk.ai also deducts scores from the category of corporate governance when the controversy is of very high impact. This is to indicate that controversies could constitute a breach of ethics by the company despite the presence of highly qualified board members and stringent policies.



Overview of Controversies in Top NSE listed companies

Controversial Key issues

ESGRisk.ai has assessed controversies occurring in NSE 600 companies in the financial year 2020-21 across environmental, social, and governance parameters. Additionally, a deep dive into key issues that are frequently controversial is also included.

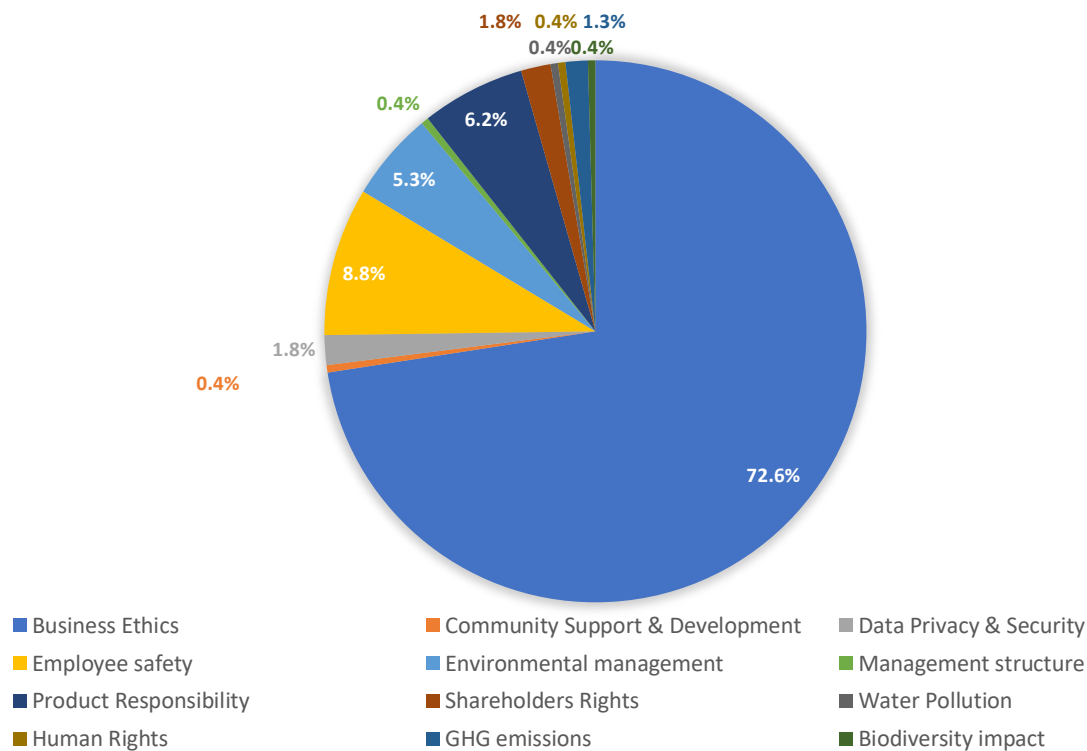


Figure 1: ESGRisk.ai Research 2022

As per the analysis conducted by ESGRisk.ai, we have observed that the greatest number of failures seem to appear within the key issue of Business Ethics followed by employee safety.

Comparison of controversies between FY2020 and FY2021

As part of its ESG Risk assessment, ESGRisk.ai has examined controversies for NSE 600 companies between the financial years 2019-20 and 2020-21 across environment, social and governance parameters. ESGRisk.ai's research has found that major disputes tend to occur in the key areas of business Ethics, employee safety, and environmental management. Controversies across the key issues of GHG emission, environmental management, employee safety, human rights and data privacy has increased in the year 2020-21.

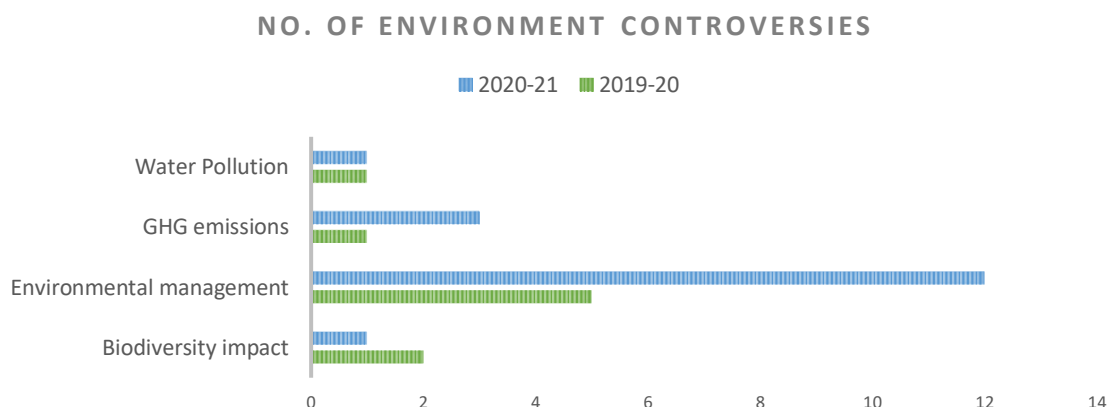


Figure 2: ESGRisk.ai Research 2022

A rise in contentions over environmental management issues has been observed in FY2021. Several controversies revolved around non-compliance with pollution control boards regulation and blatantly flouting environmental clearances in order to avoid delay in operations.

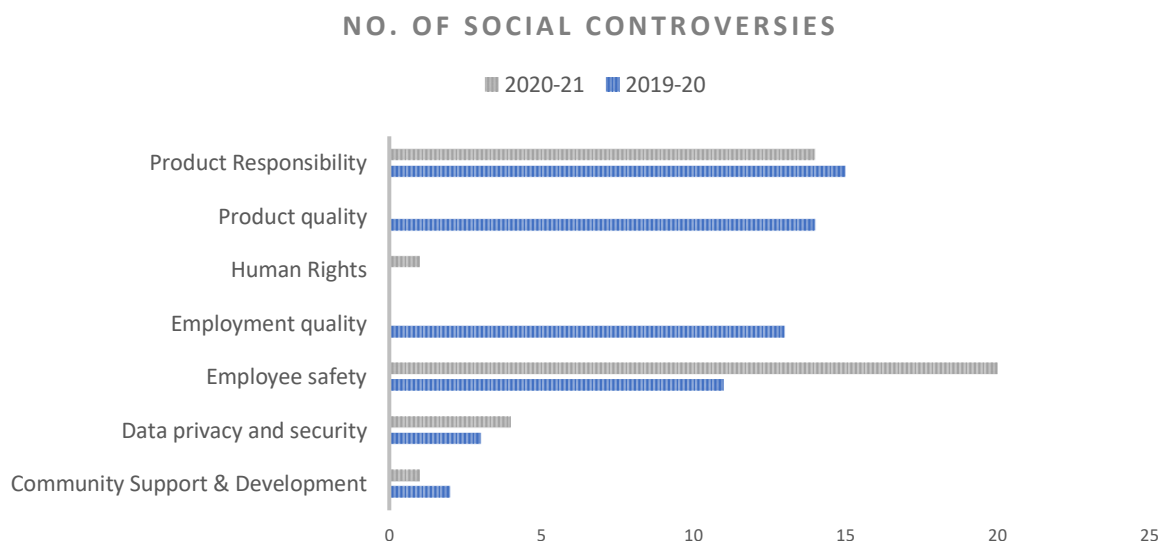


Figure 3: ESGRisk.ai Research 2022

In the social category, a rise in controversies related to employee safety has been observed. Plant fires and blasts, inadequate maintenance of machinery and equipment, and careless handling by workers are leading causes of occupational health and safety hazards.

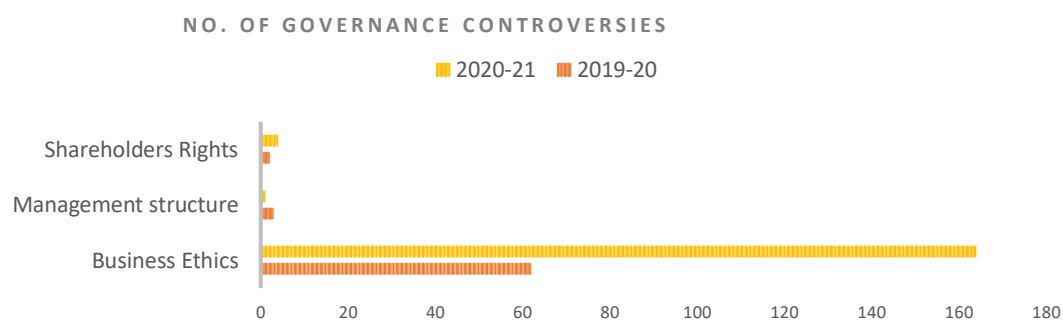


Figure 4: ESGRisk.ai Research 2022

Corporate frauds in India are so frequent and rampant that most people are no longer surprised by them. This very same fact was also observed in ESGRisk.ai's research, where the controversies in the key issue of business ethics grew significantly between FY2020 and FY2021. Several of the controversies stem from violations of insider trading rules and non-compliance with SEBI LODR guidelines.

Business ethics covers a wide range of issues such as complying with SEBI listing regulations, preventing bribery and corruption, improving fair trade practices, and reporting related party transactions. In addition to a stronger regulatory environment, Indian companies must implement better internal controls, improve corporate governance practices by establishing stronger policies and introducing mechanisms and initiatives to improve performance.

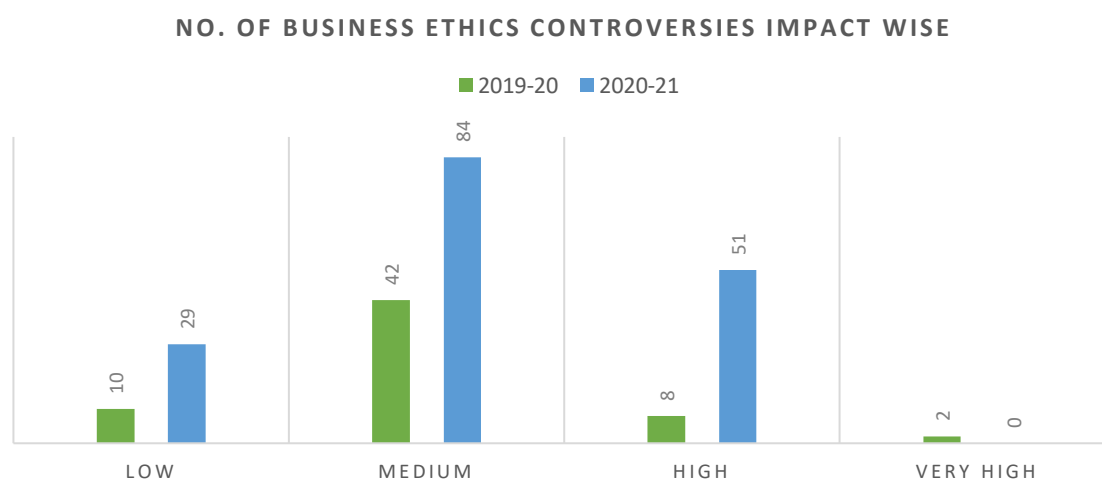


Figure 5: ESGRisk.ai Research 2022

Controversies Across Industries

Comparative analysis of the service sector and the manufacturing sector

A study of the NSE top 600 companies in India indicates that the service sector has encountered a greater number of controversies than manufacturing sector in the financial year of 2020-21. Among the industries of the service sector you will find banking, financial services, and IT consulting, while those of the manufacturing sector include pharma and metals with the highest number of controversies. Both sectors have, however, seen controversies predominantly with respect to business ethics.

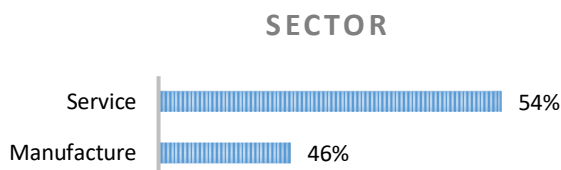


Figure 6: ESGRisk.ai Research 2022

Controversy-prone industries

While Indian corporates have espoused ESG management framework, we are seeing significant failures in risk management. Among the sectors that have experienced the most controversies are Banking & Financial Services, Pharmaceuticals, and Metals, among others. All these controversies are occurring despite the institution of appropriate Risk Management frameworks.

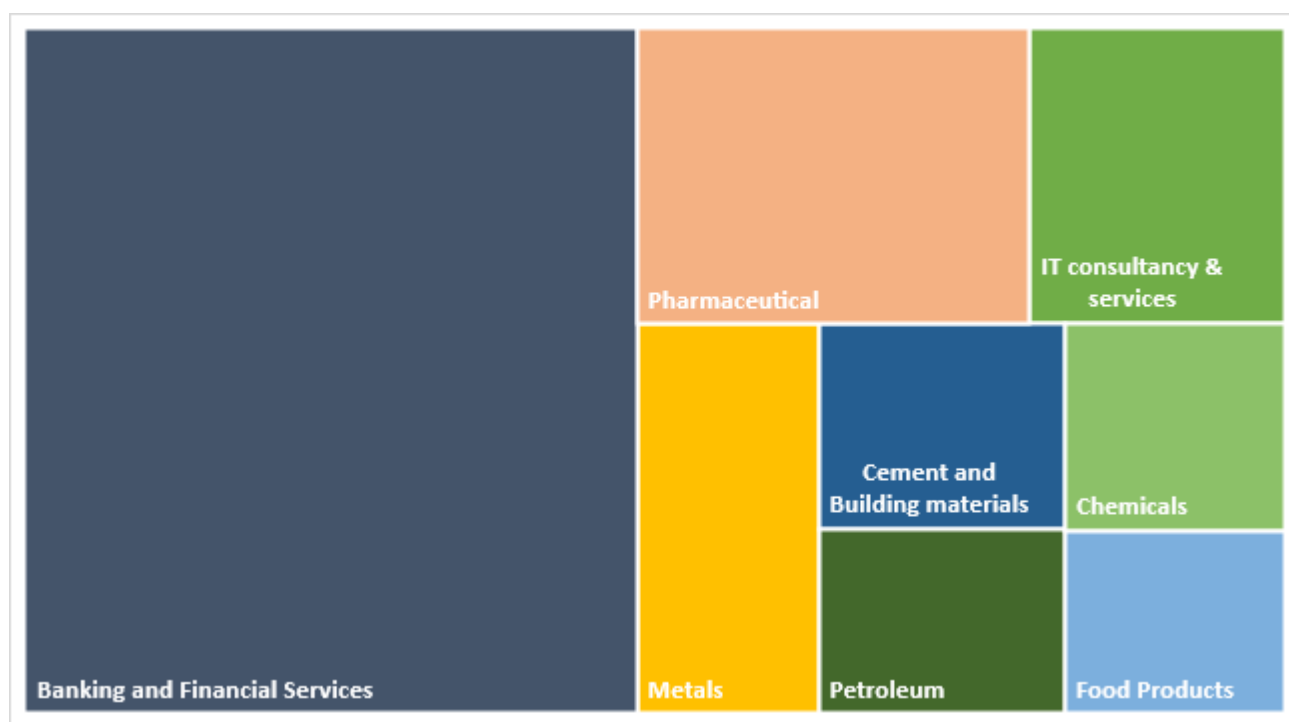


Figure 7: ESGRisk.ai Research 2022

Banking and Financial Services

The financial services industry includes Banks, Non-Banking Financial Company's (NBFCs), insurance and pension funds and other financial service entities. Banks and financial institutions are at the core of ESG integration, offering sustainable financing to customers, refinancing existing debts with sustainable instruments, and incorporating positive screening of lending portfolio as some significant ESG issues. Despite this, many scandals and controversies are rife in this sector, stemming from specific issues.

Controversial Key Issues

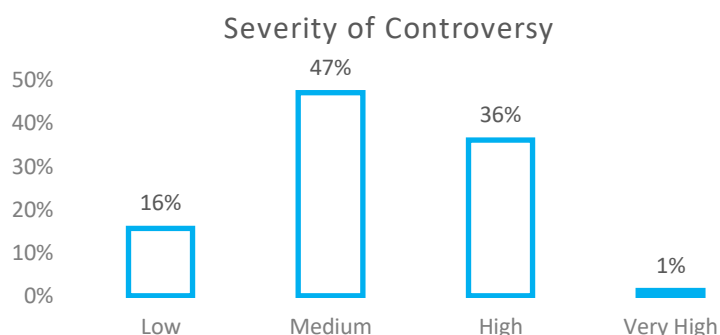


Figure 8: ESGRisk.ai Research 2022

In the financial services industry, 36 percent of controversies are deemed to be of high impact as illustrated in figure 8 above. The most common types of controversies observed in relation to the key issue of business ethics include non-compliance with RBI Guidelines, non-compliance with Banking Regulation Act 1949, violation of Insider Trading rules, non-compliance with National Housing Bank rules, and money laundering & fraudulent activities, among others. According to a study conducted by ESGRisk.ai, approximately 34 percent of the top NSE listed financial services companies have faced ethical challenges. Similarly, vulnerability in servers and programs have led to potential data breaches, exposing sensitive personal and financial data of customers. Moreover, frequent outages in online banking platforms have caused customer inconvenience.

As per a study conducted by ESGRisk.ai, in the year 2019-20 approximately 20 percent of the top NSE listed financial services companies had controversies; In the financial year 2020-21 that figure almost doubled.

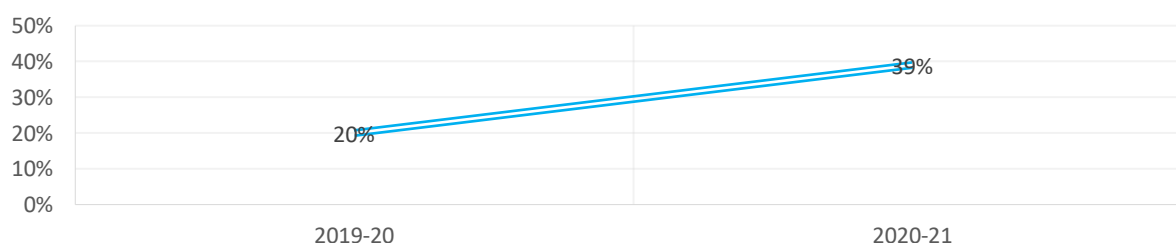


Figure 9: ESGRisk.ai Research 2022

Impact on E, S and G scores

The financial services industry places a high value on social and governance factors. The below graphs indicate that companies within this sector lose on average 33 percent of their overall ESG scores if they are involved in controversies of very high social impact, as well as 8 percent if they are involved in high-impact governance controversies.

Controversies in the ESG space

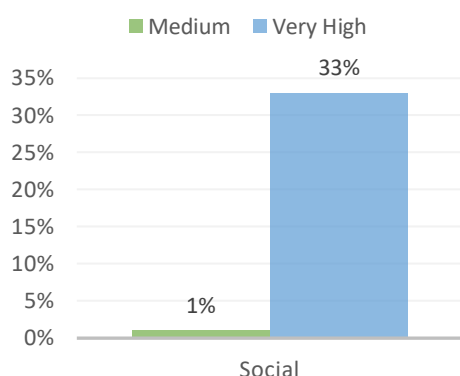


Figure 10: ESGRisk.ai Research 2022

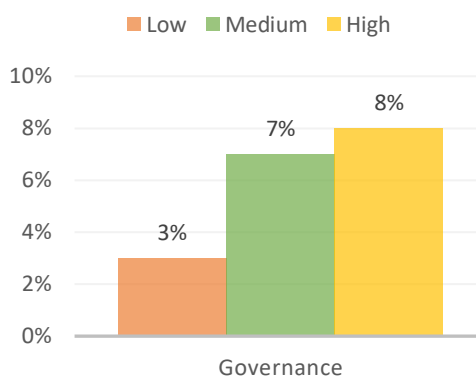


Figure 11: ESGRisk.ai Research 2022

Pharmaceuticals

Since the outbreak of the pandemic, the pharmaceutical industry has been instrumental in maintaining supplies of drugs and provide quality generic medicines at a cost-effective price. As uncertainty surrounding this virus continues to grow, maintaining the quality of the product, seeking necessary approvals, treating their employees' rights and managing biomedical waste are more important than ever.

Controversial Key Issues

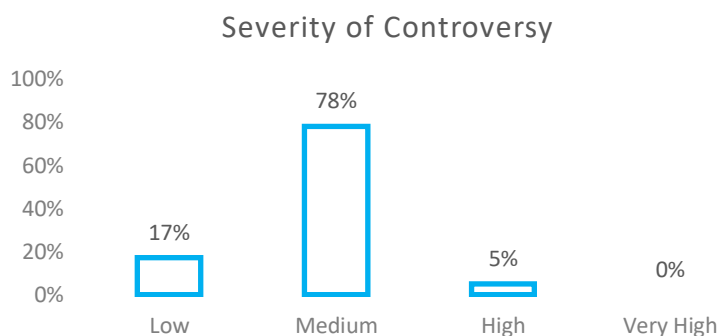


Figure 12: ESGRisk.ai Research 2022

In the pharmaceutical industry, 78 percent of controversies are deemed to be of medium impact as illustrated in figure 12 above.

In the broad arena of business ethics, the most common controversies observed relate to violations of insider trading rules, and the inflation of drug prices and overcharging customers. The study conducted by ESGRisk.ai indicates that 29 percent of the top NSE listed pharma companies struggle with ethical business practices. In addition, pharma companies are also accused of causing environmental degradation and pollution and operating in areas without the necessary environmental clearance.

The above is evidenced by the National Pharmaceutical Pricing Authority (NPPA) which has initiated almost 2116 cases of overcharging against Indian drug majors as per pharmaletter. "As on 10 February 2022, 881 overcharging cases involving \$1.12 billion are pending under the Drug Prices Control Orders (DPCO). Another 324 cases, worth \$899 million, are under litigation in various courts."¹

Impact on E, S and G scores

¹ <https://www.thepharmaletter.com/article/indian-pharma-companies-guilty-of-overcharging>

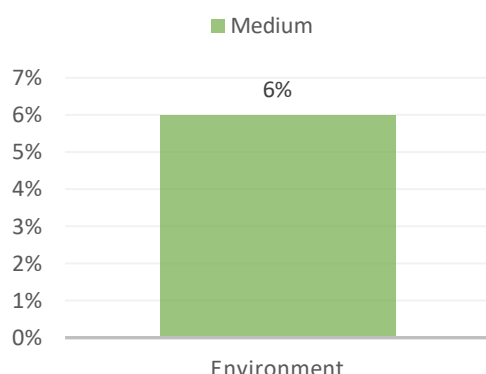


Figure 13: ESGRisk.ai Research 2022

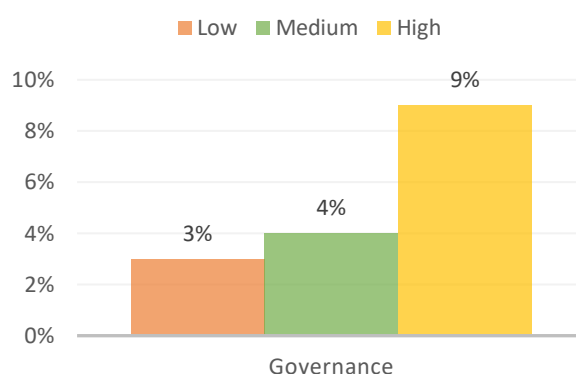


Figure 14: ESGRisk.ai Research 2022

Based on the above graphs, companies in this sector lose an average of 6 percent of their overall ESG scores if they are involved in high-impact environmental controversies. Additionally, companies in this sector lose 9 percent if they are involved in high-impact governance controversies.

Metals

The metal industry includes manufacturing of basic metals and fabricated metals. As per an article by EY, over the past 50 years, advances in technology and a move from traditional blast furnaces (BFs) toward the electric arc furnace (EAF) have reduced energy use in steel production by 60 percent. “The continued move to EAF will drive down emissions further, but creating a genuinely sustainable industry will require broader, bolder measures from all players across the value chain”²

Controversial Key Issues

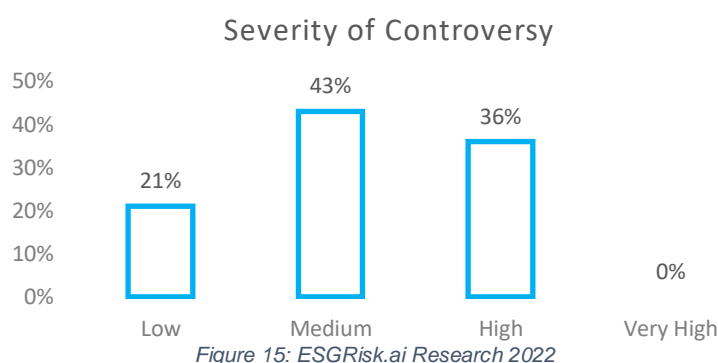


Figure 15: ESGRisk.ai Research 2022

In the metals industry, 36 percent of controversies are deemed to be of high impact as illustrated in figure 15 above.

The metals industry has faced numerous business ethics scandals, from non-transfer of GST reduction benefits to LODR violations and fraud allegations. Due to the presence of hazardous chemicals, electricity, steam, working at heights, confined spaces, and the proximity of the factories to rural areas, industrial health and safety management and community development are very

² https://www.ey.com/en_gl/mining-metals/five-actions-to-improve-the-sustainability-of-steel#:~:text=Over%20the%20past%2050%20years,in%20steel%20production%20by%2060%25.

important. Although there have been efforts made to protect employee safety and ensure the surrounding community's safety, there have been allegations of negligence leading to deaths and injuries.

ESGRisk.ai conducted a study revealing that approximately 32 percent of NSE's top metal companies have been involved in some form of controversy.

Impact on E, S and G scores

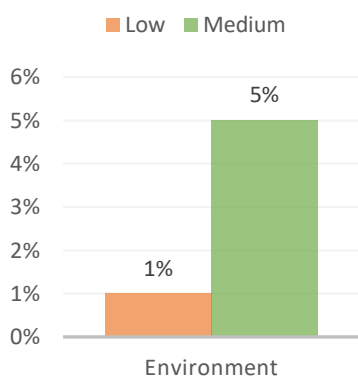


Figure 16: ESGRisk.ai Research 2022

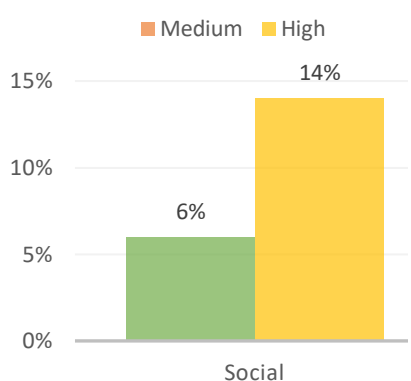


Figure 187: ESGRisk.ai Research 2022

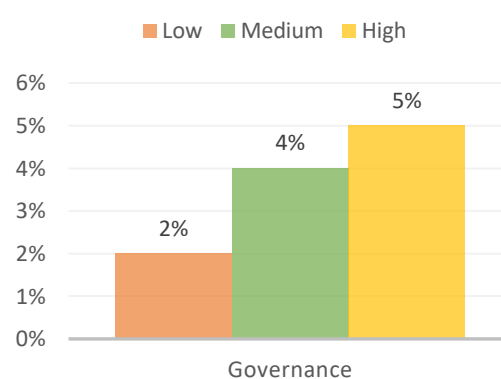


Figure 178: ESGRisk.ai Research 2022

The above graphs show that companies in this sector lose 14 percent of their overall ESG scores if they encounter social controversies. Furthermore, they also lose 5 percent if they are embroiled in environmental or governance controversies.

IT Consultancy and Services

The Information Technology (IT) industry includes companies in IT consultancy and IT services. India's corporate sector is prioritizing the protection of personal data, driven by the implementation of stricter regulations on data privacy and the growth of global operations. In light of this, it is imperative that the industry not only pay attention to data privacy but also leverage it to differentiate itself.

Controversial Key Issues

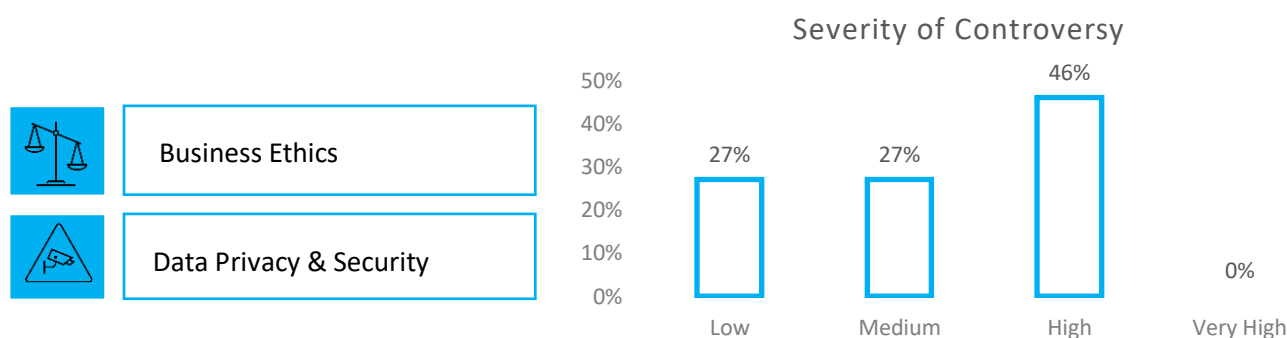


Figure 19: ESGRisk.ai Research 2022

In the IT industry, 46 percent of controversies are deemed to be of high impact as illustrated in figure 19 above.

Despite the importance of strong data privacy & security measures, vulnerability in servers and programs of many companies have led to potential and actual data breaches, exposing sensitive personal data of customers. In addition, certain IT companies have been accused of violating SEBI guidelines regarding insider trading and stealing trade secrets.

An ESGRisk.ai study found that approximately 20 percent of NSE's top IT companies were involved in ethical controversies or privacy violations.

Impact on E, S and G scores

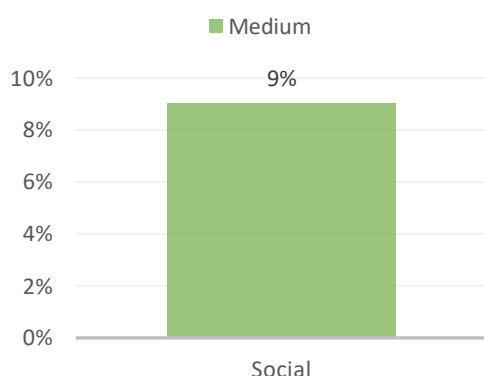


Figure 20: ESGRisk.ai Research 2022

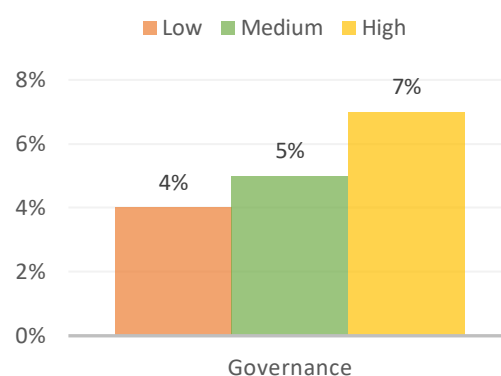


Figure 21: ESGRisk.ai Research 2022

IT industry places a high value on social and governance factors. The above graphs indicate that companies within this sector lose on average 9 percent of their overall ESG scores if they are involved in social controversies, as well as 7 percent if they are involved in high-impact governance controversies. Comparatively, financial services have a limited environmental impact and thus, as per research conducted, these types of controversies do not usually take place.

Cement and Building Materials

This industry is involved in manufacturing cement, ceramics, glass, granites, porcelains, and other

construction materials. The industry's top cement producers are testing alternative clinker technologies, designing concrete forms that reduce carbon emissions, and gradually converting to renewable energy sources, ensuring the industry's sustainability.

Controversial Key Issues

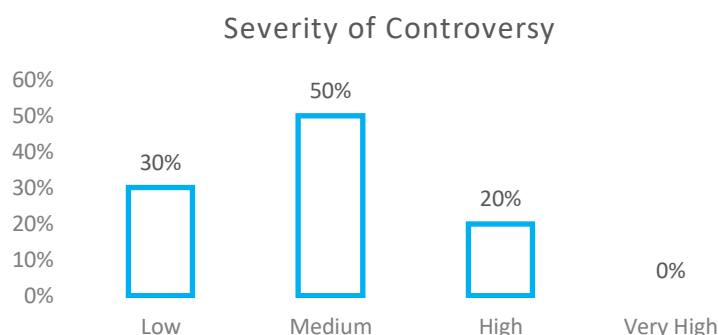


Figure 22: ESGRisk.ai Research 2022

In the cement & building materials industry, 50 percent of controversies are deemed to be of medium impact as illustrated in figure 22 above.

There have been several instances where the Competition Commission of India (CCI) ordered an investigation into anti-competitive practices and cartelization in the cement sector. "Back in 2016, the Competition Commission, on a complaint filed by the Builders' Association of India, had found that 11 cement companies had indulged in price cartelization, and levied a fine of Rs 6,300 crore on them".³ In spite of stringent laws, cement companies have found a way to engage in such practices for their profitability.

Furthermore, a number of cement companies were issued show cause notices and fined for not complying with emission standards by the Central Pollution Control Board. Additionally, though safety has been a priority, negligence has resulted in fatal and injury incidents.

According to ESGRisk.ai's research, almost 27 percent of the NSE's top cement companies are entangled in controversies.

Impact on E, S and G scores

Companies in the cement and building material industries lose on average 14 percent of their overall ESG scores when they are involved in high-profile social controversies, as illustrated in the table above.

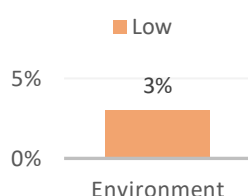


Figure 25: ESGRisk.ai Research 2022

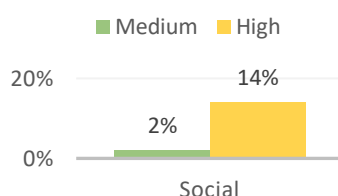


Figure 23: ESGRisk.ai Research 2022

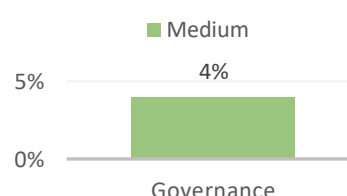


Figure 24: ESGRisk.ai Research 2022

Petroleum

The petroleum industry includes companies from exploration of crude petroleum & natural gas

³ <https://www.thehindubusinessline.com/companies/competition-panel-orders-fresh-probe-into-cartelisation-in-cement-industry/article33300290.ece>

and refined petroleum products. As the world increasingly shifts toward clean energy, the oil and gas industry faces a formidable challenge. Near-term profitability of the companies has been driven by fossil fuels, but a failure to address growing calls to reduce greenhouse gas emissions could threaten their long-term social acceptance and profitability.

Controversial Key Issues

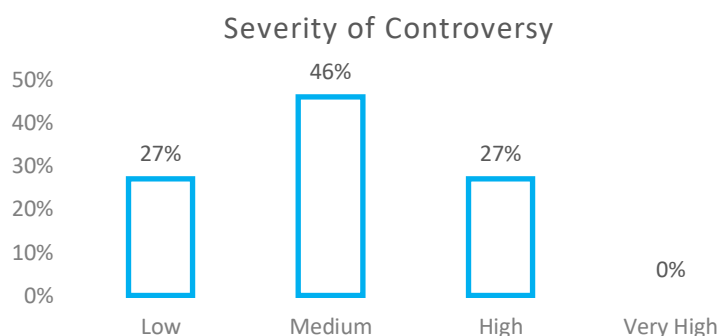
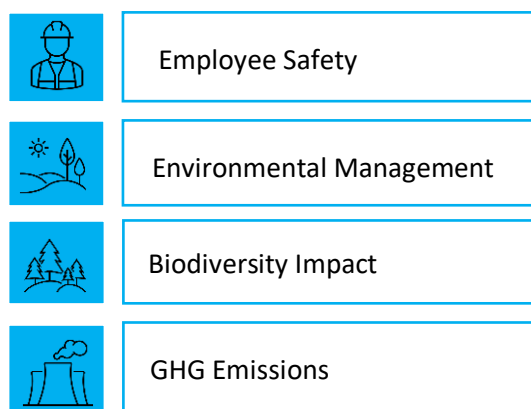


Figure 26: ESGRisk.ai Research 2022

In the petroleum industry, 46 percent of controversies are deemed to be of medium impact as illustrated in figure 26 above.

The precarious nature of the industry makes it vital to stay current with occupational health and safety standards. The most common cause of accidents at oil company plants has been fire breakouts. The effects have resulted in a number of injuries and fatalities. Furthermore, the National Green Tribunal (NGT) has had to impose a fine on multiple oil and gas companies for releasing volatile organic compounds (VOCs) among other greenhouse gases and causing atmospheric degradation.

According to ESGRisk.ai's research, a whopping 60 percent of the NSE's top petroleum companies are embroiled in some kind of controversy.

Impact on E, S and G scores

According to the graphs below, high-profile social controversies result in a loss of 18 percent of a company's overall ESG scores in the petroleum industry.

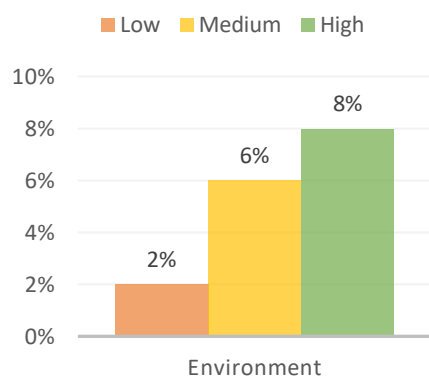


Figure 287: ESGRisk.ai Research 2022

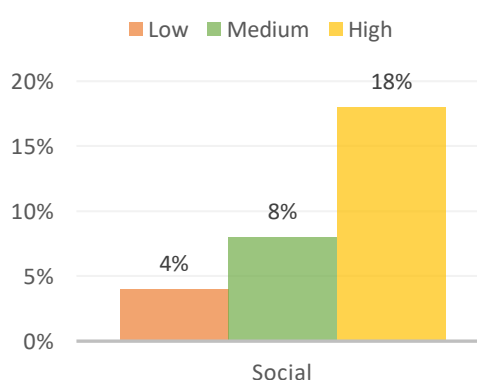


Figure 278: ESGRisk.ai Research 2022

Food Products

Each stage of this industry value chain, including food production, processing, transportation,

Controversies in the ESG space

storage, and distribution, has an environmental impact. A wide array of food processing, handling, and packaging operations creates waste. Additionally, this industry places a high value on the quality and responsibility of its products, as it significantly influences customer satisfaction and behavior.

Controversial Key Issues

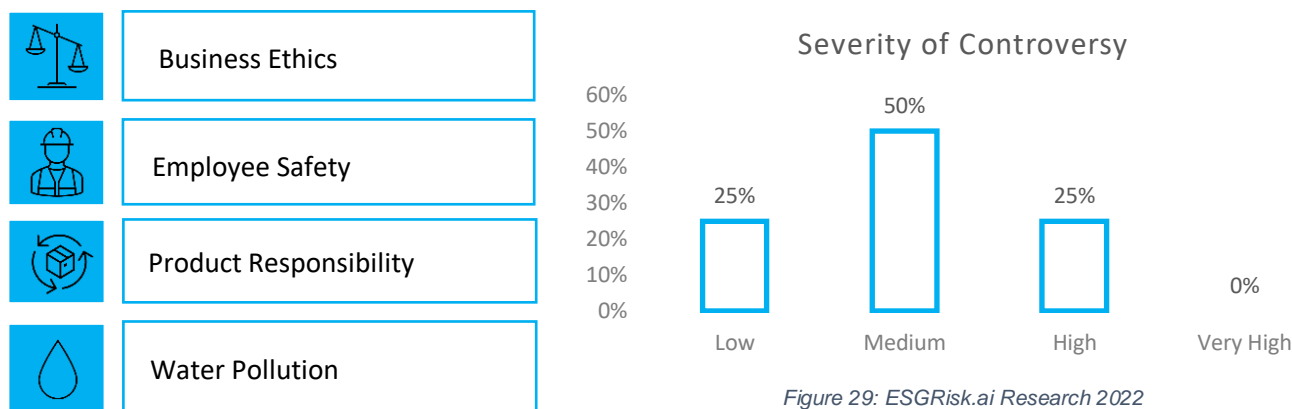


Figure 29: ESGRisk.ai Research 2022

In the food industry, 25 percent of controversies are deemed to be of high impact as illustrated in figure 29 above.

The most common types of controversies observed in the food industry includes product recalls due to substandard quality, misleading advertisements, exaggerated product efficacy, and exploiting consumers' lack of knowledge. ESGRisk.ai's study revealed that approximately 30 percent of NSE's top food production companies were involved in some form of controversy.

Impact on E, S and G scores

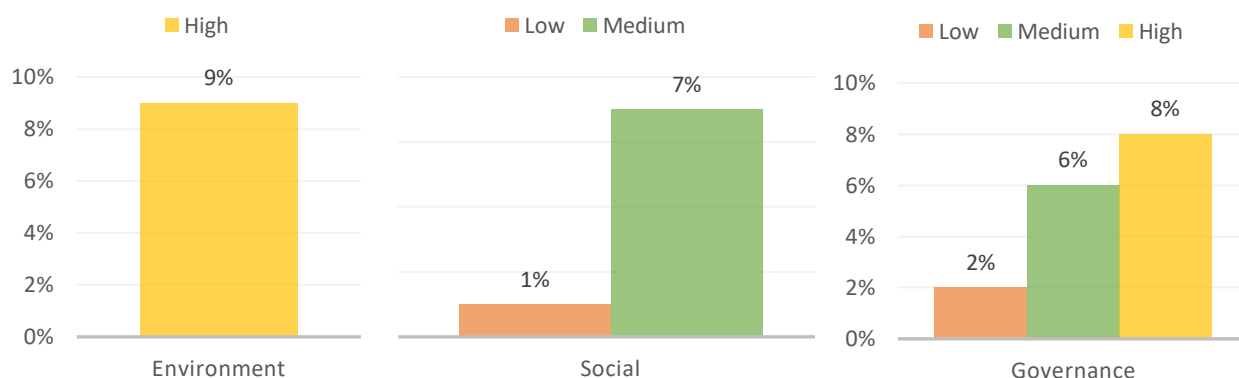


Figure 30: ESGRisk.ai Research 2022

Figure 321: ESGRisk.ai Research 2022

Figure 312: ESGRisk.ai Research 2022

In the food industry, environmental parameters play a significant role. Companies manufacturing food products lose on average 9 percent of their overall ESG scores when they are involved in high-profile environmental controversies, as illustrated in the graph above.

Chemical

Organic & inorganic chemicals, fertilizers & pesticides, paint manufacturing companies and caustic soda & fluorochemical companies are part of chemical industry. The transition from fossil to renewable raw materials offers new opportunities and is helping to make the chemical industry

more sustainable. Many companies are moving to produce various chemicals using less toxic/bio-based non-toxic feedstocks such as elimination of toxic solvents in various processes and products, use of engineered materials in production to reduce energy or water consumption, among other things.

Controversial Key Issues

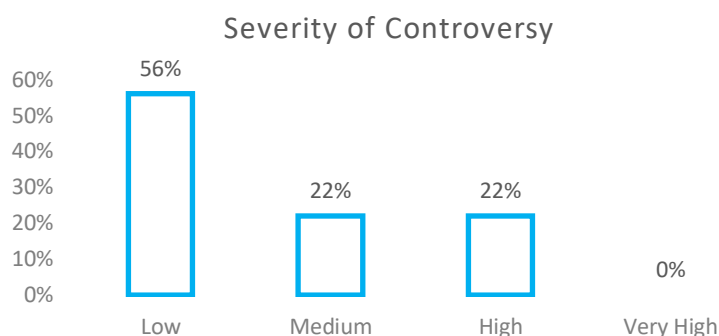


Figure 33: ESGRisk.ai Research 2022

In the chemical industry, 22 percent of controversies are deemed to be of high impact as illustrated in figure 33 above.

There are many safety hazards involved in chemical manufacturing, including machinery and equipment, contact with chemical and toxic substances and biological dangers etc. Each plant must recognize and mitigate these hazards. While there have been efforts made, the chemical industry must be more vigilant as it has seen multiple instances in which fatalities and injuries have occurred including chemical spills thus deteriorating the surrounding environment.

Moreover, misleading advertisements, exaggerated product efficacy, overcharging customers and failure to pass on GST benefits to consumers are unfair trade practices that chemical companies have employed in order to increase their profitability.

Impact on E, S and G scores

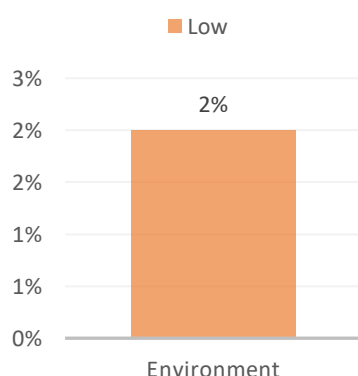


Figure 364: ESGRisk.ai Research 2022

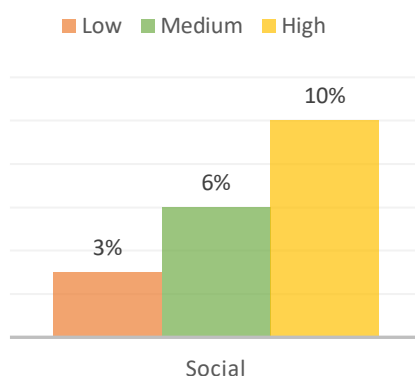


Figure 35: ESGRisk.ai Research 2022

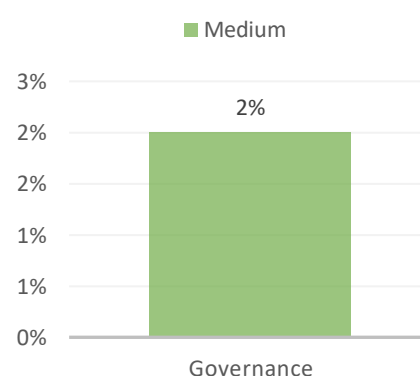


Figure 346: ESGRisk.ai Research 2022

Based on ESGRisk.ai's research, 11 percent of the NSE's top chemical companies are entangled in controversies. Companies in the chemical industry lose on average 10 percent of their overall ESG scores when they are involved in high-profile social controversies, as illustrated in the graph

Controversies in the ESG space

above.

ESG controversies across the globe

Throughout history, there have been many international scandals. A few examples are necessary to understand the impact of how these not only adversely affect the perpetrator but reverberate throughout society.



Lafarge Cement Syria human rights violation

Lafarge, a well-known French cement company, neglected basic human rights and put the lives of its employees at risk for its financial gain. The judicial inquiry revealed that between 2012 and 2014, the company, through its Syrian subsidiary Lafarge Cement Syria, allegedly paid up to 13 million euro to various armed groups, including the Islamic State, in order to keep its cement factory in northeastern Syria running. This, in spite of the ongoing war raging at its doorstep and the kidnappings and security threats faced by its employees.



Deepwater Horizon

The largest offshore oil spill in U.S. history began ten years ago, on April 20, 2010. A massive explosion killed 11 workers on the Deepwater Horizon drilling rig, and a blowout spewed more than 3 million barrels of oil from the Macondo well, located 70 miles off the coast of Louisiana.

For three months the oil company, BP, struggled to contain its runaway well and oil coated more than 1,000 miles of coastline in six states covering over 40,000 square miles of the Gulf of Mexico. This spill was the worst environmental disaster in U.S. history that till date sees ecological damage.



Bernie Madoff Financial Fraud

Pretending to be trading securities at Bernard L. Madoff Investment Securities LLC, Madoff was running a proper Ponzi scheme: promising steady, double-digit returns to his customers, while actually using cash from new investors to pay back money to older ones. Madoff was able to sustain the fraud for several years, withstanding a severe recession in the 1990s, a global financial crisis in 1998 and the jittery aftermath of the 9/11 attacks.

In total, the loss reflected by fake account statements hovered around \$64.8 billion, including the fictitious profits that Madoff was sending back to customers for over at least two decades. Madoff's client list included Hollywood luminaries. He also handled money for ordinary investors, and his scam wiped out many people's savings and retirement plans, leading some to have to go back to work or move in with friends and family.

Conclusion

As part of this study, we analyzed top 600 NSE companies and found controversies of various scales and sizes that fall under the environment, social, and governance categories. Such scams and scandals have a tendency to affect the company's reputation, goodwill, and have the potential to cause financial losses. The company may suffer investor losses, have difficulty attracting talent and retaining customers and reduce the value of its equities or bonds.

Corporations can take a number of steps to ensure compliance and be vigilant for instance, in order to improve business ethics, it is essential that companies follow rules and regulations as stipulated by the Companies Act, SEBI LODR guidelines, and other statutes. Furthermore, besides complying with the law, companies must set up policies, undertake initiatives and curate training programs to ensure that the workforce is adequately trained. Occupational hazards rank second in terms of controversies. Employers must address these by adopting occupational health & safety policies, training employees on the use of equipment, ensuring routine maintenance and audit of the plant, as well as creating a grievance mechanism. Adopting policies and implementing initiatives increases the likelihood of a company securing investor confidence and sailing through smoothly.