Environmental, social & governance in infrastructure projects

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Infrastructure projects are complicated by nature. This involve huge investment decisions and they often outlive the investment decision makers; investors are continuously looking for ways to evaluate their decisions. They try to figure out methods to evaluate factors that could impact a project not only in the near future but also in the distant one. They take into account any disrupting future event that might affect the profitability or even existence of any business, before taking the investment decision.

Environmental, Social and Governance (ESG) is one of the mechanisms that the investors use to evaluate their investment decision regarding a project. The concept of ESG started taking shape in the early 1990s when the notion of sustainability was gathering momentum. It is based on the idea that organisations not only need to focus on profits but also on people and the planet for long term profitability and sustainability.

ESG can be seen as a further extension of corporate social responsibility. It takes into account how an organisation treats the society, its people and the environment. The structure of the company, especially the top management is also a critical factor in ESG. Modern investors are increasingly taking ESG into account in order to evaluate the risk involved in investing in a company or project. Infrastructure projects are directly connected with local ecology, society and are heavily impacted by government policies. They require huge investments and usually have very long lifecycles. Due to this, ESG is especially important for infrastructure projects.

Environment factor

Modern society is conscious about the current and future situation of its environment. The future generations are expected to be more aware and concerned about their environment. Therefore, the infrastructure companies not only need to think about the circumstances of today but also the distant future. Factors like climate change can also adversely affect the performance or even existence of any project. For example a project located near the sea shore might be submerged under the water due to the rise in sea level 50 years later. Other environmental risk could be the depletion or scarcity of a natural resource critical for the continued success of a project. For example, scarcity of fresh water could lead to the failure of real estate projects.

Other factors like pollution or waste generation could lead to serious issues for the projects. Loss of reputation, resistance from local communities and legal action by the government are some of the many factors that could affect a pollution or waste generating project.

Social factor

Every infrastructure project is built to serve the society. Infrastructure finance is increasingly taking the social factor into account while evaluating any project for risk. New age financers and institutional financers are convinced that the success and profitability of any project depends on how it treats the society, the people who work for it and how much value it creates for the society.

Modern business is not only about making profits. It also needs to give back to society what it has taken from it. Social groups are becoming more and more conscious about what value any project will create for society. Not creating value for the society can bring in the risk of resistance from the community or even boycott. This might not happen in the short run, but can happen in the long run. In order to avoid the risk of public scrutiny, the social factors governing any project should be taken into account at the beginning.

Governance Factor

In a dynamic economic system in which today's corporates function, efficient management could be the difference between the success and failure of an organisation or project. ESG calls for a diversified, unbiased and gender balanced management system, especially when it comes to higher management or the board of directors. ESG also takes into account the competence and experience of the board of directors. Business ethics and transparency in the reporting system of the organisation are also becoming very important. Governance in ESG also takes into account the remuneration taken by the senior management and the other employees of the organisation. Since infrastructure projects have very long serving periods, long term value creation by the projects is also an important component of the ESG matrix.

Conclusion

As mentioned above, ESG can be considered an extension of corporate social responsibility. ESG might be in the nascent stage in India, it is already an important criteria of risk analysis of a project in the developed countries. In India, the awareness about ESG is rapidly increasing. It might also be an important factor for Indian corporates very soon. Hence the ESG component should be taken very seriously to attract the investments.