Policy Brief

Environmental, Social, Governance (ESG) Adaptation and Framework: A Blueprint for the Future

Dr. Aneel Salman
Sheraz Ahmad Choudhary

October 2023

IPRI Islamabad Policy Research Institute
Research | Innovation | Dialogue | Policy

KSBL

KSBL-IPRI Chair Economic Security

Executive Summary

The Environmental, Social, and Governance (ESG) framework is increasingly gaining global prominence, garnering significant attention from socially conscious investors and shareholders. This framework is pivotal for evaluating investment opportunities and gauging the societal impact of companies. This policy brief delves into the pressing need to embed ESG principles into Pakistan's economic fabric, spotlighting future prospects within its three fundamental pillars: Environmental, Social, and Governance. The document emphasizes the indispensable role of ESG in shaping the financial sector, highlighting a direct correlation between superior ESG performance and consistent positive business outcomes. It champions ESG's potential to foster sustainable profitability, enhanced financial performance, heightened adaptability, favorable returns on assets (ROA), noteworthy returns on equity (ROE), innovation, creativity, and unwavering regulatory compliance. The brief advocates for the inception of a comprehensive legal framework, forged through a synergy between the government and private sectors. Such a framework seeks to expedite sustainable development in Pakistan, aligning the nation with the global momentum towards conscientious and ethical business conduct.

Policy Recommendations

The infusion of Environmental, Social, and Governance (ESG) standards holds profound importance within Pakistan's corporate and investment landscape. Recognizing this, key regulatory bodies such as the Securities and Exchange Commission of Pakistan (SECP) and the State Bank of Pakistan have been proactive in weaving ESG principles into the very fabric of business operations. To further harmonize the ESG framework within Pakistan's operational ecosystem, the following policy recommendations are put forward:

- For Pakistan to fully harness the dividends of ESG-centric growth, a cohesive effort is necessary. The government, in tandem with corporate entities and civil society, should craft a robust, obligatory legal framework that not only propels sustainable development but also catalyses employment opportunities.
- As the paradigm shifts towards sustainability, certain traditional roles, especially in high-emission industries, might face obsolescence. For instance, as the renewable

energy sector burgeons, fossil fuel-related positions might wane. To navigate this transition, continuous skill development and retraining initiatives should be institutionalised, enabling the workforce to remain relevant and agile.

- Regulatory bodies should intensify their oversight, offering clearer directives and facilitating the dissemination of ESG best practices. This would serve to bolster long-term economic resilience and align businesses with globally recognised ESG benchmarks.
- The digital revolution has indelibly altered the contours of industrial progression. To surmount the multifaceted challenges of the digital era, businesses should leverage technology as an ally. Digital tools can streamline ESG reporting, enhance transparency, and foster stakeholder engagement, ensuring companies remain resilient in an increasingly interconnected world.
- By adopting these recommendations, Pakistan can position itself at the vanguard of sustainable growth, aligning its economic aspirations with global ESG imperatives.
- Bartering will regulate Pakistan’s trade with Iran and Afghanistan and reduce the smuggling of goods across Pakistan’s borders, leading to substantial foreign exchange losses.

Introduction

The dawn of the twenty-first century heralded myriad opportunities and challenges for countries worldwide. The pressing imperatives of fostering peace, conserving the environment, and cultivating collaborative efforts are fundamental for ensuring a resilient and sustainable global future. These aspirations have crystallized into the concept of sustainable development. The Brundtland Commission eloquently defined this as,

"Meeting the needs of the present without jeopardizing the ability of future generations to meet their own needs."

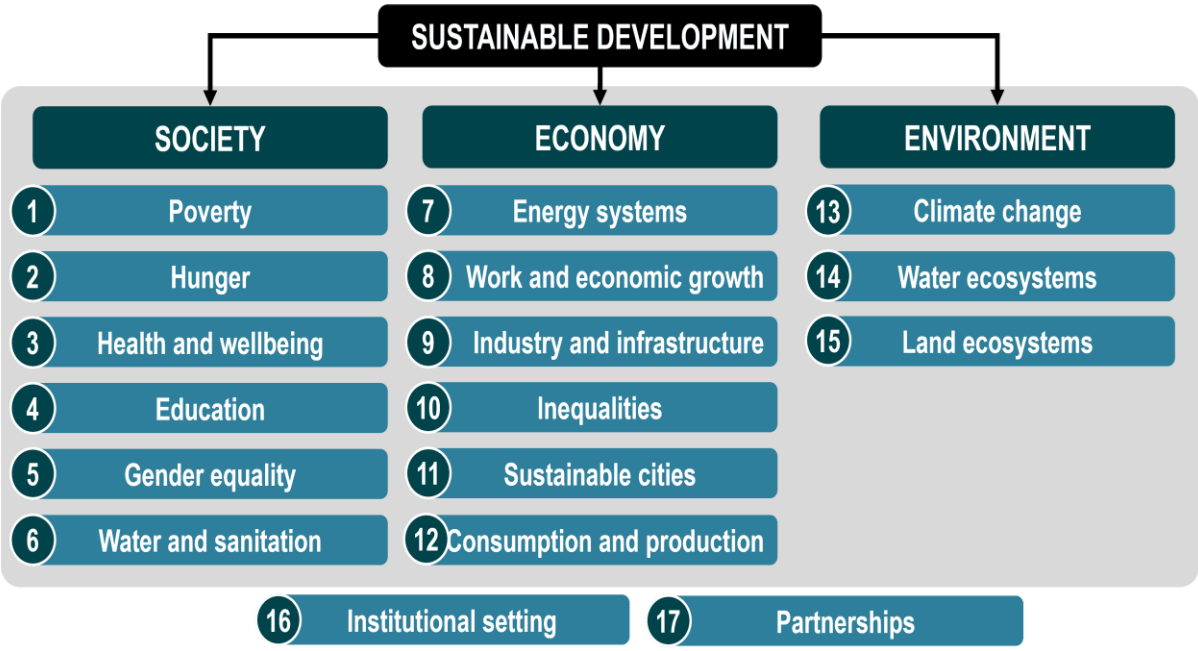
The Millennium Development Goals (MDGs) stood as the pioneering effort in this direction, centering on pivotal themes such as poverty eradication, gender equality enhancement, health improvement, and environmental preservation to drive global sustainable progress. While the MDGs did not fully realize their targets, the progress made and the collective endeavors of member nations kindled optimism for the journey ahead. Recognizing this momentum, the United Nations introduced the Sustainable Development Goals (SDGs) in 2015. The unanimous agreement of member nations to this visionary charter signaled a robust commitment to global well-being. Helen Clark, then the Administrator of the United Nations Development Program (UNDP), underscored the paramount importance of this consensus. She viewed it as a seminal stride in orienting our planet towards a path marked by inclusivity and sustainability. Clark remained sanguine that united global endeavors would pave the way for a future filled with peace, prosperity, holistic well-being, and environmental stewardship. [1]

These 17 SDGs cover the area's economic well-being (Goal 1, 2, 12), personal and social well-being (Goals 3,4,5, 6) economic growth(Goal 8, 9, 11), protecting the environment and restoring nature (Goal14, 15), reducing inequalities of income and gender(Goal 5,10), combating with climate change(Goal 13), ensuring inclusive and sustainable growth and making effort to create good governance through strengthening the institutions (Goal 8, 16,17).

[1] UNDP., (2016). Sustainable development goals. Available at: https://www.undp.org/sustainable development-goals?gclid=CjwKCAjw9-6oBhBaEiwAHv1QvEtAVB 5e5nCNzc1ikKc0O0UqCdCAP_VHqBYD5BCTI2VfV_50ubGxxoCao8QAvD_BwE

A brief description of SDG goals has been provided in Table 1 below:

Figure 1: 17 Sustainable Development Goals



The introduction of the Sustainable Development Goals (SDGs) highlighted the critical task of battling climate change. The Paris Agreement, established during COP 21 in 2015 and endorsed by 196 member nations, epitomized this global commitment to environmental sustainability. Under this accord, nations resolved to limit global temperature rise to below 2°C by 2050.[2] However, the ambitious targets set by both the SDGs and the Paris Agreement will remain elusive unless there is a concerted, unified effort that integrates the financial and production sectors. This sentiment was echoed at COP27 in Egypt. The gathering at Sharm El-Sheikh saw a consensus: the global economy must actively counter climate change and aim for a stringent 1.5ºC temperature ceiling.

In the quest to realize the objectives delineated in the SDGs and the Paris Agreement, the ESG (Environmental, Social, and Governance) criteria have emerged as a potent action plan. Developed nations have already initiated significant steps in this direction. By framing the ESG criteria, there's a blueprint not just for environmental sustainability, but also for advancing social inclusion and global development, mirroring the core tenets of both the SDGs and the Paris Agreement.

[2] COP 15., (2015). Key aspects of the Paris Agreement. https://unfccc.int/most-requested/key-aspects-of-the-paris-agreement. 12-december-2015

Furthermore, the ESG framework complements the SDGs, providing a holistic strategy to steer sustainable development. Specifically, the "E" in ESG resonates with SDG Goals 13, 14, and 15; the "S" aligns with Goals 3, 4, 5, 8, and 9; and the "G" is harmonious with Goals 16 and 17. In essence, ESG offers a cohesive approach to achieving SDGs, spanning from individual production units to overarching macro-level strategies.

Highlighting the interconnection between ESG and SDGs, various countries have embraced a global framework that underscores the significance of SDGs. The United Nations led the charge, pioneering legislation that mandated ESG report disclosures. The UN Principles for Responsible Investment (UNPRI) set a precedent in 2019 by obliging its signatories to adhere to ESG reporting requirements. Subsequent to this UN initiative, the European Union stepped forward, enforcing ESG reporting through its directives on Non-financial and Diversity Information, thereby becoming the first economic bloc to institutionalize such a mandate. Initially, EU directives applied only to firms having more than 500 employees or having minimum assets of EUR 30 million and minimum net sales of EUR 400 million. In April 2022, EU directives were revised and now they apply to all large and listed companies. Nowadays almost all multinational companies have adopted ESG reporting disclosures either because it is mandatory or to attain financial benefits and as a social responsibility to save the planet. ESG report disclosure at the corporate level has contributed significantly to strategic decision-making, risk management, and cost management and is beneficial for stakeholders of the company. Industrial strength and efforts could create sustainability, result in cost saving and diversification, increase work engagement of employees, and improve production behavior [3](. ESG reporting does not represent the company's ethics, but rather its performance. However, assessment based on ESG criteria is an indicator of its role in making changes toward companies' Sustainable

---

[3] Freeman, R. E. (2010). Strategic management: A stakeholder approach. Cambridge University Press.
Porter, M., Serafeim, G., & Kramer, M. (2019). Where ESG fails. Institutional Investor, 16(2).
Kim, W., & Park, J. (2017). We are examining structural relationships between work engagement, organizational procedural justice, knowledge sharing, and innovative work behavior for sustainable organizations. Sustainability, 9(2), 205.
Agarwal, U. A., Datta, S., Blake - Beard, S., & Bhargava, S. (2012). Linking LMX, innovative work behavior and turnover intentions: The mediating role of work engagement. Career development international.

performance. (Escrig-Olmedo et al. 2019)[4]. Besides the benefits of ESG reporting to stakeholders increased by promoting ethical investment practices and a means of better performance of managed portfolios with decreased portfolio risk and increased returns. (Broadstock et al. 2021)[5]. ESG investment has gained popularity as the firms with good ESG practices. It showed the better performance of cash flows and returns of the firms. Firms with good ESG practices also show their ability to proactively avoid shocks in future cash flows (Lee et al. (2013)[6]; Friede et al. (2015))[7]. Matos et al. (2020) examined that sustainable firms have a greater chance of stable dividend payouts compared to those firms who did not adopt ESG criteria. It is now evident that ESG is not just a new word, but it is becoming a new world as it is now a globally accepted legal and ethical mandatory requirement for achieving sustainability goals. According to the UN PRI report, Assets under management (AUM) increased from $6 trillion in 2006 to $104 trillion in 2020 for the ESG sector)[8]. Despite all this, there are no standard indicators for ESG reporting. Different information providers for ESG ranking use different indicators and weight differently to three elements of ESG)[9]. For example, the indicators chosen by the five main information providers for ESG ranking are SCM, SASB, Refinitiv, MSCI (Morgan Stanley Capital International), and S& P global for E, S, and G components are different. It is reported in the following table 2:

[4] Escrig-Olmedo, E., Fernández-Izquierdo, M. Á., Ferrero-Ferrero, I., Rivera-Lirio, J. M., & Muñoz-Torres, M. J. (2019). Rating the raters: Evaluating how ESG rating agencies integrate sustainability principles. Sustainability, 11(3), 915

[5] Broadstock, D. C., Chan, K., Cheng, L. T., & Wang, X. (2021). The role of ESG performance during times of financial crisis: Evidence from COVID-19 in China. Finance research letters, 38, 101716.

[6] Lee, D. D., Faff, R. W., & Rekker, S. A. (2013). Do high and low - ranked sustainability stocks perform differently? International Journal of Accounting & Information Management.

[7] Friede, G., Busch, T., & Bassen, A. (2015). ESG and financial performance: aggregated evidence from more than 2000 empirical studies. Journal of Sustainable Finance & Investment, 5(4), 210-233. Finance, O. E. C. D. OECD Business and Finance Outlook 2020.

[8] UNPRI., (2021). Principles for Responsible Investment, Annual report. https://dwtyzx6upklss.cloudfront.net/Uploads/b/f/m/pri_annual_report_2022_689047.pdf

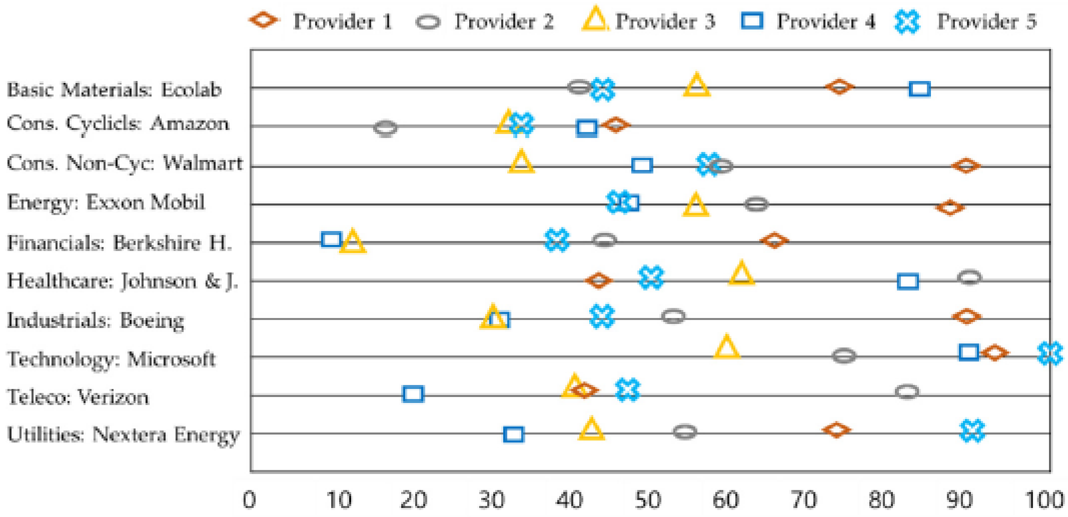
[9] Boffo, R., & Patalano, R. (2020). ESG investing: Practices, progress, and challenges. Éditions OCDE, Paris.

Table 2: ESG Components of five information providers

	Stakeholder Capitalism Metrics	SASB	Refinitiv®	MSCI	S&P Global
E	Freshwater availability Climate Change Air Pollution Nature Loss Innovation of better products and services	Energy management Climate Change Water management. GHG emission Waste and hazardous materials Product design and life cycle management Ecological damage Material Sourcing	Resource use Emissions Innovative environmental strategy Controversies on environmental issues	Natural Resources depletion Climate change Pollution and waste Environmental strategy	Operational eco-efficiency Climate strategy Environmental reporting Environmental policy and management system
S	Dignity and equality Health and well-being Skills for the future Employment and wealth generation Community and social support	Human rights and community relations Product quality, safety, selling practices, and product labeling. Customer Privacy Data security Customer Welfare Access and affordability	Human rights Community Workforce Product responsibility Controversies on social issues	Product, human capital Social opportunities Satisfaction of customers, employees, suppliers, and other stakeholders	Human rights Corporate citizenship and Philanthropy Labor practice indicator Talent attraction and retention Customer relationship management Information security and system availability Policy influence Social reporting
G	Ethical behavior Governing purpose Risk and opportunity oversight Stakeholder engagement Quality of governance body	Business ethics Business model resilience Management of the legal and regulatory environment Supply chain management Risk (critical incidence and systematic) management	Management structure and compensation, ESG strategy and reporting, Shareholder rights, Controversies on governance issues	Corporate behavior, Corporate governance	Codes of business conduct, Tax strategy, Supply chain management, Risk and crisis management, Corporate governance, Materiality

This difference in indicators leads to the difference in the Index value of the reporting firms. It is difficult to make a global comparison of the firms on ESG criteria globally ESG reporting helps get access to international financial markets and is thus helpful in broadening the financial opportunities for investment. Various financial and non-financial indicators are also associated with ESG ranking. Although ESG is now a globally accepted criterion to evaluate firms at international-level performance. The main issue with ESG is that various ESG reporting firms use their standard while ranking ESG and usually ignore country-specific needs. In Figure 2, ESG rankings from five different organizations for the same firms have been described. It is obvious that information providers ranked different firms differently based on the respective ESG framework opted for. For example, Exon Mobile a company in the energy sector is ranked differently by five different ESG ranking providers[10]. The difference between minimum and maximum ESG scores from different rankings is near to 50 points (Boffo and Patalano 2020)[11].

Figure 2: ESG Ranking 2019



Source: Source: Refinitiv, Bloomberg, MSCI, Yahoo Finance, Moody's, Fitch, S&P; OECD calculations (Boffo, R., & Patalano, R. (2020))

These differences in ESG ranking may arise because of multiple factors including selection of ESG framework, indicators for E, Sand G index, differences in calculation of sub-indices, and differences in weighting.

[10] Five ESG ranking provider are information providers from Refinitive, Bloomberg, MSCI, Yahoo Finace, Moody's. Fitch, S & P and OECD calculations

[11] Boffo, R., & Patalano, R. (2020). ESG investing: Practices, progress, and challenges. Éditions OCDE, Paris.

Pakistan is one of the countries that committed to attaining SDG targets. SDGs as a national development agenda were unanimously approved by the Pakistan Parliament on February 16, 2016, and established the Parliamentary SDGs Secretariat based at the National Assembly – one of the few countries to do so. Vision 2025 was a major step to initialize the implementation of the SDGs. Vision 2025 is a step forward to attain inclusive sustainable progress by 2025 by achieving 17 socioeconomic and environmental goals under the umbrella of seven defined pillars. Table 3 represents the link between the 7 pillars of Vision 2025 and 17 SDGs.

Table: 3 Linking 7 Pillars of 2025 to SDGs

	Pillar	**Linking with SDGs**
1	People First: empowerment of women, social development and human well-being.	SDG,1,3,4,5
2	Growth: Economics growth and decent work.	SDG 8,10, 12, 13, 14, 15
3	Governance: institutional reforms and modernized public restructurings	SDG 16
4	Security: water security, Energy food security	SDG 2,6 7 and 11
5	Entrepreneurship: sequestered industries and private enterprises commanded growth	SDG 9
6	Knowledge Economy: create a knowledge-based Economy by value addition	SDG 9 and 4
7	Connectivity: better means of transport, regional and infrastructure networks.	SDG 9 and 17

Source: Pakistan Vision 2025

ESG Practice in Pakistan

Pakistan, as a signatory of the Paris Agreement formulated under the United Nations Framework Convention on Climate Change (UNFCCC), has proactively embarked on a mission to counteract climate change. A testament to its commitment is the introduction of its Nationally Determined Contributions (NDCs). The refined NDC of 2021 provides a comprehensive overview of the strategies and actions undertaken by the Pakistani government to curb GHG emissions. This spans from nature-based solutions (NBS), such as the Ten Billion Tree Tsunami Program (TBTTP) and Pakistan's Afforestation Initiative (PAI), to technology-driven interventions. In addition to these ecological initiatives, Pakistan has explored financial avenues like the issuance of Nature Performance Bonds, Green/Blue Bonds, and Carbon Pricing Instruments.

Strategic frameworks like Vision 2025 and the NDCs are commendable endeavors by Pakistan to strike a balance among social, environmental, and economic objectives. However, for these initiatives to truly bear fruit, it's imperative for the corporate and financial sectors to align their strategies with the nation's sustainability goals. This necessitates the formulation and rigorous implementation of Environmental, Social, and Governance (ESG) criteria within these sectors. Recognizing this synergy, the government has kick-started policies aimed at involving the financial sector in the collective drive towards a sustainable tomorrow.

Corporate sector regulatory body, SECP (Securities and Exchange Commission of Pakistan) released a CSR (Corporate Social Responsibility) act in 2009 which is relevant to all public companies with voluntary options. A national CSR forum was also established in 2016. However, these measures are not taken as mandatory ESG requirements at the national level (Mirza 2017). To define the ESG index various international organizations are working. Four main ESG framework provider organizations are: The Global Reporting Initiative (GRI), the OECD Guideline for Multinational Enterprises, the United Nations Global Compact, and the International Organization for Standardization (ISO 26000)

Usually, the firms in Pakistan adopt GRI standards for ESG reporting and disclosures (Hongming et al. 2020). 17 % of Pakistani firms made nonfinancial disclosures using the GRI framework (Shekha 2022)[12]. So, it is a fundamental need of the current uncertain era especially when the global pandemic and Ukraine war hit devastatingly that a secure sustainable, and environmental change combating investment strategies are being formalized at the national level. clear mandatory national policy may need to implement ESG criteria in the corporate, finance, and production sectors to proactively respond to contemporary uncertainties. At the same time, Pakistan must devise an ESG framework based on our country-specific characteristics. This will

[12] Shekha Nazish (2022)ESG reporting in Pakistan’s corporate sector published in Dawn, The Business and Finance Weekly February 7, 2022.

assist Pakistan to uniquely identify its priority improvement areas in the corporate sector to integrate with national sustainability goals. Moreover, it will be easier for corporations and the production sector to adopt an indigenous ESG framework based on our indigenous characteristics to integrate and attract a global community of investors.

Studies on ESG framework in Pakistan

Authors	Topics	Findings
Noor Ul Hira., et al. (2023)	The Impact of Environmental, Social And Governance Factors (ESG) On Firms' Financial Performance: Evidence From Pakistan	The findings revealed a notable influence of ESG factors on both returns on assets and returns on equity. This study underscored the substantial impact of ESG considerations, offering valuable insights for management and policymakers.
Haseeb Ur Rahman., et al. (2023)	ESG and firm performance: The rarely explored moderation of sustainability strategy and top management commitment	ESG has a significant impact on ROA (return on assets). ESG, on the other hand, has a positive effect on Tobin's Q. The paper also revealed the unique moderation of sustainability strategy and top management commitment in the intersection of ESG and each of its distinct dimensions with ROA and Tobin's Q.
Rooh, S., Zahid, M., Malik, M. F., & Tahir, M. (2021)	Corporate Governance Characteristics and Environmental, Social & Governance (ESG) Performance: Evidence from the Banking Sector of Pakistan	Gender diversity, board independence, and return on assets (ROA) were found to positively improve ESG performance. The size of the board and the size of the firm have little effect on ESG performance. Firm age and previous year ESG practices (lag of ESG) play a substantial positive effect on ESG performance development.
Afeef, M., & Kakakhel, S. J. (2022)	ESG Factors and Their Influence on the Investment Behavior of Individual Investors: A Case from Pakistan	Governance factors have a significant and positive relation with investment decisions followed by social and environmental factors. ESG's factor plays a vital role in a suitable investment process for investors.

Naveed, M., Sohail, M. K., Abdin, S. Z., Awais, M., & Batool, N. (2020).	Role of ESG disclosure in determining asset allocation decision: An individual investor perspective. Paradigms	The study discovered that, on average, ESG (Environmental, Social, and Governance) factors played a role in how individual investors decide where to put their money in the Pakistan Stock Exchange (PSX). Additionally, the study found that considerations related to the environment and governance carry more weight than social factors in influencing the decisions.
Jamil, E., & Siddiqui, D. A. (2020).	Assessing firms' environmental, social and governance performance (ESGP) and its effect on financial performance: Evidence from Pakistan.	ESG has a positive and meaningful impact on returns on assets. However, when it comes to Tobin Q, there is no significant effect observed for ESG and its different aspects.

In 2021, the Pakistan Stock Exchange (PSX) in collaboration with the Pakistan Institute of Corporate Governance (PICG) instituted a dedicated task force to foster the assimilation and advancement of Environmental, Social, and Governance (ESG) standards. As highlighted by Arjumand Minani, an esteemed member of the task force, the principal ambition was to seamlessly integrate ESG considerations into the fabric of mainstream financial activities. This initiative aimed not only to champion the merits of ESG as a lucrative long-term institutional investment but also to accentuate its potential for generating substantial returns. Furthermore, the strategy involved the creation of a robust, practical framework, buttressed by regulatory instruments, to actively inspire the autonomous embracement of ESG principles and guidelines. This pioneering task force penned Pakistan's inaugural ESG adaptation guideline, encompassing aspects like facilitation, awareness, capacity augmentation, and business enhancement.

The ESG criteria furnish investors with a comprehensive lens to scrutinize prospective investments, evaluating a company's devotion to environmental stewardship, its rapport with stakeholders including employees, suppliers, clients, and local communities, and the integrity of its governance. For Pakistan, the expansive adoption of ESG practices isn't just desirable – it's paramount to magnetize sustained domestic and international capital and investments.

Policy Recommendations:

The infusion of Environmental, Social, and Governance (ESG) standards holds profound importance within Pakistan's corporate and investment landscape. Recognizing this, key regulatory bodies such as the Securities and Exchange Commission of Pakistan (SECP) and the State Bank of Pakistan have been proactive in weaving ESG principles into the very fabric of business operations. To further harmonize the ESG framework within Pakistan's operational ecosystem, the following policy recommendations are put forward:

- For Pakistan to fully harness the dividends of ESG-centric growth, a cohesive effort is requisite. The government, in tandem with corporate entities and civil society, should craft a robust, obligatory legal framework that not only propels sustainable development but also catalyses employment opportunities.
- As the paradigm shifts towards sustainability, certain traditional roles, especially in high-emission industries, might face obsolescence. For instance, as the renewable energy sector burgeons, fossil fuel-related positions might wane. To navigate this transition, continuous skill development and retraining initiatives should be institutionalized, enabling the workforce to remain relevant and agile.
- Regulatory bodies should intensify their oversight, offering clearer directives and facilitating the dissemination of ESG best practices. This would serve to bolster long-term economic resilience and align businesses with globally recognized ESG benchmarks.
- The digital revolution has indelibly altered the contours of industrial progression. To surmount the multifaceted challenges of the digital era, businesses should leverage technology as an ally. Digital tools can streamline ESG reporting, enhance transparency, and foster stakeholder engagement, ensuring companies remain resilient in an increasingly interconnected world.

By adopting these recommendations, Pakistan can position itself at the vanguard of sustainable growth, aligning its economic aspirations with global ESG imperatives.

About Authors

Dr. Aneel Salman holds the distinguished KSBL-IPRI Chair of Economic Security at the Islamabad Policy Research Institute (IPRI) in Pakistan. As a leading international economist, Dr Salman specialises in Monetary Resilience, Macroeconomics, Behavioural Economics, Transnational Trade Dynamics, Strategy-driven Policy Formulation, and the multifaceted challenges of Climate Change. His high-impact research has been widely recognised and adopted, influencing strategic planning and policymaking across various sectors and organisations in Pakistan. Beyond his academic prowess, Dr Salman is a Master Trainer, having imparted his expertise to bureaucrats, Law Enforcement Agencies (LEAs), military personnel, diplomats, and other key stakeholders furthering the cause of informed economic decision-making and resilience.

Sheraz Ahmad Choudhary is a Research Associate at IPRI. He is affiliated with the University of Sussex and his areas of expertise are Macroeconomics, Trade Public Finance, and Environmental Economics.