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Bridging the ESG Gap: A Comparative Analysis of India and the EU

PRERANA ARUN TIKUDAVE[1]

ABSTRACT

India's approach to Environmental, Social, and Governance (ESG) compliance is in an evolving stage, but the European Union's (EU) well-established and comprehensive ESG regulatory framework is a robust commitment for handling climate change. Objective of this paper is to compare India's ESG regulations with those of the EU and to identify gaps and suggest recommendations. The current ESG framework in India includes mandates under the Companies Act, —'s Business Responsibility Report (BRS) and Business Responsibility and Sustainability Reporting requirements. (BRSR) Whereas EU's regulations include Corporate Sustainability Reporting Directive, the Sustainable Finance Disclosure Regulation (SFDR), and the EU Taxonomy. This research will assess India's ESG framework, compare it with the EU's standards, and will recommend suggestions to bridge the gap and will be helpful for policymakers and stakeholders.

Keywords*: ESG Framework, India and EU Comparison, CSRD, Sustainability Reporting, Policy Recommendations.*

I. INTRODUCTION

The 21st century has ahead of it numerous challenges and opportunities that are arising from globalization. One of the challenges is climate change. Business and companies are part of the society and they have a role to play in a sustainable and healthy ecosystem. ESG has gained significant attention in global and Indian capital markets with widespread discussion and debate. ESG encompasses issues beyond corporate governance, including corporate response to climate change, internal policies, treatment of the workforce, and corporate culture. India, being the world's third largest polluter,[2] needs 7.2 trillion[3] dollars in green investment until 2050 for successful decarbonisation. Big players like Infosys and Tata Consultancy Services (TCS) are leading the charge by pledging to achieve carbon neutrality and slashing their carbon

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[1] Author is a student at Azim Premji University, Karnataka, India.

[2] STATISTA, https://www.statista.com/topics/8881/emissions-in-india/#topicOverview, (Last visited on Sept. 19,2024)

[3] [Rajat Gupta, Shirish Sankhe, Naveen Unni, Divy Malik], [Decorbonising India] [Mc Kinsey Sustainability] [October 2022], [https://www.mckinsey.com/~/media/mckinsey/business%20functions/sustainability/our%20insights/decarbonizing%20india%20charting%20a%20pathway%20for%20sustainable%20growth/Decarbonising-India-Charting-a-pathway-for-sustainable-growth-ES-Oct-2022.pdf]

footprint.

The UN World Commission on Environment and Development defines[4] sustainability as "sustainable development is development that meets the needs of the present without compromising the ability of future generations to meet their own needs." There are three pillars of sustainability: social, environmental and economic.

(A) Research Methodology:

There is abundant literature available on the topics of Indian and EU ESG frameworks; however, this paper has tried to fill the gap by analyzing the ESG framework of both jurisdictions comparatively and proposing constructive changes in the Indian ESG framework. The paper involves a comparative analytical methodology by identifying strengths and gaps in the frameworks. Primary sources involve corporate research and legislations, and secondary sources like scholarly articles and industry reports are considered in this research.

(B) Objective:

- To compare India's ESG regulations with those of the EU, identifying gaps and areas for improvement.
- To propose specific recommendations for enhancing India's ESG practices.

(C) Research Question

How can India's ESG regulatory framework be enhanced by adopting key elements from the EU's ESG practices, and what specific improvements can be proposed to bridge the ESG gap between India and the EU?"

II. Decoding "E", "S", and "G" in ESG

All the three sectors of the economy directly or indirectly work in connection with the natural and physical environment and deal with natural resources. Currently climate change is one of the most significant and urgent challenges humanity is facing. Therefore it is imperative that the environmental factor must be taken into consideration while assessing the companies. The company, by the very effect of its business, contributes to Greenhouse gas emissions, and its policies can have an effect on carbon footprint and also various other levels of pollution. Apart from sanctions, damage to the reputition of the company for avoiding compliance is real. The compliance in order to protect environmental concerns may also affect the public view of the company. People are becoming more aware about climate change and environmental concern,

[4] UNITED NATIONS, https://www.un.org/en/academic-impact/sustainability, (Last visited on Sept. 19, 2024)

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eventually it will reflect in public policies. Therefore companies who are not yet prepared for changing their ways of doing business are likely to face heavy burdens.

Coming to the "S" factor, the company cannot work in void. Its endeavors are either in society or related to society. Just like a person can't be completely devoid of social factors, same as for company. Even the profit making is the only objective of company, it has to be supported by ethical social behavior. Companies' social responsibility may be divided into two arenas. How a company behaves with inside employees and how it serves a social purpose outside the company. The entire State machinery and public sector is striving towards achieving values like equality, fairness and justice. Companies or at least big companies cannot remain aloof to it.

Governance factor is concerned with the company's internal mechanism, and how its boards of directors operate within it and manage the risk and also deal with rights of shareholders. As the company is a separate legal entity, well maintained regulations and transparent internal mechanisms can minimize the risk of potential scams and mismanagement. Also shareholders who invest in a company, it's imperative to have transparent governance within it. Ethical investing is not a new concept. Investors want to know whether the amount they invested, how it is used and what are the effects of it on society at a larger scale. Therefore indicators of ESG do attract such investors.

(A) Navigating India's ESG Framework

ESG regulations in India are at an evolving stage. The purpose of these regulations is to motivate and encourage companies to adopt sustainable practices. The primary characteristic of the ESG framework is not being contained within a single piece of legislation. The provisions of Corporate Social Responsibility (CSR) under Company Act, 2013, mandates[5] that certain companies must mandatorily contribute a certain amount towards CSR activities. The company exceeds net worth of 500 crores or, turnover exceeds 1000 crores or net profit 5 crores, during immediately preceding financial year, will be constituting 'the Board' for CSR. There is a provision for an independent director on its CSR committee. The United Nations Industrial Development Organization explains CSR as "it is a management concept where companies integrate social and environmental concerns in their business activities." The company has to maintain the balance of its CSR activities at the same time addressing the expectations of shareholders. There is a distinction between CSR and in general sponsorship or philanthropy. The CSR clearly goes beyond mere sponsorship.

[5] Company Act, 2013, S. 135, No. 18, Acts of Parliament, 2013.

The company law has Schedule VII which specifies activities related to CSR. The CSR committee will draft a policy related to CSR and will recommend the amount of expenditure.

Companies have to be careful regarding profit, people and planet. This approach is referred to as the "triple-bottom line." The ESG is a comprehensive term. It is governed by different legislations including Factories Act 1948,[6] Environment Protection Act 1986,[7] Air Act 1981,[8] Water Act 1974[9] and laws with respect to health and safety, bonus, gratuity. Section 149 of the Companies Act has made it mandatory for certain classes of companies to have a female director. Apart from it, listing regulations require the top 1000 listed companies to have an independent female director on their boards of directors. Section 177 of the Companies Act requires the board of directors of the listed company and certain classes of public companies to have an audit committee for internal audit of the company.

(B) ESG regulatory frameworks and disclosure:

Original Business Responsibility Reporting (BRS), which was introduced by the Ministry of Corporate Affairs in 2009.[10] These were voluntary guidelines. It is based on, 9 principles of National Guidelines for Responsible Business Conduct (NGRBC)[11] which was introduced by SEBI. Some of the principals are guiding its strategic planning and CSR initiative. It encouraged the core elements like:

1. Companies taking care of all stakeholders including employees, customer suppliers and people at large in society.

2. Having a governance system run by ethics and accountability rather than abusive and corrupt competition.

3. Providing a safe environment and hygienic conditions to workers.

4. Taking care of Human Rights abuses.

5. Taking care and having a check on pollution recycling and waste management.

6. Arranging social activities for the development of community.

The Ministry of Corporate Affairs (MCA) motivated the allocation of a specific amount for CSR activities. These guidelines served the purpose as a platform for further broader scope of

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[6] Factories Act, No. 63 of 1948 (India).
[7] Environment Protection Act, No. 29 of 1986 (India).
[8] Air (Prevention and Control of Pollution) Act, No. 14 of 1981 (India).
[9] Water (Prevention and Control of Pollution) Act, No. 6 of 1974 (India).
[10] Ministry of Corporate Affairs, **Original Business Responsibility Reporting (BRR)**, 2009.
[11] Ministry of Corporate Affairs, **National Guidelines for Responsible Business Conduct (NGRBC)**, (Mar. 15, 2019), https://www.mca.gov.in/Ministry/pdf/NationalGuildeline_15032019.pdf.

regulations. It took almost a decade to launch the BRSR which was more refined and complex.

In 2012, SEBI introduced the Business Responsibility Report (BRR),[12] mandating the top 100 listed companies to file a BRR, and by 2021, the BRR was replaced by the Business Responsibility and Sustainability Report (BRSR). BRSR was introduced by SEBI in 2021,[13] requiring the top 1000 listed entities to disclose a BRSR in their annual reports. The differences between BRR and BRSR is,- BRR contains 59 questions, while BRSR contains 140 questions, of which 98 are mandatory. The questions in BRR were mostly qualitative, whereas BRSR includes both qualitative and quantitative questions.

BRSR report consist three sections:

- General disclosure: Providing very basic information about the company like its business locations, products, number of employees, CSR activities and turnovers of the company.
- Management disclosure: Disclosures about the policies related to NGRBC principles concerning mainly leadership Government and take holders involved.
- Principle wise disclosures: These include how the company is working towards 9 principles and core elements of NGRBC.

BRSR is mandatory for top 1000 listed entities on the stock market. It is required to disclose in their annual report. From 2024-25 onwards, value chain partners of top 250 listed companies shall also make disclosures in annual reports which will further be shared with shareholders, and also submitted to stock exchange and published on companies website. The MCA proposed to BRSR formats in two themes, 'BRSR Comprehensive' was mandatory one and 'BRSR Lite' was encouraged to be adopted by entities which were not obligated. BRSR has got new indicators such as Greenhouse Gas (GSG) footprint, waste management, water footprint, energy footprint, well-being and safety of employees, gender diversity, inclusive development, fairness in engaging with customers and clients. Also it is required that a company must maintain a website and it should disclose the ESG ratings as well as reports and periodic annual disclosures of average rating transition rates.

SEBI has amended Securities and Exchange Board of India (Credit Rating Agencies)

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[12] Securities and Exchange Board of India, **Business Responsibility Reports** (Aug. 13, 2012), https://www.sebi.gov.in/legal/circulars/aug-2012/business-responsibility-reports_23245.html (last visited Sept. 19, 2024).

[13] Securities and Exchange Board of India, **SEBI Issues Circular on Business Responsibility and Sustainability Reporting by Listed Entities** (May 10, 2021), https://www.sebi.gov.in/media/press-releases/may-2021/sebi-issues-circular-on-business-responsibility-and-sustainability-reporting-by-listed-entities-_50097.html (last visited Sept. 19, 2024).

Regulations, 1999 ("CRA Regulations"). Under CRA Regulations, SEBI has defined ESG ratings under section 28B as,[14] "environmental, social, and governance ratings", or "ESG ratings" means ratings which provides opinion about company's ESG profile, as well as its risks and impacts related to governance, social issues, environment and the climate change. These ratings use a specific ranking system, even if not explicitly labeled as "ESG ratings." Regulation also said that, any person who undertakes business as an ESG rating provider, has to get certified by SEBI. It has issued a circular which authorized ESG rating providers (ERP) to conduct ESG rating activities. These Agencies are granted certificates by the Board. These ERPs are also permitted to provide ESG Ratings or scores based on international frameworks in addition to aspects related to Indian markets. It is mandatory to publish a final year rating on their website and also updates to the ESG scores as per the methodology adopted by ERP. It is mandatory to obtain prior approval of SEBI in case of change in control of ERP.

SEBI has also issued a Master Circular for ESG reporting.[15] There is a provision for transition scores. It is in line with India's objective of getting net zero emission by 2070. This score provides the changes that the company has made for improving their commitment towards combating emissions rather than based on their current profile. It provides the ability to transition. The combined score measures both the current status and also the transition score. Therefore combined score is the summation of ESG score and transition score.

Another parallel rating feature is 'Core ESG Rating'. It involves third party assured or audited data. This ensures the unverified data is not included in core ESG rating. Providing further "Core Combined Score" is summation of Core ESC Score and Core Transition Score. All of these scores will be provided on the scale of 0 to 100.

The Master Circular has some provisions of conflict of interest as well. Where measures are provided to have employees involved in the ESG rating process to be impartial and not biased toward the issuer. It is the responsibility of ERP to ensure that its employees involved in the scoring and audit process shall not have ownership of securities in the issuer's company. Regulation 28(k) of CRA Regulations requires that ERP should publish its average one year ESG rating transition rate on its official website. Because transition studies are crucial in the entire evaluation performance of ERP over a period of time. The disclosures shall be continuous

[14] SCC Online (https://www.scconline.com/blog/post/2023/07/07/sebi-notifies-cra-amendment-regulations-2023-legal-news/) (Last Visited on Sept. 19, 2024)

[15] Securities and Exchange Board of India [SEBI], Master Circular for ESG Rating Providers (ERPs) [available at: https://www.sebi.gov.in/legal/master-circulars/jul-2023/master-circular-for-esg-rating-providers-erps-_73856.html (accessed September 19, 2024).

and maintained on their website all the time.

The internal audits of ERP's shall be conducted annually by professionals who have no conflict of interest, covering ERP operations and SEBI compliance. Auditors should have at least 3 years of experience in the financial sector. The report of audit shall be submitted to SEBI with corrective actions within 2 months.

(C) ESG parameters in Indian Context

The parameters under ESG (Environmental, Social, and Governance) are the one which act as metrics in evaluation of ESG status of company:

Environmental (E): Includes energy consumption, biodiversity, water usage, waste management, and land use. Companies shall keep track of their carbon footprint, greenhouse gas emissions (GHG) and pollution levels. Strict adherence to environmental laws and frameworks, like zero liquid discharge and the Extended Producer Responsibility (EPR) policy, shows its environmental responsibility.

Social (S): This factor includes job creation, inclusive development , and diversity. Companies shall ensure fair wages, equal opportunities for employees who are differently-abled, and should take initiatives toward CSR. Social parameters examine how company is interacting with communities and put efforts to develop smaller towns, create inclusive supply chains, and respect human rights.

Governance (G): Governance parameters mainly deal with corporate ethics, transparency, and leadership practices. This includes governance structures, and accountability mechanisms, including how companies handle shareholders' rights and cares for minority shareholders. Companies shall ensure that there are clear policies to avoid conflicts of interest and to promote ethical behavior. Internal mechanisms should have provisions to avoid mismanagement.

The analysis of the Indian framework shows on one hand it covers a wide range of standards at the same time, it is applicable to limited entities and scattered in different legislations.

(D) Exploring the European Union's ESG Framework

The European Union is leading the movement of ESG worldwide in introducing comprehensive regulations and laying down precedents to follow for other Nations. The EU's ESG reporting framework is mainly governed by Sustainable Finance Disclosure Regulation (SFDR),[16]

[16] Regulation (EU) 2019/2088, of the European Parliament and of the Council of 27 November 2019 on sustainability-related disclosures in the financial services sector, 2019 O.J. (L 317) 1 (EU).

Corporate Sustainability Reporting Directive (CSRD),[17] Corporate Sustainability Due Diligence Directive (CSDDD),[18] Carbon Border Adjustment Mechanism (CBAM),[19] and EU Taxonomy.[20]

III. Corporate Sustainability Reporting Directive (CSRD)

Introduced in January 2023, CSRD, it applies to qualifying EU subsidiaries of non EU companies as well and requires them to disclose their social and environmental impact on the surrounding. The core objective of CSRD is providing clarity to potential investors and consumers of their products about its business impacts and effects. CSRD is an expansion of its previous version of legislation, Non-Financial Reporting Directive (NFRD). In the starting of fiscal year of 2024, organizations which were already disclosing under NFRD are now starting reporting under CSRD.

CSRD has one of the core concepts of double materiality which requires organizations to disclose how their business is affecting the planet and their efforts in taking care of that at the same time how they achieving the targets is affecting their financial stability. The two facets of their operations are such as:

- Impact materiality refers to actual or potential positive or negative effect of the business on people or environment. This also includes impact from the company's operations and its value chain. Value chain includes all activities related to production, development, and distribution of a particular product or service as well as disposal of the product. Negative impact materiality is assessed through due diligence, after considering the severity of actual impact and potential ones by considering factors like scale and scope.
- Financial Materiality identifies information regarding financial material if it can trigger significant financial effects such as risk or opportunities impacting company's financial position and financial access.

The CSRD standard requires companies to look at both sides of the story.

CSRD reports are audited by third party and publicly available. Therefore these new rules are ensuring that the investors have access to the information and assess the impact of companies

[17] Directive (EU) 2022/2464, of the European Parliament and of the Council of 14 December 2022 on Corporate Sustainability Reporting, 2022 O.J. (L 322) 1 (EU).

[18] Directive (EU) 2024/0268, of the European Parliament and of the Council on Corporate Sustainability Due Diligence, 2024 O.J. (EU).

[19] Regulation (EU) 2023/956 of the European Parliament and of the Council on the Carbon Border Adjustment Mechanism, 2023 O.J. (L 167) 1 (EU).

[20] Regulation (EU) 2020/852 of the European Parliament and of the Council on the Establishment of a Framework to Facilitate Sustainable Investment, 2020 O.J. (L 198) 1 (EU).

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on climate change as well as on their internal finances. The reports for the first time applying in 2024 shall be published in 2025. Another provision for correcting material errors from prior periods, companies should submit undertakings to reinstate comparative figures. These errors may involve omissions or misstatements in previous sustainability statements. Any mathematical mistakes which are incorrect application of matrix or targets can be corrected before reporting issues. Such undertakings did not disclose sensitive information. The intellectual property or trade secrets shall be protected by reasonable secrecy measures.

A wide range of sustainability matters are included in European Sustainability Reporting Standards (ESRS)[21] such as climate change, pollution of air, water, soil, micro-plastic, marine resources, biodiversity, impact on species. working conditions includes issues like secure working time, freedom of association, work-life balance, equal pay for equal work, diversity in employment, adequate wages, child labour, forced labour. The standards also take care of communities' economic, social and cultural rights and their political freedom. The business conduct includes corporate culture, whistleblower, and prevention of corruption.

Companies which are coming under the CSRD have to follow the standards and parameters trusted as per European sustainability reporting standards (ESRS). The ERSR standards are divided into three categories such as cross cutting standards, topical standards (environmental, social and governance standards), and sector specific standards.

Its applicability is much wider than any other country's regulation. Large company even if they are based outside the European Union comes under the ambit if any two of the following conditions fulfill:

1. 50 million Euro in turnover

2. 25 million in assets

3. 250 employees.

4. If a non-EU company having turnover exceeding 150 million Euro in the EU will also to have come under its ambit.

Small and medium enterprises will have to comply with the regulations if they fulfill any two of the following three conditions:

1. Exceeding 8 million euro in turnover
2. Exceeding 4 million euro in assets

[21] European Sustainability Reporting Standards, Regulation (EU) 2021/2139, 2021 O.J. (L 442) 1 (EU).

3. Exceeding 50 employees

The Corporate Sustainability Reporting Directive (CSRD) is expected to affect around 50,000 companies within the European Union (EU) and 10,000 companies globally.[22]

(A) Other Key EU Regulations Addressing ESG Matters

EU regulation on deforestation-free products[23] mandates companies involved in, to verify that their products do not involve or contribute to deforestation. EU legislation on packaging and packaging waste mandates a packaging recycling. The EU "women on boards" directive[24] requires representation of women in leadership and a minimum of 40% of female in non - executive directors by June 2026. The EU taxonomy for sustainable activities is a classification system maintained to clarify which economic activities are environmentally sustainable. EU taxonomy works in the context of the European Green Deal of 2020[25] which are policy initiatives by the European Commission with the aim of making the European Union (EU) climate neutral by 2050. The plan is to review each existing law with respect to its climate merits, and to introduce new legislation on the circular economy (CE), building renovation, and biodiversity.

(B) Comparative Analysis and Strategic Recommendations

The survey and research[26] shows that , out of many motives, regulatory framework and stakeholder investment are the strongest driving force. The prime focus of any evolving ESG regime should be to create a wide range of investors aware of the importance of sustainability. There is signaling theory which says adoption of ESG from the perception of investors and stakeholders conveys a positive image to public and potential investors.[27] The asset managers are in a better position to convey ESG ratings to general investors. Therefore it's not only enough for ERPs to explain ESG ratings to Asset managers but it must flow from Asset managers to investors.[28]

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[22] ECO ACT, https://eco-act.com/blog/csrd-non-financial-disclosure-in-eu/ (Last Visited on Sept. 19, 2024)

[23] Regulation (EU) 2023/1115, of the European Parliament and of the Council of 31 May 2023 on the making available on the Union market and the export from the Union of certain commodities and products associated with deforestation and forest degradation and repealing Regulation (EU) No 995/2010, 2023 O.J. (L 156) 1 (EU).

[24] DIRECTIVE (EU) 2022/2381 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 23 November 2022

[25] COUNCIL OF EUROPIAN UNON, https://www.consilium.europa.eu/en/policies/green-deal/ (Last visited on Sept. 19, 2024)

[26] Muhammad Khamisu, Ratna Paluri & Vandana Sonwaney, Environmental Social and Governance (ESG) Disclosure Motives for Environmentally Sensitive Industry: An Emerging Economy Perspective, 11 COGENT BUS. & MGMT. 1, 1–20 (2024).

[27] Michael Spence, Job Market Signaling, 87 Q.J. ECON. 355, 355–374 (1973).

[28] Manoj Pareek, Making ESG Work: Examining the Changing ESG Regulations in India, 2 *Res. Trends in Comm. & Mgmt.* 1 (2022). Available at SSRN: https://ssrn.com/abstract=4258206.

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The EU's well developed ESG framework has become model law for the globe. The confusion of the laws are another reason that laws are not prone to be followed. The various EGS related laws in India are scattered in various legislation. Thus, it becomes burdensome for law enforcing authorities to implement effectively. The EU has consolidated its ESG framework in CSRD and SFDR which provide clear and robust legal binding. Therefore consolidation of legislation into a unified framework will make it easier for businesses to comply.

The double materiality concept of EU shows maturity to provide a holistic view of explaining not only the company's impact on the environment and society but also the financial impact of ESG factors. Prima facie, India lacks such a concept. The EU has sector - specific reporting requirements to the unique needs of each sector under ESDR. India being 3rd biggest polluter, needs such a system for high impact.

Wider applicability is a difference making factor in the EU and the remaining world. While EU's ESG frameworks are affecting around 50000 companies, Indian ERP, CRISIL report found 586 companies had ESG scores in 2022. SEBI has mandated top 1000 listed companies by market cap file Business Responsibility and Sustainability Reporting (BRSR) starting with the 2022-23 fiscal year. Therefore, increasing applicability of the Indian framework is the need of the hour. Apart from its applicability, there is International Financial Reporting Standards (IFRS) which are a set of accounting and reporting guidelines that are used to prepare financial statements by many countries around the world, including members of the European Union, Australia. Studies[29] shows that there is a positive relationship between ESG reporting and IFRS introduction in India. Therefore extracting and taking relevant provisions of IFRS and applying to Indian companies will definitely help ESG factor.

There is a greater link between sustainability and technology. Survey[30] shows that Indian firms are not ready to accept technology for sustainable energy. For example, installing solar is standard practice in Europe but not in India or other Asian countries. This reluctance makes the difference between the EU and remaining developing countries.

IV. Conclusion and future directions

The paper has analyzed and compared the ESG regulatory frameworks of India and the EU. This shows that the acceptance of ESG is an evolutionary process. Both the EU and India started early, but the EU's consistent efforts have raised awareness among general investors. India

[29] Dayanandan, A., Donker, H., & Kuntluru, S., IFRS and ESG Disclosure in Indian Corporate Sector, 23 J. EMERGING MKTS FIN. 143, 143-169 (2024).

[30] Efthymiou, L., Kulshrestha, A., & Kulshrestha, S., A Study on Sustainability and ESG in the Service Sector in India: Benefits, Challenges, and Future Implications, 13 Adm. Sci. 165 (2023).

needs to make robust efforts to raise awareness of ESG and its importance in sustainability. India’s ESG regulations, even with progressive and comprehensive standards under CSRD and SFDR, need unification and wider application.

The analysis reveals that India could benefit significantly from certain elements of the EU model, like double materiality and sector-specific laws. In conclusion, addressing the identified gaps and implementing the proposed changes will be a crucial factor for the advancement of India's ESG landscape.

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