Embracing Environmental, Social and Governance (ESG) Principles for Sustainable Development in Kenya

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Kariuki Muigua

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Abstract

The paper critically examines the extent to which Environmental, Social and Governance (ESG) principles have been embraced in Kenya. It argues that ESG has emerged as arguably the most important tool of corporate governance. ESG seeks to shape corporate decision making by advocating for sustainable, responsible and ethical investments. It analyses each of the ESG principles and the progress made towards embracing this concept in Kenya. The paper further addresses some of the ESG challenges in Kenya and suggests the way forward towards embracing ESG principles for sustainable development in Kenya.

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1.0 Introduction

The growing threat of climate change and climate crisis has forced many investors to embrace sustainability as a key factor in investment decision-making[1]. At the same time, social concerns touching on issues such as human rights, diversity, consumer protection and welfare and protection of animals especially endangered species have led to many companies taking their social responsibilities and especially impact of their commercial activities on the local communities where they operate more seriously than ever[2]. The growth of social media has also increased the public risks associated with socially irresponsible behavior due to more scrutiny on companies and the emergence of socially conscious consumers[3]. Further, there has been growing corporate governance awareness since the 2008 global economic recession which has led to increase shareholder and stakeholder activism in demanding more responsive management structure, better employee relations, and reasonable executive compensation in companies[4].

Consequently, how companies handle environmental, social and governance issues is increasingly becoming a major concern especially for investors and other key stakeholders. ESG is an acronym for Environmental, Social and (Corporate) Governance, the key aspects of sustainable, responsible or ethical investment[5]. It has been defined as "a generic term used in capital markets and used by investors to evaluate corporate behaviour and to determine the future financial performance of companies[6]. ESG "is a subset of non-financial performance indicators which include sustainable, ethical and

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[1] De Francesco. A.J., 'The impact of sustainability on the investment environment.' *Journal of European Real Estate Research* (2008).

[2] Cedric.R., 'Accountability of Multinational Corporations for Human Rights Abuses." *Utrecht Law Review* 14.2 (2018): 1-5.'

[3] Mariarosaria. S & Scarpato. D 'Sustainable Consumption: How Does Social Media Affect Food Choices?' *Journal of Cleaner Production* 277 (2020): 124036.

[4] Martin.C et al., 'Corporate governance and the 2008–09 Financial Crisis." *Corporate Governance: An International Review* 19.5 (2011): 399-404; See also Erkens. D.H, et al Corporate governance in the 2007–2008 financial crisis: Evidence from financial institutions worldwide." *Journal of corporate finance* 18.2 (2012): 389-411.

[5] Stuart. L.G et al., 'Firms and social responsibility: A review of ESG and CSR research in corporate finance.' *Journal of Corporate Finance* 66 (2021): 101889.

[6] The Financial Times Lexicon, Available at: https://markets.ft.com/glossary/searchLetter.asp?letter=E (accessed on 21/07/2022)

corporate governance issues such as managing a company's carbon footprint and ensuring there are systems in place to ensure accountability[7]." ESG has also been defined as standing for the three broad categories, or areas, of interest for "socially responsible investors" who consider it important to incorporate their values and concerns (such as environmental concerns) into their selection of investments instead of simply considering the potential profitability and/or risk presented by an investment opportunity.[8]

Globally, the importance of Environmental, Social and Governance (ESG) issues is evidenced by the change in the legal and regulatory landscape to reflect the expectations of investors, customers, employees and other stakeholders. Increasingly, the investment decisions including assessment and valuation are incorporating ESG criteria with companies that are rated as having strong sustainability programs enjoying more preference from investors[9]. Issues touching on climate change and sustainability dominate current ESG focus. In addition, human rights and especially the rights of indigenous peoples and governance structures of companies are enjoying prominent attention[10]. Many projects investors and sponsors are also demanding more detailed identification and mitigation of environmental and social impacts of investment projects before making commitment or funding[11].

According to the Organisation for Economic Co-operation and Development (OECD), the growth of ESG approaches by investors has been driven by private and public sector initiatives to reach the objectives of the Paris Agreement and the Sustainable

[7] Ibid
[8] CFI, ESG (Environmental, Social and Governance), Available at: https://corporatefinanceinstitute.com/resources/knowledge/other/esg-environmental-social-governance/ (accessed on 21/07/2022)
[9] Muigua.K., 'Introduction to ESG (Environmental, Social and Governance) available at https://thelawyer.africa/2022/02/04/esg-environmental-social-and-governance/ (accessed on 22/07/2022)
[10] Ibid
[11] Norton Rose Fulbright, "Environmental, Social and Governance," Available at: https://www.nortonrosefulbright.com/en/services/203f40d1/environmental-social-and-governance-esg (accessed on 21/07/2022)

Development Goals (SDGs)[12]. This has seen the incorporation of climate transition factors into investment decisions and the growth of what has come to be known as ESG investing as a leading form of sustainable finance for long-term value and alignment with societal values. OECD defines ECG investing as generally referring to the process of considering Environmental, Social and Governance (ESG) factors when making investment decisions. Bloomberg estimates that the value of ESG investing around the world has risen to almost USD 40 trillion in 2021[13]. At the same time, as at 2020 ESG ratings were being applied to companies representing around 80% of market capitalization[14].

This paper seeks to critically examine the extent to which ESG principles have been embraced in Kenya. It analyses each of the ESG principles and the progress made towards embracing this concept in Kenya. The paper further addresses some of the ESG challenges in Kenya and suggests the way forward towards realising ESG tenets for sustainable development in Kenya.

2.0 Environment Social and Governance (ESG) Principles

The Environmental 'E' pillar of ESG is being increasingly used as a tool to align investments and capital flows with a low-carbon transition and to unlock valuable forward-looking information on firms' climate transition risks and opportunities[15]. The environmental considerations in areas such as climate risk, water scarcity, extreme temperatures and carbon emissions are now considered as key issues that can impact competitive positioning for businesses. Companies are expected to appreciate their role as stewards of the natural or physical environment and to take into account the utilisation of natural resources and the impact of their overall operations on the environment, both

[12] OECD., 'Environmental Social and Governance (ESG) Investing' available at https://www.oecd.org/finance/esg-investing.htm (accessed on 21/07/2022)
[13] Ibid
[14] Ibid
[15] OECD (2021), ESG Investing and Climate Transition: Market Practices, Issues and Policy Considerations, OECD Paris, https://www.oecd.org/finance/ESG-investing-and-climatetransition-Market-practices-issues-and-policy-considerations.pdf (accessed on 21/07/2022)

locally and across its global supply chains[16]. Companies are now required to take precautions against environmental incidents such as oil spills or pollution from mining operations as safeguards against damage to their reputation and shareholder value[17]. At the same time, more than 13,000 companies and 3,000 non-business signatories in 160 countries that are signatories of the United Nations Global Compact (UNGC), which helps businesses contribute positively toward some or all of the 17 United Nations (UN) sustainable development goals (SDGs) by 2030[18].

The COVID-19 pandemic, and its diverse implications including healthcare access, workplace safety, cybersecurity and other issues related to the communities that businesses , have proven to be a watershed moment for the often-underappreciated 'S' pillar of environmental, social and governance (ESG) considerations with the need to tackle the inequalities exposed and exacerbated by the pandemic becoming a key reason for investors to make allocations for socially conscious investments despite intangibility of social facts[19]. Companies are beginning to appreciate the role taking social responsibility can play in mitigating issues such data theft, worker strikes, litigation, workplace accidents and other people-related disruptions that can hurt a business reputation and finances. The repercussions of work-related injuries and deaths on families including on their financial security are also acknowledged as having a bearing on the United Nations Sustainable Development Goals (SDGs) of no poverty, zero hunger, good health and well-being, decent work and economic growth even as many investors are aligned with these goals[20].

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[16] Ibid

[17] Ibid

[18] Ojiambo, S., "Leadership of the UN Global Compact: Message of CEO and Executive Director," Available at: https://www.unglobalcompact.org/about/governance/executive-director (accessed on 21/07/2022)

[19] Create Research, "Passive Investing 2021: Rise of the social pillar of ESG," Available at: https://cdn.e-fundresearch.com/files/RcfPdrQdAaVI9tiBgrgLq4baO7Wciz6eepZTODEO.pdf (accessed on 21/07/2022)

[20] Standard Chartered Singapore, "The S in ESG," Available at: https://www.sc.com/sg/wealth/insights/the-s-in-esg/ (accessed on 21/07/2022)

The "G" Pillar in ESG is the oldest as governance has been an integral part of robust investment for ages[21]. However, what is considered effective governance keeps evolving and the speed of evolution has quickened as institutional investors' definition of stakeholders continues to broaden beyond shareholders[22]. While older forms of Governance focused on serving and protecting shareholders, the newer approaches stretch beyond basic dimensions related to financial and accounting misconduct as well as legal and regulatory non-compliance, such as transparency, corporate structures and ethics[23]. Investors are also aligning Governance with the 17 United Nations Sustainability Development Goals (SDGs), where governance issues include industry, innovation and infrastructure (Goal 9); peace, justice and strong institutions (Goal 16); and partnerships with public and private institutions (Goal 17)[24].

3.0 Environment, Social and Governance (ESG) Disclosure and Reporting Requirements in Kenya

The Nairobi Securities Exchange has developed an ESG Disclosure Manual to guide listed companies in Kenya on ESG reporting. The Manual (ESG Manual) provides that ESG reporting should be on a materiality basis[25]. In financial reporting, materiality is the threshold for influencing the economic decisions of those using an Organisation's financial statements[26]. A similar concept is also important in ESG reporting. In ESG reporting, "materiality is the principle that determines which relevant topics are

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[21] Muigua.K., 'Introduction to ESG (Environmental, Social and Governance) Op Cit

[22] RL360, "Governance-The G in ESG," Available at: https://www.rl360.com/row/funds/investment-definitions/g-in-esg.htm (accessed on 21/07/2022)

[23] Ibid

[24] United Nations, Department of Economic and Social Affairs, 'Sustainable Development' available at https://sdgs.un.org/goals (accessed on 21/07/2022)

[25] Nairobi Securities Exchange, 'ESG Disclosures Guidance Manual', available at https://sseinitiative.org/wp-content/uploads/2021/12/NSE-ESG-Disclosures-Guidance.pdf (accessed on 21/07/2022)

[26] Ruth.J., 'The Convergence of Financial and ESG Materiality: Taking Sustainability Mainstream." *American Business Law Journal* 56.3 (2019): 645-702.'

sufficiently important that it is essential to report on them[27]." It is necessary to undertake materiality analysis because not all ESG topics are of equal importance to an organization and an ESG report has to reflect their relative priority of the various topics[28].

The ESG Manual requires that listed companies have a structured, documented process on assessment of materiality for ESG disclosure topics[29]. It is recommended that a materiality assessment exercise be conducted at least on an annual basis and as part of every new ESG reporting season. The ESG Manual also requires that every organization discloses its approach to materiality within the ESG report[30]. The Global Reporting Initiative (GRI) gives guideline for what is material by providing that the ESG report should cover topics that Reflect the reporting organisation's significant economic, environmental, and social impacts; or substantively influence the assessments and decisions of stakeholders. In other words, for a topic to be relevant and potentially material, it should be based on only one of these dimensions[31].

It is recommended that a materiality assessment grid be used as a structured guide in prioritizing ESG topics to report on[32]. That way, by applying an internally developed rating criteria, organisations can plot ESG topics on a grid or heat map indicating the assessed level of importance considering both dimensions of materiality[33]. In that regard, materiality is dependent on whether a topic is of low or high importance to the stakeholders and the significance of ESG impacts on economy, environment and/or society. GRI gives detailed guidance that listed companies can refer to when identifying

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[27] Muigua. K., 'What are the Material Issues for ESG Reporting in Kenya?' available at https://thelawyer.africa/2022/06/05/material-issues-for-esg-reporting-in-kenya/ (accessed on 21/07/2022)

[28] Ibid

[29] Nairobi Securities Exchange, 'ESG Disclosures Guidance Manual' Op Cit

[30] Ibid

[31] Global Reporting Initiative., 'ESG Standards, Frameworks and Everything in Between' available at https://www.globalreporting.org/media/jxkgrggd/gri-perspective-esg-standards-frameworks.pdf (accessed on 21/07/20220

[32] Ibid

[33] Ibid

material topics[34]. The starting point is using the sector standards to understand the sector's content and then deduce the organization content from it[35].

The next step is to consider the topics and impact as described in the sector standard and then identify the actual and potential impact to the organization stakeholders, economy, environment and society[36]. It takes the engagement of the relevant stakeholders and experts on ongoing basis to achieve assessment of the impact of the topics. In the aftermath, the material topics should be tested against the sector standard to prioritize the most significant impacts for reporting[37]. After this, the material topics should be tested with experts and information users to determine and come up with a comprehensive list of material topics for ESG reporting for the respective organization.

The approach applied for each step will vary according to the specific circumstances of the organisation, such as its business model; sector; geographic, cultural and legal operating context; ownership structure; and the nature of its impacts[38]. Given these specific circumstances, the steps should be systematic, documented, replicable, and used consistently in each reporting period. The organisation should document any changes in its approach together with the rationale for those changes and their implications. The organisation's highest governance body should oversee the process and review and approve the material topics[39].

The ESG Manual proposes mandatory ESG disclosures for NSE listed companies to help achieve comparability and to facilitate compliance with the CMA Code, relevant international treaties, ESG standards and local regulations[40]. Further, the Capital Markets

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[34] GRI., 'The Global Standards for Sustainability Reporting' available at https://www.globalreporting.org/standards/ (accessed on 21/07/2022)
[35] Ibid; See also Fonseca.A et al., 'Sustainability reporting among mining corporations: a constructive critique of the GRI approach." *Journal of cleaner production* 84 (2014): 70-83.'
[36] Ibid
[37] Ibid
[38] Muigua. K., 'What are the Material Issues for ESG Reporting in Kenya?' Op Cit
[39] Ibid
[40] Nairobi Securities Exchange, 'ESG Disclosures Guidance Manual' Op Cit

Authority (CMA) Code of Corporate Governance Practices for Issuers of Securities to the Public in 2015 provides examples of topics that the Boards of listed companies should treat as material[41]. As per CMA code, material information means any information that may affect the price of an issuer's securities or influence investment decisions[42]. Listed firms are advised to refer to the Code when selecting material topics for disclosure[43]. The ESG Manual also recommends the Sustainable Development Goals (SDGs) as helpful guide in the identification of material topics and or impact as by aligning organisational objectives with the SDGs, organisations can identify significant impact areas that affect their contribution to the SDGs[44].

The concept of double-materiality is the latest introduction in the discussions around assessment of materiality in ESG reporting. According to the European Commission Guidelines on Non-financial Reporting, "double-materiality refers to assessing materiality from two perspectives, namely, the extent necessary for an understanding of the company's development, performance and position" and "in the broad sense of affecting the value of the company"; and environmental and social impact of the company's activities on a broad range of stakeholders[45]. The concept of double-materiality implies the need to assess the interconnectivity of the two.

A GRI research on how double-materiality is implemented in ESG reporting, and the benefits and challenges found that identification of financially materiality issues are incomplete if companies do not first assess their impacts on sustainable development[46]. The GRI white paper also revealed that reporting material sustainable development

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[41] Capital Markets Authority., Code of Corporate Governance Practices for Issuers of Securities to the Public in 2015 , Legal Notice No. 1420
[42] Ibid
[43] Ibid
[44] Nairobi Securities Exchange, 'ESG Disclosures Guidance Manual' Op Cit
[45] European Commission 'Guidelines on Non-Financial Reporting', available at https://ec.europa.eu/info/publications/non-financial-reporting-guidelines_en (accessed on 21/07/2022)
[46] Adams, C.A., Alhamood, A., He, X., Tian, J., Wang, L. and Wang, Y. (2021) The Double-Materiality Concept: Application and Issues, published by the Global Reporting Initiative (GRI) as a White Paper, Available at: https://www.globalreporting.org/media/jrbntbyv/griwhitepaper-publications.pdf (accessed on 21/07/2022)

issues can enhance financial performance, improve stakeholder engagement and enable more robust disclosure[47]. Further, it was established that focusing on the impacts of organisations on people and planet, rather than financial materiality, increases engagement with the Sustainable Development Goals (SDGs)[48]. The ESG Manual thus encourages listed companies to assess impact of ESG issues to their organisations (such as climate change and human rights) in addition to their organisations own ESG impacts to society (such as material resource use and emissions) when determining material ESG impacts for disclosure. ESG reporting is thus essential in promoting sustainable development.

4.0 The ESG Reporting Frameworks Applicable in Kenya

In addition to the ESG Disclosure Manual formulated by the Nairobi Securities Exchange, there are several other organizations that have adopted ESG reporting requirements relevant to listed companies in Kenya[49]. These include the Capital Markets Authority, the United Nations Global Compact, various investment groups, the Carbon Disclosure Programme (CDP) and industry level reporting requirements like those imposed by the Central Bank of Kenya touching on the operations of licensed Banks[50]. This part explores the basics of each of these ESG reporting requirements and how listed companies in Kenya comply with them.

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[47] Ibid
[48] Ibid
[49] Muigua.K., 'The ESG Reporting Frameworks Applicable in Kenya' available at https://thelawyer.africa/2022/06/05/esg-reporting-frameworks-applicable-in-kenya/ (accessed on 21/07/2022)
[50] Ibid

4.1 The Capital Markets Authority

The Capital Markets Authority (CMA) published the Code of Corporate Governance Practices for Issuers of Securities to the Public in 2015[51]. It requires listed companies to explain in their annual reports how they have applied the recommendations contained in the Code[52]. Within the Code, the CMA also provides examples of topics that the Boards of listed companies should treat as material[53]. The ESG Manual gives guidelines on how the ESG reporting approach suggested in it can be used to meet the reporting requirements of the CMA code[54]. These include by identifying the CMA as a key stakeholder for listed companies within the situational analysis and stakeholder engagement phases[55]. Second, it involves analysing the CMA's expectations of the organisation and the reporting requirements contained in the CMA Code[56].

Third, complying with the CMA code under the ESG Manual means including disclosures requirements on the Code as part of the assessed material ESG topics for disclosure[57]. These have been proposed as a mandatory disclosure topic for all listed companies, that is, governance under general disclosure topics. In addition, it takes generating content on the organisation's performance around these topics using the guide proposed in this manual and reference to the GRI Standards on governance disclosures. It also entails submitting extracts or the full ESG report discussing performance on these indicators to the CMA within the agreed timelines with the CMA. In this case, the ESG report should be published within the reporting timelines required for CMA submissions.

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[51] Capital Markets Authority., Code of Corporate Governance Practices for Issuers of Securities to the Public in 2015, Legal Notice No. 1420

[52] Ibid

[53] Ibid

[54] Nairobi Securities Exchange, 'ESG Disclosures Guidance Manual' Op Cit

[55] Ibid; See also Magale. E., 'Developing a green bond market in Kenya: perspectives from practitioners and lessons from developing markets.' *Journal of Sustainable Finance & Investment* (2021): 1-18.

[56] Ibid

[57] Ibid

4.2 Investor groups

As a way of managing assessed environmental and social risk in debt and equity investments, some institutional investors typically require the implementation of an environmental and social management system[58]. Thus, depending on the assessed risk profile, beneficiary organisations are required to report at least annually on performance on several pre-identified environmental and social performance metrics[59]. Through such reporting process, investors should be able to develop content around the organisation's approach to these topics and demonstrate performance during the reporting period[60]. It is noteworthy that environmental and social risk management is one of the mandatory ESG topics proposed for all listed companies. The International Finance Corporation (IFC) Performance Standards on Environmental and Social Sustainability is one example of ESG indicators and metrics that investors commonly refer to when evaluating investments[61].

4.3 United Nations Global Compact

There are more than 200 Organisations in Kenya, including some listed companies, that are participants of the Global Compact Network Kenya, the local arm of the United Nations Global Compact (UNGC)[62]. The UNGC has developed a set of 10 principles that organisations can voluntarily adopt and integrate into their own strategies and operations[63]. These principles cover four issue areas including Human Rights, Labour,

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[58] Muigua.K., 'The ESG Reporting Frameworks Applicable in Kenya' available at https://thelawyer.africa/2022/06/05/esg-reporting-frameworks-applicable-in-kenya/ (accessed on 21/07/2022)

[59] Ibid

[60] Ibid

[61] International Finance Corporation., 'Performance Standards on Environmental and Social Sustainability' available at https://www.ifc.org/wps/wcm/connect/c02c2e86-e6cd-4b55-95a2-b3395d204279/IFC_Performance_Standards.pdf?MOD=AJPERES&CVID=kTjHBzk (accessed on 21/07/2022)

[62] United Nations Global Compact: available at https://www.unglobalcompact.org/engage-locally/africa/kenya (accessed on 21/07/2022)

[63] Ibid

Environment and Anti-corruption[64]. In turn, the Ten Principles of the United Nations Global Compact is a key guideline in that regard.

The UNGC encourages participants to self-assess, prepare, and submit a Communication on Progress report to the UNGC on their performance around these four topical areas[65]. According to the UNGC, the Communication on Progress report should be fully integrated into a company's main stakeholder communications, most often the annual or sustainability report[66]. By developing an annual ESG report discussing organisational performance around these topics, listed companies can submit an extract of the ESG report to fulfil the requirements of the annual Communication on Progress report submissions to the UNGC. Further, applying the Global Reporting Initiative standards ensures compliance to the Communication on Progress reporting requirements[67]. Organisations can also refer to the UNGC guidance document on Using GRI's Guidelines to Create a CoP.

4.4 The Carbon Disclosure Project (CDP)

The CDP is a non-profit charity helps in promoting transparency in environmental reporting by cities and companies around the world[68]. Signatory companies provide performance data on climate change, water security and deforestation on a self-disclosure basis[69]. This self-reported data is then used by investors and other stakeholders to make informed data driven decisions with regards to the reporting company's environmental impacts[70]. For example, investors can use data in the CDP database to calculate the carbon

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[64] Ibid; See also Global Compact Network Kenya., 'The Ten Principles of the United Nations Global Compact' available at https://www.globalcompactkenya.org/what-we-do/ten-principles (accessed on 22/07/2022)
[65] Ibid
[66] Ibid
[67] Muigua.K., 'The ESG Reporting Frameworks Applicable in Kenya' Op Cit
[68] Carbon Disclosure Project, available at https://www.cdp.net/en (accessed on 21/07/2022)
[69] Ibid; See also Matisoff.D et al., 'Convergence in environmental reporting: assessing the Carbon Disclosure Project." *Business Strategy and the Environment* 22.5 (2013): 285-305.'
[70] Ibid

intensity of their portfolio[71]. Investors can also select entities that demonstrate climate resilience by evidenced implementation of strategies that future proof their organisations against climate related polices and regulations[72]. There is need to consider that the CDP and GRI use common metrics on reporting on carbon emissions. ESG reporting can be used to collect and report data to the CDP. Organisations can select any or all the disclosure topics as part of their materiality assessment exercise and build reporting content within the ESG report that meets the CDP self-disclosure requirements.

4.5 Industry level reporting

Certain industry groups in Kenya have developed voluntary ESG related guidelines for consideration by member organisations. For example, in the banking sector in Kenya, the Kenya Bankers Association, the trade association for banks in Kenya, has developed the Sustainable Finance Initiative (SFI) industry principles for the banking sector[73]. Further, recently the Central Bank of Kenya (CBK) has developed Guidance on Climate Related Risk Management for the banking sector[74]. The aim of the Guidance is to sensitize the banking sector on mitigation of climate-related risks and harnessing of opportunities[75]. It also offers guidance on the development and implementation of appropriate climate-related strategies and policies[76]. Given the current trajectory of ESG and emphasis placed by investors on ESG integration, it is expected that more trade associations and industry groupings in Kenya will develop specific ESG guidelines for adoption by their members. Industry guidelines provide relevant insights on ESG issues impacting the industry and

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[71] Muigua.K., 'The ESG Reporting Frameworks Applicable in Kenya' Op Cit
[72] Ibid
[73] Sustainable Finance Initiative, available at https://sfi.kba.co.ke/ (accessed on 22/07/2022)
[74] Central Bank of Kenya., *'Guidance on Climate-Related Risk Management'* October 2021, available at https://www.centralbank.go.ke/wp-content/uploads/2021/10/Guidance-on-Climate-Related-Risk-Management.pdf (accessed on 22/07/2022)
[75] Ibid
[76] Ibid

listed companies can refer to such guidelines when identifying material ESG topics for disclosure using the framework proposed in this manual.

5.0 ESG Concerns in Kenya

The concept of ESG acknowledges some of the Environmental, Social and Governance concerns that arise from the activities of corporations. From an environmental perspective, the activities of corporations have resulted in direct and indirect greenhouse gas emissions contributing to the climate change menace[77]. Further, the activities of multinational corporations especially those involved in the exploration of natural resources have resulted in environmental concerns such as environmental degradation, extinction of biodiversity, contamination and destruction of soil and air pollution affecting the socio-economic lives of indigenous populations[78].

In the social context, ESG acknowledges some of the challenges that organization's face in their relationship with stakeholders. Some of these challenges include unfair labour practices and standards. In Kenya, there have been accusations of human right abuses such as killings, rape, and other forms of sexual and gender-based violence, bad labour practices and land injustices against the neighbouring communities perpetrated by certain multinational corporations[79]. The activities of an organization can also impact the communities where such an organization operates resulting in social concerns such as land injustices and displacement of people.

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[77] Peterdy.K., 'ESG (Environment, Social and Governance): A Framework for Understanding and Measuring How Sustainably an Organization is Operating' available at https://corporatefinanceinstitute.com/resources/knowledge/other/esg-environmental-social-governance/ (accessed on 21/07/2022)

[78] Ajibade, L.T & Awomuti, A.A. 'Petroleum Exploitation or Human Exploitation? An Overview of Niger Delta Oil Producing Communities in Nigeria' *African Research Review Vol. 3 (1), 2009. Pp. 111-124*

[79] Kenya Human Rights Commission., 'Heavy price for Kakuzi's egregious human rights violations' available at https://www.khrc.or.ke/2015-03-04-10-37-01/press-releases/737-heavy-price-for-kakuzi-s-egregious-human-rights-violations.html (accessed on 21/07/2022)

Governance challenges have also impacted the profitability and sustainability of organizations. These challenges include mismanagement of organizations, lack of transparency, accountability by the board of directors, conflict of interest and poor internal controls[80]. These challenges have resulted in failure of some of the leading organizations in Kenya. ESG acknowledges these challenges and seek to integrate good governance practices in the affairs of organizations.

6.0 Way Forward

There is need for corporations to embrace the concept of ESG in Kenya in order to promote sustainable development. According to the Nairobi Securities Exchange, listed companies in Kenya have a general awareness of ESG issues and corporate sustainability but there is need for capacity building on how to integrate ESG into business strategies of listed companies and how to report ESG performance in a consistent, transparent and principle-based approach that meets stakeholder expectations[81]. The ESG Disclosures Guidance Manual (ESG Manual) is thus designed to guide listed companies in Kenya and other organizations interested in ESG reporting on how to collect, analyse, and publicly disclose important ESG information in a way that meets international sustainability reporting standards[82].

The ESG Manual is proposed to act as a guide on how to progressively integrate ESG in strategy, operations, and performance management. It recommends the adoption of the Global Reporting Initiatives (GRI) Standards as the common framework for ESG Reporting for listed companies in Kenya to help reduce uncertainties[83]. For an organization to claim that it has prepared information in accordance with the GRI

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[80] Seth.A., 'Corporate governance challenges in emerging economies." *Corporate Governance: An International Review, Forthcoming* (2017).
[81] Nairobi Securities Exchange, 'ESG Disclosures Guidance Manual' Op Cit
[82] Ibid
[83] Ibid

Standards, it is required to have applied the GRI Reporting Principles. This is a set of reporting principles which guide organizations in ensuring the quality and proper presentation of the reported information[84]. The principles include accuracy, balance, clarity, comparability, completeness, sustainability context, timeliness and verifiability[85].

According to a 2020 Global Survey on Sustainability reporting conducted by KPMG, the GRI Standards are the most widely used framework for sustainability reporting[86]. The listed companies on the NSE that were reporting on ESG performance had already settled on and were using the GRI standards as their preferred framework for ESG Reporting even before the ESG Manual[87]. The ESG Manual proceeds to propose a common set of ESG metrics for reporting by all listed companies to help facilitate comparability of ESG performance of listed companies in Kenya. It is also projected that over time, upon maturity of the ESG disclosures, it will become possible for stakeholders to correlate financial performance with specific ESG indicators such diversity and air emissions[88].

Further, applying the ESG Manual is expected to assist listed companies comply with reporting requirements for other organizations such as the Carbon Disclosure Project (CDP) and UN Global Compact (UNGC). The manual also includes a guide on how to meet corporate governance reporting requirements contained in the Capital Markets Authority (CMA) Corporate Governance Code. The ESG Manual also includes examples of sector specific ESG disclosures for reference by listed companies in its Annex 6[89]. The ESG Manual is expected, with time, to make it possible to compare the ESG performance of organizations reporting within the same sectors including adopting common reporting

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[84] GRI., 'The Global Standards for Sustainability Reporting' Op Cit
[85] Ibid
[86] KPMG, "The Time has Come: The KPMG Survey on Sustainability Reporting 2020," Available at: https://assets.kpmg/content/dam/kpmg/be/pdf/2020/12/The_Time_Has_Come_KPMG_Survey_o (accessed on 22/07/2022)
[87] Ibid
[88] Nairobi Securities Exchange, 'ESG Disclosures Guidance Manual' Op Cit
[89] Ibid

framework for the respective sectors. The ESG Manual also seeks to support future plans for a responsible investment index by the Nairobi Securities Exchange (NSE).

The ESG criteria proposed in the Manual is also anticipated to be applied in investment selection given the momentum the trend has gained in recent years which is expected to continue in the future[90]. According to the Manual, along with national policies and directives, ESG considerations in investments have become the most important driving force for ESG integration and disclosure in capital markets. As such, companies seeking to attract responsible investors are incentivized to ensure that they adopt the top ESG metrics commonly sought by investors[91]. These include having an overarching ESG policy, assigning ESG management responsibility, having a Corporate code of ethics, presence of litigation on matters touching on environmental, social and ethical affairs, the presence or absence of People diversity among employees, Board and management, net employee composition including ratio of part-time and full-time employees, having formal environmental policy and estimation of carbon footprint, data and cybersecurity incidents if any that can put the company at risk and health and safety events that affect ability to provide safe working environments for employees, contractors and the wider value chain[92].

The expected benefits for Listed Companies adopting the ESG Manual include ensuring transparency in ESG disclosures which helps in building integrity and trust in the capital markets thus enhancing competitiveness to attract investment to the capital markets. The adoption and promotion of ESG reporting by the NSE is expected to enhance trust and integrity of the capital markets in Kenya by providing valuable information that is of

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[90] Muigua.K., 'The Need and Benefits of ESG Reporting in Kenya' available at https://thelawyer.africa/2022/06/04/benefits-of-esg-reporting-in-kenya/ (accessed on 22/07/2022)

[91] Ibid

[92] Broderick, S., "The Top 10 ESG Metrics Private Equity Funds Should Collect," IHS Markit, 2019; Available at: https://cdn.ihsmarkit.com/www/pdf/0720/ESGTop10-Digital-Final-HiRes.pdf (accessed on 22/07/2022)

increasing importance to investors, thus contributing to more efficient capital allocation[93]. Other key benefits of integrating and disclosing ESG performance by listed companies in Kenya include the fact that it ensures investors can assess and preferentially invest in issuers that demonstrate better ESG linked financial performance, resulting in more efficient capital allocation[94]. Further, implementation of the ESG Manual is geared to ensure that organisations that demonstrate responsible investment practices are able to access new sources of capital from sustainability conscious investors such as Development Finance Institutions (DFIs) and Private Equity firms[95].

In addition, a holistic view of corporate value facilitates product innovation by enabling consideration and management of the embodied environmental and social impacts of products and services. Measuring and reporting ESG performance also enables organisations embed circularity in their operating models and achieve operational efficiencies by optimizing energy and raw costs in production[96]. By adding and demonstrating ESG integration into their supply chains, production systems and service delivery, the listed companies applying the manual will benefit from preferential access to new markets. ESG value creation framework also helps organisations to proactively address non-financial but critical environmental and social risks, thereby preserving and creating long term value for stakeholders. ESG integration enhances regulatory compliance and helps anticipate the impact of future ESG related regulations and policies. Finally, organizations are perceived as responsible corporate citizens and achieve brand value enhancement by systematically identifying and responding to stakeholder needs and expectations[97].

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[93] Muigua.K., 'The Need and Benefits of ESG Reporting in Kenya' Op Cit
[94] Ibid
[95] Nairobi Securities Exchange, 'ESG Disclosures Guidance Manual' Op Cit
[96] Ibid
[97] Ibid; See also Africa Sustainability Matters., 'What do ESG guidelines mean for corporates?' available at https://africasustainabilitymatters.com/what-do-esg-guidelines-mean-for-corporates/ (accessed on 22/07/2022)

The implementation timelines of the ESG Manual for listed companies on the NSE includes the requirement of issuing a public report on their ESG performance at least annually[98]. The steps outlined in the ESG Disclosures Guidance Manual are expected to guide such reporting. In addition, the manual is also made available as a public good for other organisations in Kenya that would be interested in ESG reporting. On their part, listed companies have been given a grace period of one year from the date of issuance of the guidelines (29th November 2021) to interact and familiarize themselves with the ESG reporting steps contained in these guidelines for implementation[99]. Thus, listed companies will after 29th November 2022 be expected to include a sustainability/ESG report in their annual integrated reports[100]. The Sustainability/ESG Report under the NSE ESG Manual must at minimum contain the mandatory ESG disclosures discussed in Chapter 6 of the manual. Issuers can also choose to publish a separate ESG/sustainability report. Adopting and adhering to the ESG manual will thus be an important step in promoting ESG in Kenya.

7.0 Conclusion

Environment, Social and Governance (ESG) has emerged as arguably the most important tool of corporate governance in the current era. It acknowledges the environmental, social and governance concerns faced by corporations and seeks to integrate these concerns in corporate decision making in order to promote sustainable, responsible and ethical investments. There is need for organizations to continue embracing ESG in order to promote corporate sustainability. Embracing ESG as a pillar of sustainable development is an ideal whose time has come.

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[98] Ibid

[99] Nairobi Securities Exchange, 'ESG Disclosures Guidance Manual' Op Cit

[100] Ibid

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