



ESG in the defence and aerospace sector

India's aerospace and defence sector is highly complex, with both private and public players in the market. The Government of India is, however, the biggest stakeholder, acting as both supplier as well as major procurer in this industry. On both fronts, there are many opportunities to incorporate an ESG lens, as well as drivers for this agenda.

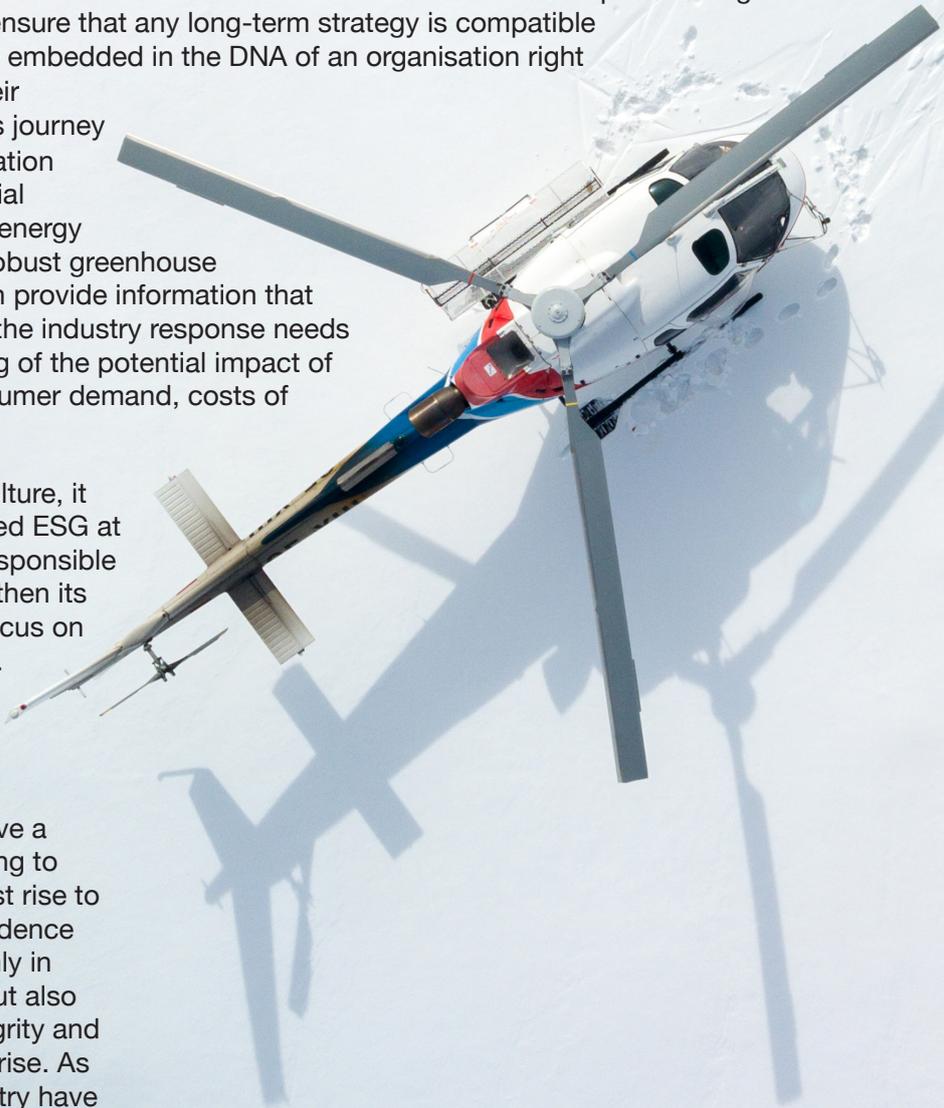
According to a study by the Stockholm International Peace Research Institute (SIPRI), India ranked as the **second largest** importer of arms for its armed forces in 2016–20. To reduce this heavy dependence on imports of major foreign arms, the Make in India programme focuses on import substitution. The Government has promulgated a list of 400-plus defence items that will be indigenised in a phased manner over the next few years to substitute imports. In addition, the country aims to strengthen its export capabilities for defence equipment, parts and components. From FY17 to FY22, defence exports grew at a CAGR of 32%, with an increasing role of the private sector. Thus, many private players today stand an excellent chance to contribute to the Indian defence manufacturing growth story.

The Government's 'Make in India' and 'Make for the World' initiatives under defence and aerospace are laudable moves and need to be backed by a robust defence production and export promotion policy. It also calls for institutional investment. Institutional investors are now increasingly aligning towards ESG metrics for making important investment decisions and are exerting pressure on companies to act on climate change. Companies that ignore this clarion call will find it increasingly difficult to access markets, human capital and financial capital – with a growing cost for non-compliance. Switching to renewable energy sources and energy-efficient infrastructure with a zero-waste management system, performance accountability and implementation of ethical corporate practices – all will now become the new norm for doing business. It is clear that organisations that do not act risk narrower partnership opportunities across the value chain. All strategic partnerships, be it with the Government or the private sector, will increasingly assess ESG policies as part of due-diligence checks. Therefore, organisations need to implement their ESG ambitions, assess strategic options and align their growth with a ESG-coherent strategy.

The aerospace and defence industry impacts the environment through not only its operations but also its product offerings. Therefore, the Government now has increasing expectations from suppliers to comply with higher sustainability standards as part of their procurement process. Suppliers will however need to be incentivised on both financial and non-financial parameters and at all stages of supplier engagement. Embedding decarbonisation into procurement processes, such as mandatory carbon reporting and carbon reduction requirements in defence and aviation tender proposals, is a good way to start the decarbonisation journey. Likewise, performance management contracts must also have carbon reduction clauses that could mean penalties, including termination of contracts, for suppliers that fail to comply. A number of technological advancements in the aerospace and defence sector (e.g. sustainable aviation fuel, hybrid-electric propulsion, hydrogen-powered aircrafts, use of lightweight composite materials during manufacturing) could help address ESG concerns by improving fuel efficiency.

With large defence public sector undertakings (DPSUs) and business conglomerates increasingly recognising the importance of ESG, it is no longer a tick in the box but an absolute must to create and protect long-term stakeholder value. All organisations must ensure that any long-term strategy is compatible with a low-carbon future. ESG needs to be embedded in the DNA of an organisation right from the beginning and must be part of their continuous growth strategy. The earlier this journey begins, the more likely it is that an organisation will meet its goals and achieve a commercial advantage. As the economic link between energy efficiency and operational cost deepens, robust greenhouse gas monitoring and reporting practices can provide information that promotes operational efficiencies. Hence, the industry response needs to be driven by an increased understanding of the potential impact of climate change on operational costs, consumer demand, costs of resources and regulatory changes.

Once an organisation has adopted ESG culture, it needs to communicate how it has integrated ESG at the strategic and operational levels as a responsible market player. Doing this will help it strengthen its international business with an increased focus on exports and a world-class brand presence. If local small export players want to compete in the global market, then they will have to be ESG compliant so that when they sell to foreign original equipment manufacturers (OEMs), they have a better business case in terms of contributing to the global ESG agenda. Organisations must rise to the challenge of building stakeholder confidence by sharing and reporting on targets, not only in relation to sustainability and profitability, but also thinking, behaving and operating with integrity and transparency across their extended enterprise. As the defence sector players within the country have strategic plans to increase exports, ESG in the supply chain will become a key market driver. For increasing foreign revenues and competing in the global market, it is inevitable to thoroughly monitor the ESG performance of the supply chain.



About PwC's Environment, Social and Governance (ESG) practice

Our ESG team assists organisations in understanding the impact and urgency of action on ESG regulations and helps them make it an integral part of their corporate and business strategies. It unleashes the potential to not only retain their licence to operate, but also identify opportunities for growth, mitigate risks, improve performance, enhance reputation, ease access to finance and be competitive in talent acquisition. Our ESG specialists also assist in effective execution on the ambitions and targets set, reimagining the operating model - reflecting ESG in stakeholder engagement, business and people processes. PwC's sustainability specialists know your industry and the challenges it faces, and can help you find the right solutions on the path towards sustainability.

About PwC's Aerospace and Defence (A&D) practice

PwC India has one of the strongest A&D practices in India and has been offering strategic advisory, capability assessment, HR, technology advisory, and other consultancy services to the Government (Ministry of Defence, Ministry of Civil Aviation, etc.), all the DPSUs, the erstwhile Ordnance Factory Board, Global and Indian A&D companies, large OEMs and start-ups. PwC's A&D team offers its clients an integrated, capability-based and professional industry perspective across areas such as commercial aviation, military aerospace, military land systems, maritime domain, shipbuilding, defence electronics, space consulting, security consulting and defence strategy.



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