Consider two news items in the first three days of this week. The first was that loss-making renewable energy company Suzlon Energy has asked the state-owned Power Finance Corporation for a ₹4,200 crore bailout. The other was that the fossil fuel giant BP reported its highest profit in eight years.

The contrast between Suzlon's crisis and BP's good fortunes are telling. One has seen losses swell from cumulative operational problems — soaring raw material costs, a glut of projects and tariff pressures on wind power. BP, on the other hand, is riding on buoyant oil and gas prices spurred by a geopolitical crisis in the Ukraine.

SWOT

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Suzlon was a poster boy of the early trend of investing on ESG, or Environmental, Social and Governance, metrics. Its failure highlights the risks associated with ESG investing, which has gained momentum after the Paris agreement on climate change, which committed countries to greenhouse gas reduction targets.

This wind turbine maker with debt of ₹6,640 crore had attracted interest from blue-chip private equity players such as IDFC PE, Olympus and Asia Climate Partners and even a white knight investor in Sun Pharma's Dilip Shanghvi. Now, with a step-down subsidiary in the US having filed for bankruptcy, it is asking for a government bailout.

ESG investing can be seen as a continuum of a global investment philosophy that gained traction after the great accounting frauds of the early 21st century — Enron, WorldCom, Freddie Mac, AIG *et al*. Occurring about a decade after capitalism's grand victory over communism in the Cold War, these scandals were an embarrassingly public reminder of the seamier side of free enterprise.

At Davos and other global talk shops, earnest discussions focused on ways to "save" capitalism, and the twin notions of "compassionate capital" and "impact investing" emerged. These concepts posited that capitalism should not be a force of profit only but a source of good ("impact") too. Bill Gates was an early proponent of this concept. Inevitably, vast amounts of compassionate capital sloshed into global markets spawning impact investment funds focused on healthcare, infrastructure and education in poor countries.

These new-age capitalists acquired a confirmatory theory from management guru C K Prahalad, a much-awarded professor of the University of Michigan. He wrote *The Fortune at the Bottom of the Pyramid* that made the argument for helping the poor and making profits. The book became all the rage, though careful observers pointed out that in several case studies, the "helping the poor" part seemed to be an afterthought to the "making profit" part. Others felt uneasy at the thought of making money by selling soap and salt to the poor.

Strangely, the 2008 financial crisis did not prompt a rethink, though the implosion was caused by high finance chasing bottom-of-the-pyramid consumers with dodgy home loans. The crisis revealed the old risk of accounting and accountability. That applied to impact investing too. These investments poured into countries with weak or non-existent laws and institutional governance mechanisms and rampant corruption. How to determine whether, say, a hospital for the poor or a power utility was delivering bang for the compassionate buck?

The answers were hazy, at best, which opened the doors for a world-class fraudster such as Arif Naqvi, the Pakistani founder of Abraaj Capital. This investing impresario's compelling story of deploying capital to eradicate global poverty fooled Bill Gates, Edgar Bronfman, John Kerry, Prince Charles, Klaus Schwab, Bank of America, McKinsey, KPMG, Hamilton Lane, the World Bank and the US, British and French governments. Abraaj, now in liquidation, extracted capital from top-of-the-line global investors for projects in India, Pakistan, Nigeria, Ghana, Turkey and so on, by spinning a fantasy that they wanted to hear.

It took about 13 years for someone to figure out that the profits Mr Naqvi promised weren't forthcoming. In fact, Mr Naqvi, the toast of the Davos crowd, operated a global Ponzi scheme, extracting money from one investor to finance a high-roller lifestyle for himself and senior executives, shifting money from one fund to another whenever payments came due (all deliciously chronicled in *The Key Man* by two *Wall Street Journal* reporters.

This is not to say that ESG Funds are incipient fraudsters — far from it. But the fact that ESG investing is impact investment bolstered by a climate change agenda should raise the level of caution. In May last year, the US Securities and Exchange Commission released an unprecedented ESG-focused risk alert pointing to inadequate disclosure, misleading claims and insufficient knowledge of ESG investment analysis. That's one problem. The other is the variable national policies, especially in emerging markets, that make investments difficult to measure. In India, for instance, the long-standing problems of regulated energy pricing add layers of complexity to the RE business. Equally, high fossil fuel-using companies are known to make token investments in RE power or corporate social responsibility projects to attract ESG money. In short, the more opaque the metric, the higher the risk.