ESG INVESTING IN INDIA

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ESG investing nowadays, gaining momentum, though the investors is making investment in the corporations who are practicing ESG standards and thereby doing the right thing and also making corporate owners to build such companies and handling such operations which are as per the ESG standards. As ever-changing times, and severe climatic circumstances, a demand for such investing criteria evolved and fostered its expansion, idea that is primarily driven by responsible investors' desire to have an influence on society and environment in addition to economic rewards of investing. This expansion is the net outcome of larger trend cycle that is being noticed throughout the world to factor in efforts to contribute to a worldwide cause and, as a result, enhance environmental conditions.

The principles behind this practice have existed for centuries in the form of religious codes and moral norms as well as cultural values. More specifically, the United Nations (UN) was the driving force behind the first ESG investing initiatives, which can be traced to the year 2004. ESG Investing is the investment strategy that takes non-financial factors, i.e. Environment, Social and Governance into consideration whilst making a financial portfolio. ESG Investing is the concept that arises from Socially Responsible Investing (SRI) and Corporate Social Responsibility (CSR). SRI is the predecessor of the ESG.

ESG investments are still in early stages in India, but they are gradually gaining ground there. Recent policy initiatives have mostly strengthened the country's focus on climate-friendly investments and private investment for green energy. Even the Government of India's Economic Survey 2020–21 acknowledged the need to combine financial and environmental policy and outlined a number of initiatives that would encourage ESG investments in the nation.

MEANING OF ESG INVESTING

ESG refers for Environmental, Social, and Governance, and it is a phrase that is commonly used in the other two categories of Responsible Investment. Consideration of ESG elements can be said to be both the backbone and the primary source for responsible investing. Although ESG investment is often confused with SRI, it is a distinct type of investing.

SRI strives to exclude investments in properties or industries that do not adhere to ethical principles from the portfolio development process. ESG investing, on the other hand, entails incorporating Environmental, Social, and Governance aspects into the basic investment research with the primary goal of increasing investment performance. As a result, it enables investors to build a portfolio that is consistent with their ideals. The United Nations issued the six Principles for Responsible Investing (PRI) in 2006 in order to incorporate sustainability through into investment process and create a more sustainable financial system (Barclays, 2016).[1]

ESG investing takes into account environmental, social, and governance factors in addition to financial factors when making investment decisions. A key goal of Sustainable and Responsible Investing is to include Environmental, Social, and Corporate Governance (ESG) considerations into investment analysis and portfolio development across a variety of asset classes. By incorporating economic, social, and governance (ESG) considerations into investing decisions, the investor hopes to better control risk and achieve long-term, sustainable returns. It should be noted that the Governance metric varies from the Environmental and Social metrics by definition, as investors may have different priorities when rating them.[2]

Components of ESG Investing

Environmental, Social, and (business) Governance factors are the three main ESG components. Since ESG factors are frequently connected, it would not always be possible to identify and categorise an activity relating to ESG simply as an environmental, social, or governance practise. There are no standard instances of ESG problems, and the list is ongoing because there are always new problems that are arising.

The letter E symbolizes for Environmental. Environmental considerations are the environment consequence(s) and risk management procedures of a company. This promotes the prudent and effective use of resources. Among these are: loss of biodiversity, air and water pollution,

[1] Barclays, (2016), *Sustainable investing and bond returns.*
[2] MSCI (2018) MSCI ESG RATINGS Methodolgy. Available at: https://www.msci.com/documents/10199/123a2b2b-1395-4aa2-a121-ea14de6d708a.

deforestation, waste management, carbon emissions, the effects of climate change, water scarcity, and the preservation of natural resources. They includes both indirect and direct greenhouse gas emissions, management's natural resource stewardship, and the firm's overall resilience to physical climate threats (like climate change, flooding, and fires). This indicator assesses the company's impact to climatic changes through greenhouse gas emissions, waste management, and energy efficiency. With global warming on the rise, the manner in which firms reduce those carbon emissions is becoming increasingly important in this metric.

According to Derwall et al. (2004)[3], more environmentally friendly enterprises benefit from greater stock returns compared to their less environmentally friendly rivals. Even after various methodological controls, these findings remain significant. Manrique and Mart-Ballester (2017)[4] reach similar conclusions using a sample of 2982 big enterprises both from developed and developing nations.

The letter S stands for Social. This indicator indicates the company's approach to human resource management. If a company is strongly incorporated with in local community and has a "social licence" to operate with consent, the metric rises. The social pillar encompasses factors such as gender policies, human rights protection, labour standards, workplace and product safety, public health, and income distribution, all of which have an impact on employee satisfaction. Edmans (2011)[5] asserts that there is a definite positive association between employee satisfaction with long-run stock return. In particular, from 1984 to 2009, American firms regarded to have the greatest working conditions achieved a 4-factor alpha of 3.5% each year (2.1% over the industry standard).

Lastly, the letter G stands for Governance. This indicator will offer the investor with just an assessment of the corporation's governance. It is an indicator of managerial quality and how important it is for the organisation to preserve the interests of its shareholders. According to research, this statistic is directly related to financial performance. Corporate governance is the process through which a company is led and managed. ESG analysts will aim to better understand how leadership incentives fit overall stakeholders expectations, whether shareholder rights are seen and honoured, and what sorts of internal controls exists to encourage

[3] Derwall, J., Bauer, R., Guenster, N., & Koedijk, K. G. (2004). The ecoefficiency premium puzzle. Financial Analysts Journal, 61, 51–63.
[4] Manrique, S., & Martí-Ballester, C. (2017). Analyzing the effect of corporate environmental performance on corporate financial performance in developed and developing countries. Sustainability, 9, 1–30.
[5] Edmans, A. (2011). Does the stock market fully value intangibles? Employee satisfaction and equity prices. Journal of Financial Economics, 101(3), 621–640.

leadership transparency and accountability.[6] The governance pillar addresses issues such as board of administration independence, shareholder rights, management salaries, standard operating procedures and anti-competitive practises, as well as legal compliance. Many research, such as Velte (2017) examines German corporations, while Gompers et al. (2003) examine US firms, showed that greater governance standards have a beneficial impact on company profitability.[7]

ESG Ratings and Disclosure

Several third-party report and rating providers review and grade the environmental, social, and governance (ESG) performance of most worldwide as well as domestic public (and also many private) companies. These reports and ratings are increasingly used by institutional investors, asset managers, financial institutions, and other stakeholders to monitor and measure a company's ESG performance over time and in comparison to peers. This evaluation and measurement is frequently used as the foundation for informal and shareholders proposal-related investor interaction with corporations on ESG issues. Yet, the approach, scope, and coverage of reports and ratings differ widely amongst providers. Several suppliers promote feedback and interaction with those subject companies in order to improve or, in some cases, correct data.

In broad sense, the initial literature identifies numerous firm-level characteristics linked to ESG disclosure. The primary firm-level characteristics associated with ESG disclosure are size (Cowen et al. 1987; Roberts 1992), industry (Cowen et al. 1987; Roberts 1992; Cho and Patten 2007), strategic orientation (Roberts 1992), and environmental performance (Patten 2002; Cho and Patten 2007). According to recent research, firms with CSR governance committees make more voluntary CSR or ESG disclosures (Bui et al. 2020; Zhang et al. 2021).[8]

DEVELOPMENT OF ESG INVESTING IN INDIA

The last ten years has seen a surge of strategy changes that have prompted the more noteworthy consideration of ESG in Indian associations. In the year 2007, Hold Bank of India (RBI) gave

[6] Francisco Sousa Cardoso, *The Growing Role of ESG in Investment DecisionsInvestors' Preference*, CBS (2019). https://research-api.cbs.dk/ws/portalfiles/portal/59750983/688418_The_Growing_Role_of_ESG_in_Investment_Decisions_Investors_Preference.final.pdf

[7] Monica Billio, Michele Costola, Iva Hristova, Carmelo Latino and Loriana Pelizzon, *Inside the ESG ratings: (Dis)agreement and performance*, Corp Soc Responsib Environ Manag. 2021, Pg. 1–20.

[8] Albert Tsang, Huijuan Cao, Tracie Frost, *Environmental, Social, and Governance (ESG) Disclosure: A Literature Review*, November 8, 2022). https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4270942.

a letter to all planned business banks, prompting them on their job on Corporate Social Obligation, reasonable turn of events, and non-monetary detailing. In the year 2008, CRISIL, Standard and Poor, KLD Exploration and Examination sent off the S&P ESG India File, first investable record of organizations whose business techniques and execution show an elevated degree of responsibility towards fulfilling ESG guidelines.

In 2009, the Service of Corporate Undertakings (MCA) distributed Corporate Social Obligation (CSR) rules. It prescribed all organizations to plan a CSR strategy based on six center components care for partners, legitimate working, regard for laborers' freedoms and government assistance, regard for common liberties, regard for the climate, and exercises for social and comprehensive turn of events. In 2010, the Division of Public Undertakings (DPE) gave CSR rules for Focal Public Area Ventures (CPSEs), requiring Public Area Endeavors to have a CSR strategy endorsed by their separate top managerial staff.

In 2011, MCA distributed Public Willful Rules (NVGs) on friendly, ecological, and monetary obligations of business. The rules were intended to be involved by all organizations in India. They would then write about the nine standards as Business Obligation Report (BRR).

In 2012, the Protections and Trade Leading group of India (SEBI) gave a roundabout that made it compulsory for the biggest 100 recorded organizations to distribute a yearly business obligation report. The prerequisite was stretched out to the 500 organizations in SEBI's Posting Commitments and Exposure Necessities Guidelines 2015. Bombay Stock Trade (BSE) sent off Greenex and Carbonex.

In the year 2013, MSCI India ESG Pioneers Record was sent off. In 2014, a milestone CSR regulation was passed to command organizations of a specific scale and productivity to burn through 2% of normal benefits of going before years. In 2015, RBI included social foundation and environmentally friendly power inside the Need Area Loaning prerequisites for banks.

In 2016, SEBI distributed its green bond rules, making India the second country after China to give public level rules. Indian Bank's Affiliation emerged with the Public Willful Rules for Capable Supporting to give a precise and normalized system of activity taking special care of banking area's dangers, valuable open doors and obligations around climate, social and monetary variables in a coordinated way.

In 2017, Kotak Board of trustees on corporate administration was shaped. In 2018, the Bombay Stock Trade (BSE) distributed Direction Record on ESG Divulgences, which filled in as an extensive arrangement of deliberate ESG detailing suggestions, directed by worldwide supportability revealing systems. It highlights the significance of ESG revelations to financial backers and gives 33 explicit issues and measurements on which organizations ought to center. Clever 100 ESG Record was sent off.

In 2019, MCA further reconsidered NVCs to Public Rules on Capable Business Lead (NGRBC) to line up with SDGs and the 'Regard' mainstay of the Assembled Countries Core values (UNGP). MCA is currently fostering India's Public Activity Plan on Business and Common freedoms (in conference with different Services and State Legislatures) by 2020. A zero draft has been delivered and transferred on MCA site.

In view of this large number of rules throughout the long term, ESG putting created in India, prompting better corporate way of behaving and straightforwardness.[9]

SCOPE OF ESG IN INDIA

Following its global success and growth globally, ESG investing made its way to Indian markets. Assets under management (AUM) have nearly doubled in the last four years, reaching $40.5 trillion in 2020. Since its inception in 2011, the Nifty 100 ESG Index has beaten its parent index, returning 10.6% versus 9.1% for the standard Nifty 100 Index.

This demonstrates Indian investors' growing interest in ESG investing. According to Kaustubh Belapurkar, Director of Fund Research at Morningstar India, the covid issue proved to be a tipping point in the eyes of Indian investors, and the flow of money has substantially increased into ESG funds. Previously, Indian investors had few ESG fund options, but by October 2020, more than a half-dozen asset management firms will have developed ESG-centric fund programmes. Axis ESG Equity Fund, Quantum India ESG Equity Fund, and SBI Magnum Equity Fund (India's oldest ESG fund) are among the major funds. Aside from these, ICICI Prudential AMC, Kotak, and Aditya Birla have all launched similar funds. India now has two significant ESG indices: the S&P BSE 100 ESG Index and the Nifty 100 ESG Index.

According to Morningstar, in the period ended December 2020, Indian markets witnessed a net influx of 3,749 crores into ESG-based funds, and in March 2021, it saw a net inflow of 678 crores. Because capital is pouring into ESG funds in India, it is extremely possible that more

[9] Angel One, *ESG Investing: The new Paradigm for India*, *https://www.angelone.in/knowledge-center/share-market/esg-investing*

companies will follow suit and demonstrate stronger Environmental, Social, and Governance practises.

The success of ESG funds in India may be attributed largely to more investors becoming socially aware and knowledgeable of the ESG components. Furthermore, considerations such as statutory regulatory obligations have played an important role in motivating corporations to be more ESG compliant. There have been numerous instances where businesses and corporations have been forced to close their doors. Penalties will be imposed for failing to comply with these regulations, with serious repercussions looming. Aside from that, a large number of overseas institutional and independent investors are heavily investing in ESG-compliant companies and sustainable business strategies. These enticing promises have enticed many businesses to obey rules, and the prospect of Foreign Direct Investment (FDI) has strengthened ESG investing in India.

According to Nifty reports, ESG indexes are more productive in the post-Covid time than in the pre-Covid period. As a result, it appears that investors are gravitating towards ESG indices in the aftermath of Covid. As a result, an ESG portfolio can be designated as a Covid-free portfolio.

ESG FUNDS IN INDIA[10]

At present, India has ten ESG-focused funds, each with its own set of characteristics. Some funds have a global stock allowance, some have their own market capital and distinct sector preferences, while some are passive funds. SBI Magnum Equity ESG Fund, Axis ESG Equity Fund, Quantum India ESG Equity Fund, Aditya Birla Sun Life ESG Fund, ICICI Prudential ESG Fund, Invesco India ESG Equity Fund, Kotak ESG Opportunities Fund, Mirae Asset ESG Sectors Leaders FoF, Quant ESG Equity Fund, and HSBC Global Equity Climate Change Fund are the ESG Funds in India.

- **SBI Magnum Equity Fund (renamed SBI Magnum Equity ESG Fund) -** It is one of the most established funds. In India, there is an ESG fund. This was a 1987 collaboration between SBI and AMUNDI (France), one of the world's premier investment management organisations. The SBI Magnum Equity Fund was established in 1991. It has 42 equity holdings (as of March 19, 2021), with ICICI Bank, HDFC

[10] Akshatha Sajumon, *What is ESG Investing: List of ESG Funds in India* (March 22, 2023) https://www.fisdom.com/esg-investing/

Bank, Infosys, TCS, and Tata Motors among its top holdings. It had invested 95.36% in equity, 0.05% in debt, and 4.59% in other categories as of October 31, 2021.

- **Axis ESG Equity Fund -** It is an Axis mutual fund thematic ESG mutual fund scheme. It would be available in February 2020. As of October 31, 2021, it had equity stakes in 50 firms, with Nestle India, Bajaj Finance, Avenue Supermarts, Wipro Ltd., and TCS ranking first through fifth. It has invested 96.24% of its funds in stock, 4.09% in debt, and 0.33% in other sectors.
- **Quantum India -** A thematic-ESG mutual fund product from Quantum mutual fund is ESG Equity Fund. It debuted in July of this year. It had stock investments in 45 firms as of October 31, 2021, with Infosys Ltd., TCS, Housing Development Finance Corpn. Ltd., Wipro, and Marico Ltd. ranking as its top 5 holdings. 94.75% of its capital were allocated to equities, 5.82% to debt, and 0.57% to other categories.
- **Aditya Birla Sun Life ESG Fund** - 97.35% of the fund's assets are invested in domestic equities, of which 47.32% are large cap stocks, 21.9% are mid cap stocks, and 11.82% are small cap stocks. It is suitable for Investors that have in-depth knowledge of macrotrends and favour placing selected bets for higher returns than other equity funds. Even while the market as a whole is doing better, these investors should still be prepared for the prospect of moderate to significant losses in their assets.
- **ICICI Prudential ESG Fund** - In domestic equities, the fund has an investment of 89.3%, of which 49.54% are large cap companies, 10.82% are mid cap stocks, and 13.64% are small cap stocks.A total of 0.03% of the fund's investments are in debt, of which 0.03% are low risk securities. It is appropriate for Investors that have in-depth knowledge of macrotrends and favour placing selected bets for higher returns than other equity funds. Even while the market as a whole is doing better, these investors should still be prepared for the prospect of moderate to significant losses in their assets.
- **Kotak ESG Opportunities Fund** - The fund invests 98.18% of its assets in domestic equities, including 74.75% in large cap companies, 7.82% in mid cap stocks, and 9.57% in small cap stocks. It is suitable for Investors with advanced knowledge of macrotrends who like to make targeted bets for higher returns than other Equity funds. At the same time, these investors should be prepared for moderate to large losses in their investments, even if the general market is performing well.
- **Mirae Asset Nifty 100 ESG Sector Leaders ETF** - The fund invests 99.58% of its assets in domestic equities, with 93.46% in large cap companies, 2.85% in mid cap

stocks, and 0.51% in small cap stocks.

- **Invesco India ESG Equity Fund -** The fund invests 98.31% of its assets in domestic equities, with 58.73% in large cap companies, 14.15% in mid cap stocks, and 9.67% in small cap investments. It is suitable for Investors with advanced knowledge of macrotrends who like to make targeted bets for higher returns than other Equity funds. At the exact same time, such investors should be prepared for moderate to large losses in their investments, even if the general market is performing well.
- **Quant ESG Equity Fund -** The fund invests 98.31% of its assets in domestic equities, with 58.73% in large cap companies, 14.15% in mid cap stocks, and 9.67% in small cap investments. It is suitable for investors with advanced knowledge of macrotrends who like to make targeted bets for higher returns than other Equity funds. At the exact same time, such investors should be prepared for moderate to large losses in their investments, even if the general market is performing well.
- **HSBC Global Equity Climate Change Fund** - By investing in businesses that could gain from the shift to a low-carbon economy, the sub-fund seeks to offer long-term total return. The sub-fund aims to achieve this by having a lower carbon intensity and a higher ESG rating than the weighted average of the MSCI AC World Net index's constituents, which is calculated, respectively, as a weighted average of the carbon intensities and ESG ratings given to the issuers of the sub-fund's investments.

CHALLENGES TO ESG INVESTING

ESG investing sounds very optimal and futuristic and it also has definitive facts and figures to back it up, though it hasn't been able to realise its full potential in the financial domain, and it has its own set of challenges and shortcomings to overcome in order to achieve the goal of a sustainable future.

According to the US SIF Foundation, the Forum for Sustainable and Responsible Investment, assets held by investors who meet ESG criteria have increased. This is expected to rise from $12 trillion in 2018 to $17.1 trillion by 2020. Furthermore, according to Sustainalytics, the NIFTY 100 ESG Index outperformed its parent index NIFTY 100, with an overall ESG risk rating score of 24.6 as opposed to 27.5 for the NIFTY 100.[11]

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[11] Ritika Seth, Shubham Gupta and Harshita Gupta, *ESG Inveting : A Critical Review*, VOL.2 Issue 2 (2021) Hans Shodh Sudha, Pg. 60-80. https://www.hansshodhsudha.com/volume2-issue2/October_December%202021_%20article%207.pdf

Several critics and ESG researchers have pointed out that ESG investments frequently lose out to financial gain and profit, limiting the efficiency of financial markets and organisations. The primary goal of financial markets is to increase investor wealth while maintaining economic balance. When choices are restricted owing to ethical standards, the sense of balance and growth is lost, and some good return possibilities are missed. This recognises the tension between ethical standards and the profit drive. Milton Friedman, a famous economist, agrees and believes that ESG policies create unnecessary expenses and dilute shareholder and investor earnings. He believes that a stock should be valued based on the company's financial standing and profit.

There are many ESG funds that perform and generate returns comparable to index funds, with the exception of select companies that may have an impact on the overall performance of your portfolio. For example, if oil stocks unexpectedly flourish and an ESG fund lacks those stocks, the fund will outperform, making it restrictive.

Another difficulty that ESG investing confronts is that it is more expensive than traditional index funds. ESG funds are slightly more expensive than index funds owing to additional research and labour. ESG funds necessitate extensive and ongoing study, which can cut into an investor's earnings because the individual must spend more to be a part of that fund. Financial firms frequently regard ESG techniques as a premium offering and demand a greater cost for them.

CONCLUSION

The performance of ESG in India has been phenomenal, but when we look at ESG in other areas of the world, we can conclude that we still have a long way to go, but India is going ahead in this area. With rules growing more strict and periodic examination of regulations becoming more common, ESG compliance standards are becoming more robust by the day. Firms must now follow these standards, and it is better to be on the safe side because harsh consequences may result if detected. Due to increased consumer awareness and non-compliance competitors failing to fulfil the criteria and pass the bar, ESG compliant companies in India will see a considerable increase in market share.

Despite these setbacks and hurdles, many people believe that adhering to ethical values and ESG issues might help a firm flourish in the long run. For example, if a corporation engages in bad faith, acts irresponsibly, and is irresponsible in environmental matters, it will almost certainly incur liabilities and harm the firm's image and reputation. In terms of rate of return, it is expected that ESG funds will produce returns comparable to other index funds over time. Furthermore, there is no specific evidence that ESG funds produce lower returns.

Furthermore, the ESG investing has a bright future because it supports moral and sustainable practises that can benefit both investors and firms in the long run. As the subject of climate change gains traction, there is a likelihood that prospects for ESG investing will improve. And, to that end, an initiative should be launched to improve the circumstances and eliminate the barriers to ESG investing. It should include

- An attempt should be made to improve the information and tools available for ESG analysis.
- An attempt should be made to do research on the relationship between ESG investing and its returns.
- An attempt should be made to establish a methodology for evaluating the ESG rating and to offer prospective investors with accurate information.
- Efforts should be made to improve the performance of the various ESG instruments.