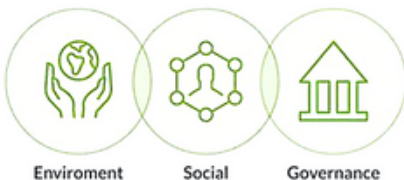


ESG IN INDIA

A BRIEF OVERVIEW

What is What is ESG?



ESG investing is rapidly growing in India, emphasizing sustainable, ethical, and low-risk investments alongside financial returns.

Introduction

The investment landscape in India is rapidly evolving, with ESG (Environmental, Social, Governance) investing gaining traction. ESG investing focuses on companies that prioritize sustainability, maintain strong stakeholder relationships (e.g., employee diversity, data protection), and uphold ethical governance (e.g., tax transparency, anti-corruption).

This trend accelerated globally after COVID-19, as investors began assessing ESG performance alongside financial metrics. High ESG scores indicate lower risk and long-term value creation, while low scores suggest potential instability and future losses.



Environment



Social



Governance

Factors influencing the rise of ESG investing in India

- Long-term sustainability- Investors start to acknowledge that companies with robust ESG practices are more likely to achieve long-term success, particularly when environmental restrictions are rising.
- Social Awareness- Investors are now aware of the social impact of their purchases, hence, preferring companies that prioritize social responsibility.

- Regulatory support- The government is also taking strict initiatives like mandatory ESG reporting standards for listed companies.

ESG funds: A step towards sustainability

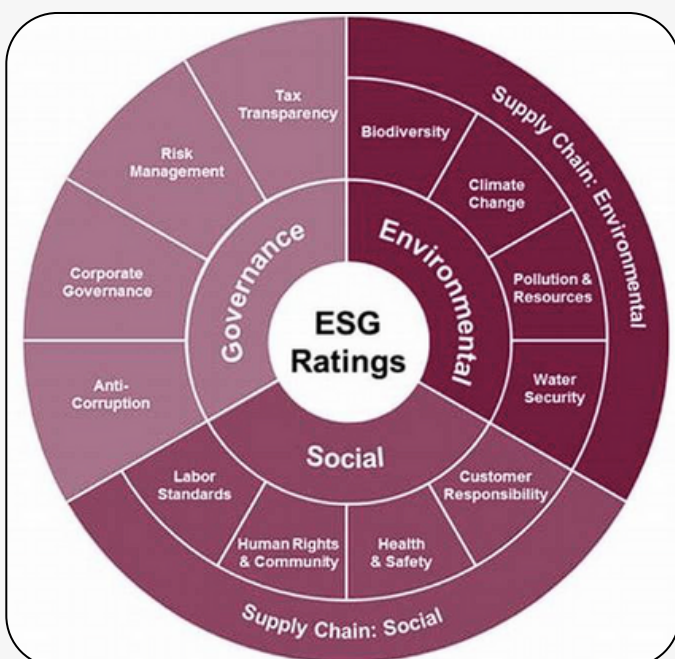
ESG funds are theme-based investment funds that invest in companies meeting specific Environmental, Social, and Governance (ESG) criteria, typically measured through ESG scores provided by research firms like Bloomberg, CRISIL, and JUST Capital. These scores, usually on a 100-point scale, reflect a company's ESG performance - higher scores indicate stronger alignment with ESG principles.



As of now, India has only 10 ESG funds, including both actively and passively managed options. These funds lack a long track record compared to traditional equity or debt funds. Top performers over the last 3 years include:

- Quant ESG Fund – 18.10% annualized return.
- ICICI Prudential ESG Exclusionary Strategy Fund – 16.48%.
- SBI ESG Exclusionary Strategy Fund – 11.31%.

In 2024, the average return for ESG funds was approximately 16.52%, lower than many equity funds due to the relative novelty of ESG investing in India. As of March 2024, the total AUM of ESG funds stood at around ₹9,753 crore.



List of available ESG funds in India (active and passive included):

- Quant ESG Equity fund.
- ICICI Pru ESG Exclusionary Strategy fund.
- SBI ESG Exclusionary Strategy fund (holding major AUM).
- Invesco India ESG Equity fund.
- Mirae Asset Nifty 100 ESG sector leaders ETF.
- Quantum ESG Best in class strategy fund.
- Mirae asset nifty 100 ESG sectors leaders FoF.
- Kotak ESG Exclusionary Strategy Fund.
- Aditya Birla SL ESG integration strategy fund.
- Axis ESG Integration Strategy fund.

Fund	Inception Date	AUM	1 Year Return
Aditya Birla Sun Life ESG	Dec-20	949	
Axis ESG Equity	Feb-20	1,904	41.2
ICICI Prudential ESG	Oct-20	1,666	
Invesco India ESG Equity	Mar-21		
Kotak ESG Opportunities	Dec-20	1,573	
Quant ESG Equity	Nov-20	15	
Quantum India ESG Equity	Jul-19	38	60.13
SBI Magnum Equity ESG*	Nov-06	3,518	47.78
Mirae Asset ESG Sector Leaders ETF	Nov-20	129	
Mirae Asset ESG Sector Leaders FOF*	Nov-20	107	
Index			
Morningstar India Sustain NR INR			51.93
Category Averages			
Large Cap Fund Category Average			44.47
Flexi Cap Fund Category Average			49.19
AUM: As on March 2021 in Rs. Crore. Trailing Return as on April 30, 2021.			

Most ESG funds have failed to impress

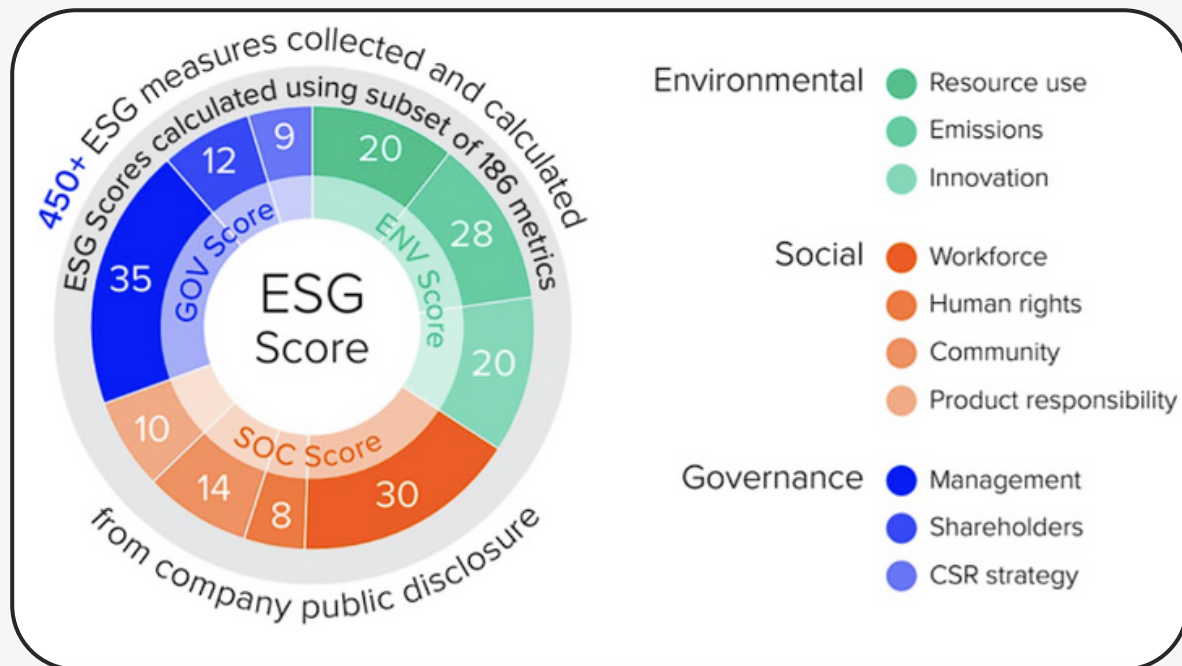
Scheme/Index	Returns (%)		
	1 Year	2 Year	3 Year
Quant ESG Equity Fund	47.96	24.18	30.90
ICICI Pru ESG Exclusionary Strategy Fund	40.09	22.07	17.13
Invesco India ESG Equity Fund	35.71	15.26	16.52
Quantum ESG Best In Class Strategy Fund	29.37	16.19	15.09
Kotak ESG Exclusionary Strategy Fund	31.18	16.38	14.00
Aditya Birla SL ESG Integration Strategy Fund	26.83	11.51	12.89
Axis ESG Integration Strategy Fund	29.41	14.77	11.95
NIFTY100 ESG - TRI	33.56	15.11	16.38

Data as of May 1, 2024.

India's ESG Trend and Market Insights

ESG investing in India is still in its early stages, gaining traction after 2020. The total AUM of ESG funds grew from a modest ₹2,630 crore in 2019 to ₹12,320 crore in 2022, reflecting initial investor interest. However, growth has stalled - by March 2023, AUM declined to ₹10,427 crore, a 16% drop year-on-year, indicating reduced investor inflows.

Despite government initiatives and increased awareness around climate financing, ESG funds have underperformed compared to other fund categories. Over the last 3 years, the average return of ESG funds stood at 16.52%, lower than large-cap funds, which averaged 19.72%. Only 3-4 ESG funds managed to outperform their benchmark, the Nifty 100 ESG Index. To make matters worse, no new ESG funds have been launched since 2021, raising the question: Why are ESG funds, despite global popularity, struggling to gain momentum in India?



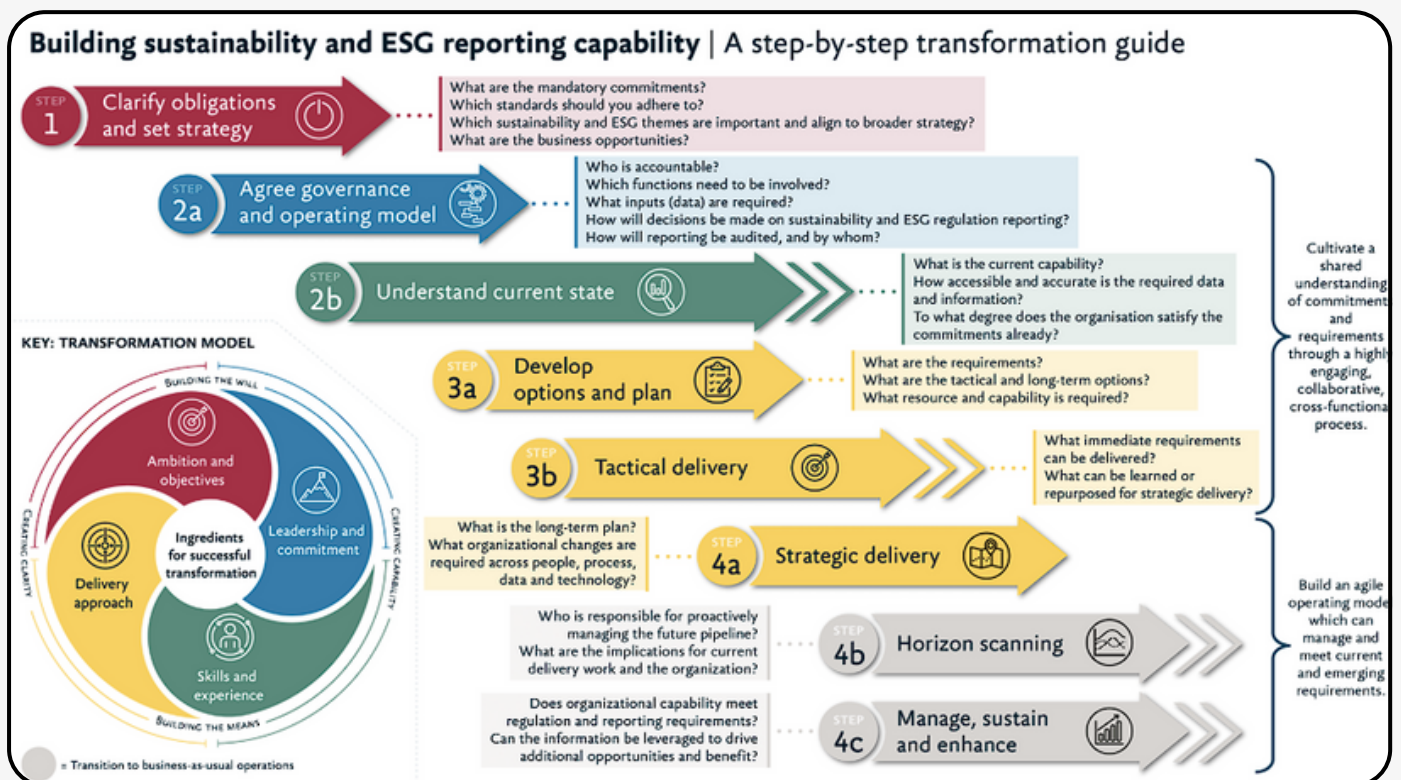
Reason for why ESG funds are losing traction in India:

The low demand for ESG funds in India can be attributed to investors shifting towards higher-return options like small and mid-cap funds, which have seen significant growth in recent years. ESG investing in India is still in its nascent stage compared to a more developed investment philosophy in the U.S. and European markets. SEBI's mandate for ESG schemes to invest 65% of AUM in companies with BRSR core reports may lead to high concentration in large-cap stocks, as ESG compliance is still not widespread among mid and small-cap companies in India. This limits the investment universe, potentially looking smaller. Most of the ESG funds are currently dominated by banking, financial services, information technologies and consumer staple stocks due to their high ESG score; this focus on a high ESG score limits portfolio diversification.

ESG Reporting in India

As investor demand for sustainability grows, India's regulatory framework for ESG reporting is evolving to promote corporate sustainability and environmental responsibility. In May 2021, the Securities Exchange Board of India (SEBI) introduced the Business Responsibility and Sustainability Reporting (BRSR) format. This requires the top 1000 listed companies (by market capitalization) to include BRSR in their annual reports from FY 2022-23 onwards. The BRSR mandates disclosures on performance against the nine principles outlined in the National Guidelines on Responsible Business Conduct (NGBRCS).

The rising importance of ESG disclosures for investors and stakeholders has led to a need for assurance on these reports. In February 2023, SEBI released a consultation paper proposing a framework to enhance ESG disclosures. The proposal includes the BRSR core, value chain disclosures for the top 250 listed companies, and assurance specifications, with a phased implementation timeline. SEBI approved the proposal on March 29, 2023, for gradual implementation.

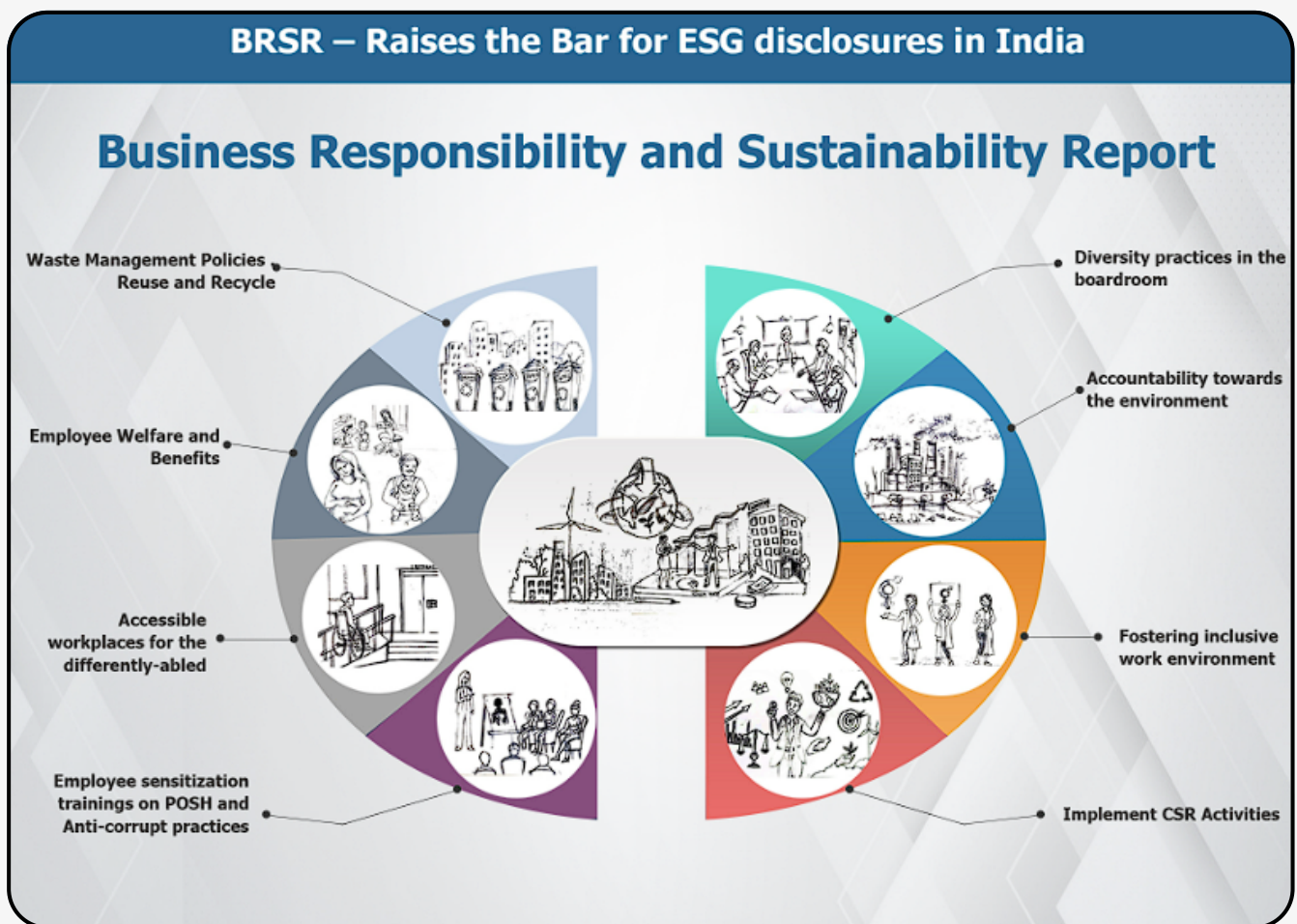


Implications of the BRSR Framework

The Business Responsibility and Sustainability Reporting (BRSR) framework mandated by SEBI for top-listed entities in India aims to enhance transparency in ESG practices. Key implications include:

- Assurance Requirement- Transitioning from reasonable assurance to an assessment model may ease compliance burdens, allowing companies more flexibility in reporting.

- Value Chain Reporting- Proposed changes simplify the definition of value chain partners, focusing on significant contributors, which could streamline ESG disclosures for companies heavily reliant on supply chains.
- Green Credit Disclosure- The central government proposed the green credit program in the FY 2023-24 budget to promote environmental sustainability among companies. On June 26, 2023, the Ministry of Environment released Draft Implementation Rules on, how companies can earn green credits through tree plantation on degraded lands. A recommendation was also made to enhance the BRSR by adding a leadership indicator focused on Environmental protection.



Opportunities For ESG in India

India offers significant opportunities for companies and investors to adopt Environmental, Social, and Governance (ESG) principles:

- Growing Investments: Increasing climate concerns and regulatory requirements for ESG reporting are driving higher investments in ESG, highlighting its importance.
- Job Opportunities: ESG-related jobs in India have grown by 223% from April 2019 to April 2023, according to Indeed, reflecting the sector's expansion.

- **Value Creation for Mid-Cap Companies:** Mid-cap companies can enhance value by integrating ESG, attracting institutional investments and improving operational efficiency for sustainable growth.
- **Opportunities for Startups:** Cleantech startups, such as EcoRatings, are thriving by leveraging AI and Big Data to support ESG goals, attracting investment and becoming key partners for other organizations.
- **Growth for ESG Investments:** India's ESG funds are set to grow with new sub-categories introduced by SEBI, enhancing their appeal to investors focused on environmental and social impacts.

Challenges For ESG in India

While ESG adoption in India reflects growing awareness of sustainable practices, several challenges hinder its progress. Regulatory complexity, with no unified ESG law, leads to confusion and increased compliance burdens due to overlapping frameworks. Small and medium enterprises often lack the resources and expertise to meet ESG standards, affecting the broader supply chain. Data quality is another major issue. Inconsistent ESG reporting standards and varied scoring methodologies make benchmarking difficult. Identifying relevant ESG factors is complex, and stakeholder engagement remains limited. Institutional investors also struggle to guide companies effectively due to these gaps. Greenwashing where companies falsely claim to be sustainable, undermines trust. Additionally, low awareness, especially among smaller businesses, and a lack of ESG-related education and training further slow adoption. Addressing these issues is crucial to unlocking ESG's full potential in India.

CHALLENGES	SOLUTIONS
Understanding KPIs	» Conducting a benchmarking study of ESG metrics used by peers » Using sector-specific ESG standards and frameworks
Identifying stakeholder groups	» Obtaining the assistance of all heads of departments in the organisation » Appointing a head of ESG/chief sustainability officer/chief impact officer
Tracking ESG data	» Integrating ESG data-collection software and tools » Deploying a third-party environmental assessment agency to create a dashboard to track environmental issues
Identifying material topics	» Creating sector-specific short-term/long-term ESG goals » Comparing material ESG topics of publicly listed peers

Conclusion

In conclusion, the evolution of ESG investing in India underscores the increasing focus on sustainable and responsible business practices. SEBI's mandate for ESG disclosures is driving transparency and accountability among listed entities. As companies embrace ESG principles, they enhance their competitiveness and contribute to equity and sustainability goals. ESG-focused mutual funds, though currently facing challenges, show strong long-term potential and may outperform traditional funds by offering both financial returns and positive societal impacts.



While integrating ESG into business strategies can be complex, it presents an opportunity to improve governance, reduce risks, and create long-term value. By aligning with ESG principles, companies can attract conscious investors and foster innovation, ultimately supporting India's transition to a sustainable future.

References

- First Notes- SEBI framework on BRSR core and value chain (asset.kpmg.com)
- ESG Investing- The New Paradigm for India (angelone.in)
- What's slowing down ESG funds and is it time to invest? Insights from experts (cnbctv18.com)
- India ESG asset up 4.7 times in two years (Business Standard)
- ESG preparedness survey report (www2.deloitte.com)
- ESG theme based mutual fund give up to 32% in three years. (The Economic Times)
- ESG Mutual funds: Why these MFs may