Sustainable Investment Factors Getting Prominent in India (Mechanism of ESG Funds)

Dr. Rupali Shah[1], Ms. Rupa Kurapati[2]

[1]Principal, Akhand Anand Arts & Commerce College, Surat - 395004, Gujarat, India
[2]Junior Research Fellow, Veer Narmad South Gujarat University, Surat - 395007, Gujarat, India

Abstract

Despite the escalating concerns about the environmental, social & governance (ESG) factors in the corporate world, limited academic studies & researches have been conducted on this subject. ESG theory & practices are highly unexplored in growing economies like India. Major proportion of capital market investors do not even have adequate knowledge about the ESG funds as a sustainable investment option. Direct or indirect cause of this scenario is lack of clear dissemination of ESG related information & various ESG fund alternatives available in the market. This informative article / research report aims to cover the conceptual base of ESG theme & it's prominence in the Indian market. It also highlights various categorical parameters used by SEBI to judge the ESG performance of the companies. Over & above this, the basic terminologies associated with ESG like ESG rating, ERPs, ESG Indices & ESG funds are also discussed in this article.

Keywords: Sustainable investment, Business Responsibility & Sustainability Report (BRSR), ESG rating, ESG Indices, ESG funds

Introduction

Recent COP 26 (United Nations Climate Change Conference of the Parties) has taken place in Glasgow, United Kingdom from 31st of October to 12th of November 2021, where India has pledged to become a net zero carbon emitter by 2070. This will lead to the demand for sustainable finance in the Indian Capital market. And a few months after COP26, India has submitted its Long-Term Low Emissions Growth Strategy indicating low carbon transition pathways in key economic sectors. This will lead to the demand for sustainable finance in the capital market. Also, Gen-Z or modern investors are driven by two interlinked objectives i.e. "Producing finance" & "Gaining environmental and social equilibrium". All these circumstances & affairs have led to the Corporate watchdog SEBI (Securities & Exchange Board of India) mandating ESG Reporting for the top 1000 listed companies (by market capitalization) in the form of Business Responsibility & Sustainability Report (BRSR). These companies have to disclose their initiatives on the ESG front in BRSR & attach it with the annual reports mandatorily.

Review of Literature

1. (Seth et al., 2021) has described that the growing influence of environmentally & socially responsible investment among the concerned investors has compelled the Organizations to notice the big scope in ESG Investing and adapt to it by creating the process of converting raw information to definitive ratings & scores, which led to wise & calculative financial decisions by people without harming the

nature. The author also states the fact that, even though the process and ratings have shortcomings, it outperforms the traditional form of investing in certain aspects. According to the author, ESG Investing has the potential to achieve a "triple bottom line" by benefiting the Company, Investors & the Society all together. And it could be the "new normal" in the world of Finance.

2. (Sarangi, Gopal K., 2021) has conducted an analytical study on "Resurgence of ESG investment in India" and derived a conclusion based on his study that there is an increasing appetite for ESG integrated assets in the country. And this is evident from the increasing interest of many mutual fund companies in such assets as well as from investors and corporate entities. He discloses the fact through his study that among all the factors of ESG, social factors are given comparatively lesser priority by the entities. As stated by him, the ESG investing in India has altered some patterns and led to trajectories. First, the scope of policies has widened over the years, in line with the emphasis on ESG investments. Second, a gradual movement from voluntary regimes to mandatory regimes has characterised the evolution of policies. Third, there has been a significant emphasis on Reporting & disclosure of information by corporate entities.
3. (Azman & Ali, 2016) states in their research publication that the potential development of innovative risk-sharing instruments like Social Impact Bonds (SIB) & Sustainable & Responsible Investment (SRI) Sukuk is very encouraging but needs to be developed further. Therefore, efforts to develop these tools need to be facilitated in order to address the challenges & risks involved. Author highlights the need for (1) Professional benchmarking & measurable impact on societal issues & development. (2) A special taskforce with authority to be set up by the government in order to accelerate the development of the Social Impact investment market by creating awareness in the general public. (3) Establishment of a Social Investment Bank for underwriting the issuance of SIB (Social Impact Bonds). (4) Reducing the cost of capital by offering Tax incentives.
4. (Ps et al., 2022) advocated in his theory that studying sustainable practices through ESG in terms of overall and individual element linkage to firm value can be highly beneficial for corporates as ultimately they are focused on wealth maximisation. Investing in ESG practices is highly rewarding to the corporates in terms of value creation through increase in sales, reduction of cost of production, fewer legal & regulatory interventions, production enhancement, increased market capitalization etc. He also confines that the impact of ESG practices vary across countries, industries and business models. The results can be fetched only in the long run so, it is advisable for the firms (especially energy sector) to not to expect instant impact or outcomes after setting ESG benchmarks.

Decoding the Concept of ESG

ESG is an abbreviation used for Environmental, Social & Governance. This broader concept favours the companies that aim to achieve market-rate financial returns while considering positive impact on environment, society and the stakeholders of the business entity. The new age investors are becoming increasingly interested in ESG disclosures of the companies to pick the right securities for their portfolio. They are more concerned about how their investment is paying-off to the environment & society.

SEBI's Advocacy in the promotion of ESG Reporting

1. Business Responsibility Report (BRR)

The expanding global trend of Environmental, Social & Governance (ESG) norms being religiously observed by the corporations across the world has led to Indian companies planning to align their financial goals with the concerns of the stakeholders for long term reputation & financial returns of the company. This in turn resulted in the watch-dog of the Indian corporate sector, Securities & Exchange Board of India (SEBI)" to demonstrate the ESG initiatives of the companies through "Business Responsibility Report" (BRR) framework. BRR is the first Environmental, Social & Governance (ESG) regulatory disclosure framework in India, which was initiated on 13th August 2012 by SEBI. The inclusion of BRR disclosures as a part of the annual reports was mandated for top 100 companies listed on stock exchange by market capitalization. In 2015, BRR extended the mandatoriness of ESG reporting to top 500 listed entities. In 2019, the extension covered the top 1000 companies listed on the stock exchange.

2. Business Responsibility & Sustainability Report (BRSR)

In order to fortify the ESG disclosures and improve the accuracy & depth of reporting, SEBI has replaced BRR with BRSR (Business Responsibility & Sustainability Report) as a panoramic framework which aligns at par with the standards of Global Reporting Initiative (GRI) & Sustainability Accounting Standards Board (SASB). Under the regulation 34 (2) (f) of SEBI - LODR (Listing Obligations & disclosure Requirements), BRSR is mandatory for top 1000 companies listed on Stock Exchange by market capitalization, where the clause demands the companies to mention their initiatives on the ESG front. Whereas, for all the other listed entities, the BRSR is voluntary.

3. BRSR Core - Framework for Assurance

certain number of listed entities in India. In order to facilitate a smooth verification process, the BRSR Core specifies data and approach for reporting & assurance. Under BRSR Core framework ESG scores are assigned to the companies based on the data & information verified by third parties. However, the approach specified is only a base methodology. For ease of references, the BRSR contains a cross - reference to the disclosures contained in the BRSR. For this intense reporting purpose, the board of the listed entities should ensure that the assurance provider of the BRSR Core has the necessary expertise.

BRSR Core represents a subset of comprehensive BRSR & it includes a specific set of 9 Key Performance Indicators (KPIs) as mentioned below

1. GHG Footprint
2. Water Footprint
3. Energy Footprint
4. Embracing circularity
5. Employee well-being & safety
6. Gender diversity in business
7. Inclusive development (Regional)
8. Fairness in engaging with customers & suppliers
9. Open-ness of Business (Transparency)

SEBI has proposed the following timeline for the enforcement of BRSR Core assurance in order to allow the companies to get used to the BRSR Core structure

Financial year 2023-24 ➡ Assurance on BRSR Core for top 150 listed entities

Financial year 2024-25 ➡ Assurance on BRSR Core for top 250 listed entities

Financial year 2025-26 ➡ Assurance on BRSR Core for top 500 listed entities

Financial year 2026-27 ➡ Assurance on BRSR Core for top 1000 listed entities

4. ESG Disclosures for Value Chain (Under the framework of BRSR Core)

In July - 2023, on the recommendations of the ESG Advisory Committee & after due public consultation, SEBI added new ESG metrics for mandatory disclosure under 'BRSR Core' for **ESG Disclosures for**

Value Chain (Under the framework of BRSR Core). Disclosures for the value chain shall be made by the listed companies as per "BRSR Core" as a part of its Annual Reports. For this purpose, the value chain shall include the top upstream and downstream partners of a listed entity, cumulatively comprising 75% of its purchases / sales (by value) respectively. Listed entities shall report the KPIs in the BRSR Core for their value chain to the extent it is attributable to their business with that value chain partner. Such reporting may be segregated for upstream and downstream partners separately or can be reported on an aggregate basis.
ESG disclosures for the value chain shall be applicable for the top 250 listed companies (by market capitalization) from the financial year 2024-25 and the limited assurance of the above shall be applicable on comply or explain basis from the financial year 2025-26.

ESG Parameters prescribed by SEBI (Indian context)

E/S/G Pillars	**Factors**	**Dimensions / Data points**
Environment	**Energy**	• Is there any facility identified as Designated Consumers (DCs) under the PAT (Performance, Achieve & Trade) Scheme ? (Y/N) • If yes, then disclose whether the targets set under the PAT scheme are achieved. • If targets are not achieved, then state the remedial actions taken.
	Water	• Mechanism for "Zero liquid Discharge". (Y/N)
	Waste Management	• Applicability of Extended Producer Responsibility (EPR) Plan to the activities of the entity. (Y/N) • If yes, then whether the "Waste Collection Plan" is in line with the "Extended Producer Responsibility Plan" submitted to the Pollution Control Board ?
	Land usage & Biodiversity	• Whether Company has its operational plant situated near ecologically sensitive areas such as national parks, wildlife sanctuaries, biosphere reserves, wetlands, biodiversity hotspots, forests, coastal regulation zones etc. ?
Social	**Inclusive Development (Regional)**	• Job creations in smaller towns / backward areas
	Inclusive Development (Industrial)	• Proportion of input material sourced from :- 1. MSMEs or Small producers 2. Domestic producers (within India)

	Diversity (Gender based)	• Gender wise disclosure of wages & salary
	Diversity (Ability based)	• Job opportunities & conducive working environment facilitated for differently abled people.
Governance	**Compliance**	• Does the company have Regulatory technology/System solutions for monitoring & evidencing compliance ? (Y/N)
	Governance	• Percentage of voting "against" the appointment of independent directors among non promoter shareholders.
	Related Party Transactions – I	• Percentage of voting "against" the RPTs among non promoter shareholders.
	Royalty	• Is the increase in Royalty payments over the last 5 years more than the increase in PBT ? • If yes, then provide the data of last 5 years royalty payments and the reason for increase.
	Related Party Transactions - II	• Share of RPTs as the percentage of :- 1. Purchases 2. Sales 3. Loans & Advances 4. Investments (PSUs are to be considered as exceptions)

Source :- SEBI | Master Circular for ESG Rating Providers (ERPs)

ESG Rating & Types of ESG Rating

Credit Rating Agencies (CRA) Regulations define "ESG ratings" as the rating products, that are marketed as opinions about an issuer of the securities, regarding its ESG profile or characteristics or exposure to ESG risk, governance risk, social risk, climatic or environmental risks or impact on society, climate and the environment, that are issued using a defined ranking system of rating categories, whether or not these are explicitly labelled as "ESG ratings". The two nouns - ESG "rating" & ESG "score" are used synonymously or interchangeably. But the key difference lies in the fact that score is specified numerically (on a scale of 0-100) and rating is assigned through letters (e.g. A, AA, AAA). ESG Rating should be convenient enough to compare the performance of two different companies.

ESG Score / ESG rating evaluates the performance of the business entities with respect to the sustainability metrics i.e. environment, society or governance related aspects or issues. This whole rating process is executed by ESG Rating Providers (ERPs), who are certified & registered under the Securities & Exchange Board of India (Credit Rating Agencies) Regulations, 1999. ESG Scores are generated by the ERPs on the basis of corporate disclosures, interviews of the management / company personnel / stakeholders / trade unions / NGOs, review of the publicly available information about the company etc. in order to capture the perceptions of companies from various dimensions. Later, this unstructured data is filtered & is converted into quantitative figures through an AI based technology. These quantitative figures are known as ESG scores.

ESG Indices

An Index prepared on the basis of the Environmental, Social & Governance (ESG) performance of the companies is known as ESG Index. Companies with superior ESG performance are scrutinised on the basis of ESG scores and are listed on the ESG Index. Currently, two major ESG Indices mentioned under this head are reigning the Sustainable Investment segment of India. These two indices are used for the purpose of benchmarking, creation of index funds, ETFs & structured products etc.

(A) S&P BSE 100 ESG Index

The S&P BSE 100 ESG Index was launched on 26th October, 2017 and constitutes 54 companies (Sep. 2023). It is designed to measure the sustainability investing criteria of the Indian companies while maintaining a risk and performance profile similar to the S&P BSE 100 (the "underlying index"). The index targets companies covering 75% of the float-adjusted market capitalization using S&P DJI Environmental, Social, and Governance (ESG) score as the defining characteristic. This index excludes companies conducting anti-social business practices, performing against the principles of United Nations' Global Compact, and involved in relevant ESG controversies.

(B) Nifty 100 ESG Index

Nifty 100 ESG Index was launched on 27th March, 2018 and constitutes 88 companies (Sep. 2023). It is designed to reflect the performance of companies within the Nifty 100 Index based on Environmental, Social & Governance (ESG) risk score. The weight of each constituent in the index was derived from free float market capitalisation & the modified ESG risk score. Companies involved in the business of tobacco, alcohol, controversial weapons & gambling operations shall be excluded from the Index.

ESG Funds

"ESG Funds are a kind of thematic Mutual funds managed by Professional Fund Managers, that invest in stocks & bonds of companies with strong commitment towards Environmental, Social & Governance (ESG) practices". As an asset-class, the main objective of ESG funds is to promote sustainable business practices & to generate financial returns without harming the social & environmental factors.

Types of ESG Funds

(1) ESG – Equity Funds

ESG – Equity funds are actively managed & open ended ESG-thematic mutual funds, where pooled money collected from the investors is professionally managed by the expert & experienced fund managers. The fund managers perform the duty of investing these funds in stocks, bonds or debt funds of the companies where ESG parameters are balanced rationally with the financial returns. These funds are to be bought from the Asset Management Company directly.

(2) ESG – Exchange Traded Funds (ETFs)

ESG - ETFs are passively managed & open ended ESG-thematic mutual funds, where pooled money collected from investors is invested in a basket of securities, bonds or debt funds of companies with high ratings on the ESG front. The investment pattern of ESG-ETFs rather follows a specific ESG Index (eg. Nifty 100 ESG Index, S&P BSE 100 ESG Index etc.) and are not managed by professional fund managers.

ESG-ETFs are listed on Stock exchanges for public trading purposes. Therefore, these funds cannot be bought from the Asset Management Company directly.

(3) ESG – Fund of Funds (FOFs)

ESG – FOFs are actively managed & open-ended ESG-thematic mutual funds. These funds are not invested in equities or bonds directly. The professional fund manager decides to invest this pooled investment fund in some other mutual funds / hedge funds / ETFs, following the ESG theme. It contains different portfolios of other funds, which allows the investors to take the benefits of diversification with a limited amount of investment. ESG – FOFs can be both domestic & international.

List of ESG Thematic Funds available in Indian Capital Market

Sr. no.	List of ESG Funds available in India	Launch date	AUM (31st July 2023)
	ESG – Equity Funds		
(1)	SBI Magnum Equity ESG Funds	01-01-2013	₹ 4,999 Cr.
(2)	Quantum India ESG Equity Funds	12-07-2019	₹ 71 Cr.
(3)	Axis ESG Equity Funds	12-02-2020	₹ 1,483 Cr.
(4)	ICICI Prudential ESG Funds	09-10-2020	₹ 1,292 Cr.
(5)	Quant ESG Equity Funds	06-11-2020	₹ 186 Cr.
(6)	Kotak ESG Opportunities Funds	11-12-2020	₹ 1099 Cr.
(7)	Aditya Birla Sun Life ESG Funds	24-12-2020	₹ 775 Cr.
(8)	Invesco India ESG Equity Funds	18-03-2021	₹ 592 Cr.
	ESG – Exchange Traded Funds (ETFs)		
(9)	Mirae Asset Nifty100 ESG Sector Leaders ETF	17-11-2020	₹ 138 Cr.
	ESG – Fund of Funds (FOFs)		
(10)	Mirae Asset Nifty100 ESG Sector Leader FoF	18-11-2020	₹ 118 Cr.
(11)	HSBC Global Equity Climate Change FoF	17-03-2021	₹ 256 Cr.
(12)	BNP Paribas Aqua FoF	17-05-2021	₹ 83 Cr.

Source :- Site Search for ESG funds | Value Research (valueresearchonline.com)

Today, India is the nation with the highest population but the overall asset base of ESG thematic funds in India is comparatively much smaller than that of other growing nations. And as per the latest reports published by morningstar, the size of ESG funds in India is decreasing day by day. various factors responsible for this outcome need to be studied further.

References

1. Seth, R., Gupta, S., & Gupta, H. (2021). ESG INVESTING: A CRITICAL OVERVIEW. 2(2). Hans Shodh Sudha
2. Sarangi, Gopal K. (2021) : Resurgence of ESG investments in India: Toward a sustainable economy, ADBI Working Paper, No. 1284, Asian Development Bank Institute (ADBI), Tokyo
3. Azman, S. M. S., & Ali, E. R. A. E. (2016). The potential of innovative financial tools: Social Impact Bond (SIB) and Sustainable and Responsible Investment (SRI) sukuk, towards the sustainable growth of the Islamic finance industry. European Journal of Islamic Finance, 4, Article 4. https://doi.org/10.13135/2421-2172/1644
4. Ps, R. K., Makhija, H., Sharma, D., & Behl, A. (2022). Board characteristics and environmental disclosures: Evidence from sensitive and non-sensitive industries of India. International Journal of Managerial Finance, 18, 677–700. https://doi.org/10.1108/IJMF-10-2021-0547
5. Carlsson Hauff, J., & Nilsson, J. (2023). Is ESG mutual fund quality in the eye of the beholder? An experimental study of investor responses to ESG fund strategies. Business Strategy and the Environment, 32(4), 1189–1202. https://doi.org/10.1002/bse.3181