A Study of Essence of Socially Responsible Investment and Environmental, Social and Governance (ESG)-linked Investment Market in India

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Abstract: **People are now becoming more and more aware of the environment and its effect on planet and people. The investors- individual investors as well as institutional investors- are now interested in investing in those companies which are ethical and have societal concerns. These investors aim at having not only financial returns but also ensure that the companies they are investing in are conscious of the impact they are making on the society and its environment because of its business activities. They are of the view that such an investment focus would make a favourable impact on the environmental issues around the world. They consider some Environmental, Social and Governance (ESG) factors in addition to monetary returns to decide where to invest their money. Thus, they will choose those companies for investment that reduce environmental damage. Socially responsible investors do not want that the returns they are getting are result of those unethical and irresponsible business practices followed by companies that do not acknowledge ESG factors. These investors include ESG information in taking decisions about investment so as to ensure that all relevant factors are accounted for when assessing risk and return. In India, few companies have taken initiatives to reduce carbon footprint by investing in green technologies. Bombay stock exchange (BSE) and National Stock Exchange (NSE) have launched a number of thematic indices which include companies that meet ESG norms. Mutual funds have also launched few exchange traded funds (ETFs) based on socially responsible investment theme. My research paper tries to study and analyse the various aspects related with ESG-linked investments in India.**

Objective of the Study: **The paper aims to explain the various aspects related with socially responsible investment and its role in India with specific focus on ESG –linked investment scenario in India**

Keywords: **Socially Responsible Investing (SRI), Environmental, social and corporate governance (ESG) factors, India, Paris Agreement, National Stock Exchange (NSE), Bombay stock exchange (BSE), ESG Mutual Funds, Objectives of SRI**

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1. INTRODUCTION:

In Socially Responsible Investing (SRI), investors would invest in companies that are socially and environmentally responsible. SRI also suggests that investors would withdraw their investments from such companies that do not behave in ESG friendly manner. Such investors have an investment strategy which considers both financial viability and social/environmental sustainability thereby achieving their twin objectives of financial return and positive social/environmental impact. Environmental factors include issues like climate change, pollution, greenhouse gas (GHG) emissions, renewable energy, resource depletion, etc. Social factors include issues related with human rights, working conditions, health, safety and welfare concerns, etc. Corporate governance factors include composition and accountability of Board of Directors, financial reporting, transparency, etc.

2. RESEARCH METHODOLOGY AND DESIGN:

2.1 Exploratory study with Secondary Data: Information has been collected from Government bulletins, reports, online newspapers and websites.

2.2 Major Variables of the study: Socially Responsible Investment (SRI), Environmental, Social and Governance (ESG) factors, Objectives of SRI investors, ESG Indices of National Stock Exchange (NSE) and Bombay Stock Exchange (BSE) , ESG Mutual funds.

3. RESEARCH ANALYSIS AND FINDINGS*:*

3.1. Meaning of Socially Responsible Investing:

Investors are interested in financial returns from their investment in companies but not at the cost of irresponsible business activities of the companies that damage the planet and harm the people. At the same time investors also expect the companies to be ethical and truthful in disclosing their financial performance. These investors expect competitive financial returns while making a positive measurable impact on the environment and society. The drive towards responsible investment is influenced by recognizing that ESG factors affect financial performance, risk and return on investment and issues such as climate change, pollution, working conditions, employee diversity, corruption, etc. destroy the value and reputation of companies.

3.2. What a socially responsible investor does:

The investor

a. Incorporates ESG information while carrying out fundamental analysis of company.
b. Communicates various relevant ESG factors to the companies, specifically those factors which they are going to consider for taking investment decisions.
c. encourages the companies to be transparent and disclose various ESG factors that affect or do not affect them;
d. reviews periodically the ESG risk in the investment portfolio by studying the impact of various ESG factors associated with the companies in the portfolio, for example, by measuring the portfolio's carbon footprint;

3.3. Objectives of Socially Responsible Investors:

The objectives of socially responsible investors is to invest in those companies which

a. are involved in business activities that do not harm the environment or society,
b. try to reduce carbon footprint of their products and services and protect the environment from pollution thereby promoting cleaner environment,
c. do not violate human rights, provide reasonable wages and better working conditions to their workers, thereby promoting social justice,
d. are not involved in war related activities like making weapons or making profits from economic volatility and conflict thereby promoting peace.
e. do not sell health deteriorating products like tobacco and diabetes causing high sugar drinks.
f. are not involved in any sinful business activities like leather, liquor, gambling, zinga farms/ponds etc.
g. are ethical in their dealings, for instance, they are paying regular taxes, are not involved in corruption or are not manipulating the accounts, etc.

3.4. Accomplishment of the objectives of SRI:

The above mentioned objectives can be achieved in three ways:

1- ***The investors adopt the strategy of screening or scanning the companies.*** There may be negative screening or positive screening and it can be related to carrot and stick hypothesis. In negative screening i.e. stick, investors do not invest in companies or withdraw their investments from companies, which adversely affect the society by polluting the environment and hence are not in line with investors' core values. In positive screening method i.e carrot, the investors invest in those companies which are ESG cognisant.

2- ***The investors rigorously advocate that companies be more ESG compliant***. Through corporate engagement, socially responsible investors communicate with the companies, convince them or even force them into improving practices and policies that are harming the environment and society thereby safeguarding long-term values and financial performance. The investors encourage the companies to become more and more transparent about where and how they are using investors' money. If the company is unresponsive, the investors sell the securities issued by that company.

3- ***Investors allocate their investments to those communities that are deficient in income and capital.*** These communities are included in undeserved unprivileged sector, have less or no access to credit facilities and do not have any skill or training. Such investments can be allocated towards providing valuable and needed community services like child care, healthcare, education and housing.

3.5. SRI in India:

Countries around the world believe and support the fact that the companies need to be more ESG-compliant. Hence, they have started enacting legislations related with ESG aspects like environment, pollution, climate-change, workplace policies, human rights, resource depletion and product safety. Those nations which do not comply with ESG norms are not looked upon favourably for investment. India has framed policies and enacted regulations with respect to improving corporate governance so as to achieve balance between diverse interests of stakeholders. These improvements are related with requirements to have independent directors, more transparency and accountability of top management, etc. At the same time, India also has some 'renewable energy' plans to observe, address and protect environmental and social issues. In December 2015, 194 nations signed the Paris Agreement, India being the 62nd nation to join the Paris deal. The main objective of the Paris agreement was to combat climate change and to give an impetus to the actions and investments needed for a sustainable low carbon footprint. India accounts for about 4.5 per cent of global greenhouse gas emissions and is the world's fourth-largest carbon emitter. Through the Paris treaty, India has committed to achieve 33-35% reduction in greenhouse gas emissions per unit of gross domestic product. In March 2016, India and EU signed a joint declaration, where they will work in co-operation towards clean energy and climate. Another effort in this direction was taken in 2011 by The Ministry of Corporate Affairs which introduced 'National Voluntary Guidelines on Social, Environmental and Economic Responsibilities of Business'. The primary objective of these guidelines is to recognize the importance of adopting responsible business practices in the interest of the social set-up. These guidelines focus on integrity, accountability, transparency, providing safe and sustainable goods and services, well being of all employees, promoting human rights and safeguarding interests of stakeholders. A few listed Companies have started publishing 'Business Responsibility Reports' in their annual reports. In 2017, India accepted the amendment relating to the second commitment period of the Kyoto Protocol, the international emissions reduction treaty, thereby reaffirming its commitment to climate action. The concept of social responsibility investing is more significant in case of ESG- vigilant foreign investors, as they would avoid investing in those businesses that do not meet their social and environmental goals. Thus, the value of such environmental and socially irresponsible companies will be eroded. Norway's

Government Pension Fund Global (GPFG), the world's largest sovereign wealth fund, has excluded many Indian companies in metals, coal and thermal power sectors from their investment strategies because of ESG related concerns such as human rights, environmental and climate-change. In April 2016, GPFG withdrew its investment from 13 leading Indian coal firms as these firms failed to address issues related with non compliance of and transgressions in business operations and activities and non-protection of human rights. There are some top-league funds such as T-Rowe Price and Blackrock which are constructing their portfolios to include companies that are sensitive towards ESG concerns.

In India, ESG indices have been introduced by Bombay Stock Exchange (BSE) and National Stock Exchange (NSE) which can help investors screen such companies.

S&P BSE has introduced three sustainability indices:

a. S&P BSE 100 ESG Index: This index measures performance of those securities in S&P BSE 100 which achieve the criteria of sustainability investing with respect to certain ESG factors. These securities are also expected to maintain a risk and performance profile similar to the S&P BSE 100.
b. S&P BSE CARBONEX: This index measures performance of such companies within the S&P BSE 100 which are committed to manage, control and mitigate risks resulting from climate change.
c. S&P BSE GREENEX: This index measures the performance of the top 25 companies in the S&P BSE 100 index which can be termed as green companies as their measurement is based on their levels of greenhouse gas emission, market cap and liquidity.

NSE has also introduced two thematic sustainability indices:

a. NIFTY 100 ESG Index
b. NIFTY 100 Enhanced ESG Index

Both these ESG related NSE indices measures the performance of companies that are included in Nifty 100 index and are constructed in such a way that the resultant portfolio has sector exposure similar to NIFTY 100 (parent index), but with specific reference to ESG factors.

S&P and CRISIL have also introduced ESG based index called S&P ESG India Index which provides information about 50 best performing companies as per ESG parameters from largest 500 companies listed on NSE. These 50 companies are involved in business activities and strategies that meet highest level of ESG standards, follow certain ethical and socially responsible principles. There are also few socially responsible funds such as Taurus ethical fund, Tata Ethical fund and Reliance ETF Shariah BeES mainly dedicated to ethical investing as per Shariah principles. More specifically, these funds follow the Shariah law and are guided by the Islamic investment philosophy having some moral codes which does not allow investing in companies dealing in alcohol, weapons, gambling, and similar sinful business activities. It had also launched a closed ended fund called 'Sustainable Development fund' which invested in companies complying with ESG issues. Another fund called SBI Magnum equity ESG Fund is also an open ended equity scheme which invests in companies observing ESG criteria. JM Mutual Fund had also introduced JM Ethical Fund in 2002, but its efforts had failed at that time. It can be seen that these funds have been functioning in the Indian capital market for quite some time. In 2016, an index called Morningstar India Sustainability Index was introduced by Morningstar which (a) measures how the companies in which investments are made are managing their ESG risks and (b) ranks companies as per their ESG grades, thereby helping investors make an informed decision about investment in the funds. This index includes technology companies like Infosys, Tech Mahindra and Wipro having the highest ESG ranking. As an impetus to national socially responsible equity investment programme, 'Yes Bank' has also introduced a scheme called "Tatva" which invests in early stage small & growth enterprises operating in sectors like microfinance, food & agribusiness, healthcare, education, livelihood creation, low income housing & utilities, thereby contributing positively and profitably towards planet impact. There are Indian companies who are committed to reduce their carbon footprints and have set carbon emissions reduction initiatives. Large Indian companies like Infosys, Tata motors, Dalmia Cement have set targets to reduce emissions by using energy more efficiently and deploying the use of renewable energy for its business operations, thereby aligning with India's commitments made under the Paris Agreement on climate change. ITC's 'E-chaupal' is another such initiative in direction of SRI attempt. This tobacco manufacturing company, which could have been screened out by ESG alert investors, have done positive SRI work through its most innovative socially responsible activity 'E-Chaupal'. Though ITC ltd. is in a tobacco making business which is harmful to an individual's health, it has developed many farms and forests. It also introduced the green hotels concept based on eco friendly structure. Through these CSR activities, ITC has gradually reduced its dependence on cigarette business thereby minimizing its impact on environment. Socially and environmentally beneficial activities have also helped ITC to earn good number of carbon credits. Navin Flourine ltd. in Surat, has invested in green technologies which reduces carbon dioxide in atmosphere. It has earned many green points called carbon credits resulting into improvement in profits. The company which was traded at Rs. 200 in 2015 is now trading at Rs. 2500 mainly for being SRI compliant.

4. RECOMMENDATION AND SUGGESTIONS:

a. Sustainable environmental stewardship and corporate engagement should be practised and encouraged so that companies carry out business in a socially responsible manner and are held accountable for their activities. This will protect and achieve long term value and ESG objective of the stakeholders.
b. Investments should be directed towards projects and organisations that work with communities, empower people, create jobs for low-skilled workers, provide primary education, build-up rural infrastructure, and contribute towards such activities and innovations that raise the quality of life of the people.
c. There should be proactive voluntary compliance of ESG factors by the private sector companies so that they can give social returns to the investors from their investments.
d. The companies should start disclosing information on how they have put investors' money to use, their performance on environmental factors say, carbon footprint and on the returns to society.
e. Companies should produce annual accounts through the Economic Value Added approach thereby advocating and encouraging corporate social responsibility culture.
f. There is need to create a greater level of awareness among the educated investors who are interested in making a positive contribution to the society by investing in ethical and environmental responsible companies and at the same time achieving their long-term financial objectives.
g. Companies should gradually start the process of making ESG related policies, following sustainable investment practices and being socially responsible, instead of an abrupt and sudden reaction if and when government imposes regulatory compliance of ESG practices.
h. Companies should follow strict disclosure norms, set targets and diligently implement those practices and policies which address environmental and societal concerns in a positive manner.

5. CONCLUSION:

In India, SRI is in developing stage. The government, companies, investors and market participants have started considering ESG factors while planning their conventional investment strategies. The primary objective of any company is wealth creation and value maximization for its stakeholders. To achieve this objective, the companies have started formulating policies which address ESG issues thereby resulting in alignment of long-term financial sustainability with public interest. The stakeholders have also started demanding that the companies should be transparent and report on where and how their money is being utilized. The market participants are formulating investment strategies which are based on ESG considerations and which are different from conventional investment strategies. SRI has started to become a distinctive investment category where financial value and social value need not be mutually exclusive. There are some policy gaps in Indian companies. Though they may have become sensitive and responsive towards environmental and social factors, but still Indian companies are weak in, and have to work for, good corporate governance and transparent financial reporting.

6. FUTURE SCOPE OF STUDY: The performances of SRI in India can be studied further to determine whether the goals of socially responsible investors have been achieved.

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