Understanding the Risk and Opportunities as Well as Performance Variance Associated with ESG Funds for the Future of Investors in India

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Abstract

Environment, Social and Governance (ESG) is an evolving field where the investors can grow their long term capital by keeping environmental and social objectives intact such that it is done in a socially responsible way. The ESG market has also got several risks as well as opportunities which may affect the investor in the long run. The investors in the recent scenario has got new avenue for investment by taking care of the social and environmental aspects and, thereby the ESG funds are increasing day by day and its value is also rising since its inception. Stakeholders are finding such socially responsible funds better than normal funds for investment at times which is urging the companies to go for sustainable reporting standards and to introduce more such ESG funds for the future of investors. Though the ESG funds and the companies associated with such funds have sustainable values, there is an inherent risk associated with ESG and there are future opportunities for the market which is not ignorable. Therefore, the researcher attempted to study and understand the risks and opportunities associated with ESG for the companies and investors in general, and furthermore to access the performance of such ESG funds in our country such that the investors can reap benefits out of it during choosing their portfolio. The researcher arrived at definite findings ascertaining the results of the study and based on that conclusion of the current study have been given by the researcher with several recommendations such that the market can evolve in future.

Key Words: ANOVA, ESG, Opportunities, Performance, Risk.

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Introduction

ESG stands for Environment, Social and Governance; which is about making a difference for the entire business entity such that it can drive towards value while strengthening our environment and society in the process. The Environmental part deals with preservation of our nature; while Social attributes considers the society including humans and it's interdependencies; and Governance intakes the logistics and related defined process for running an organization.ESG investing in the modern era is used interchangeably with socially responsible or sustainable or mission related investing and such investment has progressively increased throughout the 21st century since its inception. The success of investing through ESG factors lies in the fact that the investors are getting optimum return that too in a socially responsible manner, and several index shows that the companies which are having a high performance in ESG matrices outshine its peers who are having low performance. Talking about sustainable investing, ESG funds are such funds which can give the investors optimum return that too in a sustainable manner. The concept of ESG is not new but it will take time to grow further which is beneficial for the shareholders along with the environment. ESG funds are not as popular as normal growth funds but with time, they are evolving and more number of funds is coming to the market which is accepted by the investors such that investment is done in a sustainable manner.

But the ESG factors also got linked with risks which can be harmful for the stakeholders and the companies, and on the other hand, the investors can also identify several opportunities in the businesses who are responding positively to the ESG issues. The problem of ESG investment also lies in the fact that the products which are bearing the name of ESG investment may actually not be related to any ESG material. The various issues related to ESG have become very much important for the investors and that is the reason why many companies clearly shows and releases more vital information about their related efforts about the firm. But there is a lack of standardization in terms of adequate policies, goals, vision and progress monitoring which has led to a propagation of ESG metrics and disclosure standards. Each company faces different kinds of risk profile and therefore they need to develop their own kind of internal control system and an effective risk management process which will mitigate both financial and non financial risks in the business. Therefore, it is necessary for the companies to identify possible ESG risks to nullify it and then work on its possible opportunities in the market. Finally, it is the best interest of both the companies and its investors to understand the relationship between the business models, environment, economy and the society which will ultimately lead to better corporate decision making with favorable outcomes for all the investors.

Review of Literature

The researcher studied several review of literatures in the concerned area for the identification of research gap of the study, which are outlined below:

Kotsantonis, et al. (2016) found that earlier the number of public companies that were reporting ESG information were fewer than 20 which was in the year 1990 and that which rises to 8500 companies reporting ESG information during the year 2014. The researchers also found that the firms with more number of ESG programs and with high ESG scores have actually outperformed their competitors in a various number of ways, and finally it was concluded that the ESG factors tend to have a positive correlations with corporate value and corporate financial performance.

Birindelli, et al. (2018) studied the composition of firms board of directors on the ESG performance of the banking industry and it was found that the relationship between the banking industry and working women's on the board of directors are inversely related. The main findings of the study reveal that there is a negative link between ESG performance and the share of independent directors but there is a positive relation between board sizes or the presence of a CSR committee with the performance of ESG.

Banu (2021) assessed the efficacy of ESG Funds, especially State Bank Of India ESG mutual fund scheme in the investment portfolio of investors using correlation analysis and the results of the study reveals that the SBI mutual fund along with Nifty of the four different types of SBI ESG funds have a strong and high participation, that too in sector wise in different industries of our country.

Pareek and Pasumarti (2021) conducted a comparative analysis of ESG reporting practices in 30 biggest companies of India, America and England and it was found that based on the international comparison of the country's corporate governance practices which contributes to a better understanding of the sustainability reporting practices in all the three countries, especially among the big companies such that the large companies have actually maintained their reporting standards better compared to the small businesses.

Research Gap

Based on the detailed survey of extensive review of literature, it has been found by the researcher that there is a scanty of definite research work regarding ESG, especially in the Indian context to gain an in depth knowledge regarding the risk and opportunities associated with ESG as well as the variation in performance of ESG Funds for the future of investors of our country. It has been observed that there is a research gap which has got a major social significance in our economy and therefore, the current study makes an attempt to bridge the gap by conducting an empirical, analytical and exploratory study through its below defined research objectives.

Research Objectives

The following research objectives have been identified by the researcher based on the need and importance of the study:

- To understand the Environmental, Social and Governance (ESG) market for the investors and companies in general.
- To assess the variation in performance of Environmental, Social and Governance (ESG) mutual funds in India.
- To study the risk and opportunities associated with the Environmental, Social and Governance (ESG) investment.

Research Questions

Based on the objectives of the study, the following research questions have been raised by the researcher:

- Are Environmental, Social and Governance (ESG) market important for the investors and companies?
- Does there are variation in performance of Environmental, Social and Governance (ESG) mutual funds in India?
- Does there are any risk and opportunities associated with the Environmental, Social and Governance (ESG) investment?

Research Methodology

Research methodology is one of the most important parts of the study which describes how the study has been done. It also describes the overall procedure including tools and techniques that have been used to carry out the research work. The methodology part here in the current study consists of sources of data, period of the study, sample size and hypothesis of the study.

Sources of Data

The study is empirical, analytical and exploratory in nature which is based on secondary sources of information and data, where the secondary sources of available information have been collected from various research articles, news reports, journals, research bulletins and published information. Various websites including blogs and news reports have also been visited by the researcher to find the relevant information related to the objectives of the study.

Period of the Study

The empirical part of the study is conducted for the period of last three quarters of year 2021 i.e. for the quarter ending 30th June 2021, 30th September 2021 and 31st December 2021. Since most of the ESG funds considered in the study are new and therefore last three quarters are considered here for the study whose data was available, and was thought of to be sufficient enough to draw inference there from by analyzing the performance variation of various funds considered here in the research work, and finally conclusion can be drawn from it.

Sample Size

To assess the variation in performance of Environmental, Social and Governancemutual funds in India, eight ESG funds have been considered for the study which is currently operating in our country. Therefore, the funds which have been selected in the current study as sample are Aditya Birla Sunlife ESG Fund, Axis ESG Equity Fund, ICICI Prudential Equity Fund, Invesco India ESG Equity Fund, Kotak ESG Opportunities Fund, Quant ESG Equity Fund, Quantum India ESG Equity Fund and SBI Magnum Equity ESG Fund.

Based on the relevant data and information collected, it was then analyzed to examine the performance variation among the ESG funds and also to understand the risks associated with ESG investment as well as the possible opportunities of ESG in the emerging market. Single factor ANOVA has been considered in the study to analyze the relevant data to arrive at definite findings of the study. Microsoft Excel has been used for the need and suitability of the research work. Finally, logical conclusion along with several recommendations and scope for further research in the concerned area has been provided by the researcher based on the clear and conceptual analysis and findings of the study such that the business entity along with its investors can sustain in this competitive market.

Hypothesis of the Study

On the basis of the objectives of the study, the following testable research hypothesis has been formulated by the researcher:

H_{01}: There exists no significant variation in mean Net Asset Value (NAV) among the ESG funds for the period of the study.

H_{11}: There exists significant variation in mean Net Asset Value (NAV) among the ESG funds for the period of the study.

Data Analysis And Discussion

ESG is more than simply Environmental, Social and Governance but it is about making a difference for the future businesses, investors and the entire world. Day by day the ESG considerations by the industries and companies are increasing and the firms which are adhering to the ESG standards are believed to create sustainable outcomes which will drive towards value and infuse growth while strengthening our societies and environment. ESG is more of a stakeholder centric approach of doing business and it is increasingly becoming at the top of the mind for the companies since it is essential to consider the global nuances that drive focus from one economy to another. The ESG metrics are not essentially part of mandatory financial reporting disclosures, though the companies are increasingly making such disclosures in their sustainability reporting standards or in their annual report such that the investors can get a better picture of the companies who are at par with the ESG standards.

For investors, the ESG market and its considerations are of growing priority and the companies which are having desirable ESG performance are associated with high financial performance. ESG investing is growing exponentially since more investors utilize ESG tools to support their investment decision making. Moreover, the company's stock prices which are having high ESG rankings are tend to be less volatile in nature and as per reports, the companies which are in the S&P 500 that ranked in the top quintile for ESG factors outperformed those who are in the bottom quintile by more than 25% points between the years 2014 to 2018. In the contemporary scenario, the importance of investing in ESG based companies are increasing since such rankings and scores are increasingly being published in the public domain where an investor can judge its effectiveness. Apart from ESG scores and rankings of the organizations, the reputational value of proactive approach to ESG issues is also being recognized by the investors attention such that the ESG oriented investing have also experienced a tremendous rise in recent years. Though ESG are non financial in nature for the business entity but this non financial factors are being increasingly applied by the investors as a part of their analytical process to identify material risks and its growth opportunities.

Table 1: Net Asset Value (NAV) of Environmental, Social and Governance (ESG) Funds for the last three Quarters

ESG Funds	30.06.2021	30.09.2021	31.12.2021
Aditya Birla Sunlife ESG Fund Regular Plan Growth	11.54	13.24	13.79
Axis ESG Equity Fund Regular Plan Growth Option	14.72	16.51	16.71
ICICI Prudential ESG Fund Regular Plan Growth	12.96	13.8	13.74
Invesco India ESG Equity fund Regular Plan Growth	11.24	12.93	13.33
Kotak ESG Opportunities Fund Regular Plan Growth	11.41	12.327	12.303
Quant ESG Equity Fund Regular Plan Growth	15.7811	18.3103	19.2314
Quantum India ESG Equity Fund Regular Plan Growth	15.63	17.04	17.22
SBI Magnum Equity ESG Fund Regular Plan Growth	147.2862	162.9996	168.016

Source: Retrieved from the website of the Mutual fund Association of India

Table 2: ANOVA - Single Factor

Groups	Count	Sum	Average	Variance
Aditya Birla SunlifeESG Fund Regular Plan Growth	3	38.57	12.85667	1.375833
Axis ESG EquityFund Regular Plan Growth Option	3	47.94	15.98	1.2007
ICICI Prudential ESGFund Regular Plan Growth	3	40.5	13.5	0.2196
Invesco India ESGEquity fund Regular Plan Growth	3	37.5	12.5	1.2307
Kotak ESGOpportunities Fund Regular Plan Growth	3	36.04	12.01333	0.273152
Quant ESG EquityFund Regular Plan Growth	3	53.3228	17.77427	3.191641
Quantum India ESGEquity Fund Regular Plan Growth	3	49.89	16.63	0.7581
SBI MagnumEquity ESG Fund Regular Plan Growth	3	478.3018	159.4339	116.9666

ANOVA Table

Source of Variation	SS	df	MS	F	P-value	F crit
Between Groups	55261.03	7	7894.433	504.3707	0.000	2.657197
Within Groups	250.4327	16	15.65205			
Total	**55511.46**	**23**				

Source: Computed by Researcher using Microsoft Excel

Based on the above Table 2, it can be seen that the value of F is 504.3707, which is greater than the critical value of F at 2.657197 with 95% level of confidence and at 5% level of significance having a P value of 0.000. Therefore, the Null hypothesis H_{01} is rejected and it can be said that there isa significant variation in mean Net Asset Value (NAV) among the ESG funds for the period of the study. It was also observed from the above table that SBI Magnum Equity ESG Fund Regular Plan Growth outperformed its peers for the period of the study with a average Net Asset Value of 159.4339 whereas Kotak ESG Opportunities Fund Regular Plan Growth was the least performer during the period of the study with a average Net Asset Value of 12.01333.

Risks associated with ESG Investment

There is always a risk associated with investment but the investors always want to diversify risk in the best manner possible. Every organization have their own problems and if ESG are considered taking society, governments and corporations; it has its own issues through which the investors can identify material risks which may heavily affect later if not now. Responsible investors are those who will invest considering the impact of change in voluntary regulations or guidelines as well as the requirements for transparency.

- ESG risk is the consideration of non financial risks arising from the environment, social and governance sustainability, product or service quality, reputation of brand, technological and legal risk, labor laws and regulations, compliance, strategic considerations and ethical conduct.

- ESG risks are also associated with social inequality and changes in climate; which are one of the global challenges across the country and it is too large for a single economy or a single investor to address the risks without significant widespread support.

- The challenges and risks associated with ESG such as privacy and data security, flood risk and rising sea levels, various regulatory pressures, demographic shifts and corruption practices are introducing new avenue of risk factors for investors that may not have been seen previously.

- ESG risks are also related to adaptation and mitigation of sudden environmental and governmental changes, working and safety condition, compliance to relevant laws and regulations and respect for human rights. Companies are facing such rising risk and complexity on a global scale and thereby the investors may reevaluate traditional investment approaches.

- Risks related to ESG also include water crisis, extreme weather events, environmental management practices and duty of care, data theft or fraud, cyber attacks, anti bribery, increased regulatory pressures, social and demographic shifts; which represent new or increasing risks for investors.

Opportunities of ESG for the Investors

ESG investment has grown considerably in recent years and the long term focus is not only on material risks, but opportunities also lie at the heart of ESG field of investment. With a lens of several ESG risks and issues, investors can also identify opportunities in the new companies those who are rising to address the challenges and mitigate the risks that are within the control of the company such that the stakeholders can get maximum return with their investment.

- The companies who are engaged with ESG investment helps the investors to provide with the most qualitative and accurate data. Stakeholders and shareholders make decisions from the information they know to be true which brings trust and confidence among themselves for investment.

- The opportunities of ESG is also linked with the emerging global frameworks and agreements which are keen to bring innovations and new technologies in the transition to a better economy which are free from several ESG risks, and also the companies who are able to manage, measure and mitigate such risks will get rewarded by the market.

- ESG based companies which exceed or even meet ESG reporting standards and governance criteria are attracted by global investors such that good ESG strategy translates to efficient and competent governance. A number of regional and global initiatives and entities have helped to set ESG guidelines and standards which continue to drive progress and has got tremendous future prospect.

- With an increasing value in ESG investment, the success of investing through ESG lies with the companies which have high performance in ESG metrics compared with their peers and better performance on ESG metrics can yield decreased interest rates and loan prices.

- The ESG market is finding unpredicted and new opportunities in an evolving competitive landscape which continues to evolve in the recent scenarioin its asset class coverage, thematic investing, benchmarking, data availability, and much more.

- The opportunities of ESG also lies in the fact that the companies which pay attention to ESG have a high culture of excellence and also better engaged employees who are much more productive, and thus the investors are also optimistic that adding ESG to a company can give them additional return.

Findings

On the basis of the above analysis and discussion of the study, it was found that there exists a statistically significant variation in performance and its value of all the Environmental, Social and Governance (ESG) funds for the period of the study considered in the current research work. It was observed that there is not much of a variation in Net Asset Value of the ESG funds except SBI Magnum Equity ESG Fund Regular Plan Growth which is completely an outperformer than the other seven ESG funds whose variance is also very high compared to other funds. SBI funds have outperformed then its peers and the probable reason being the market capitalization and growth of SBI over the years. The SBI funds have a high reputation and market value over the years which makes them one of the popular funds, be it in the ESG environment. The inheritance risk and the future probable opportunities involved with all the ESG funds are there but in some funds it maybe more variable and in some it maybe less. It was also observed that all the ESG funds have improved and grown over the month which signifies that the ESG environment and its funds are evolving and growing and the investors can be optimistic about the future ESG market.

Conclusion

Even though there are various risks linked with ESG investment, there are numerous opportunities for the market which are very much considered by the companies as well as the investors since the market is growing with ESG matrices in the current scenario. There will be always an exposure to ESG risks which is inherit in nature and therefore the companies should have the ability to manage and reduce them for the better benefit of the investors. It was also observed that the companies face greater scrutiny and rising complexities if they are not able to adequately manage their ESG risks and on the other hand, investors prefer those companies which have high ESG metrics and are able to manage such risks effectively. Over the years, the ESG market both for the companies and investors have risen such that investing responsibly or considering the ESG criteria in investment assessment and valuation can generate long term competitive financial returns along with having a positive societal impact. Different ESG metrics for different companies also plays a major part for the investors where they want to understand the relative advantages and demerits of different metrics which can help to identify a more complete picture of ESG risks and opportunities. ESG investing and its analysis has been of an increasing interest over the decades and various reports also shows that the companies which follow ESG practices are in a better position than its peers. A company following ESG criteria will indeed attain sustainable business advantage which will add measurable value to the business and its stakeholders. Therefore, in this changing world where competitive advantage is no longer measured by financial terms alone, ESG approach should be adopted by every company which will future proof the business by making necessary operational and cultural changes.

Recommendations

ESG is a new concept, especially in India and there are several risks that are associated with ESG environment and their investors. ESG funds involves in investment keeping in mind about the social and environmental factors in mind. The ESG funds are evolving and growing since they are maintaining adequate sustainablestandards as well as keeping the accounts and environment clean in the process. But there are certain inheritance risks that are associated with ESG which creates certain challenges for the investors as well as for the stakeholders. There are several opportunities associated with ESG market since it is a growing and evolving market, but that does not necessarily mean that the risk of ESG market can be nullified filly. Therefore, several recommendations have been given by the researcher regarding ESG market such that the market can sustain in future and investors can reap the benefits out of it.

- The government and the policy makers along with several committees who are in charge of several disclosures should take adequate and necessary steps regarding comparable and meaningful disclosures on matters and materials relating to ESG.

- The regulatory authority should also foster the issuers to adopt a proper framework for disclosing consistent and comparable ESG matters and also to identify how such frameworks could play a more concrete and authoritative role for the investors in near future.

- To avoid Environment, Social and Governance risk, the issuers should provide an explanationif no meaningful, consistent and comparable disclosure framework is adopted by the companies who are having ESG funds for the better benefit of the shareholders.

- There should be a standardized set of information about ESG policies and procedures that can play a proactive and definite role in defining narrative and standardized disclosures along with assessing companies which are following the disclosures or not.

- The ESG metrics along with its policies should identify a vision that will encompass the strategic goals at the society level that will finally backtrack to define the objectives and goals of the companies which are achievable such that the investors find it reliable.

Limitations of the Study

One of the major limitations of the study is that the research work is conducted based on only secondary sources of data. The number of ESG funds is limited in the current juncture and there is no scope of taking more number of ESG funds to expand the study which is also a limitation of the study. To ascertain the variation in performance of the ESG funds, only data for three quarters have been taken since some funds are newly incepted. The current study is based on simple and basic statistical tools which can be improved further in later literatures.

Scope for Future Research

The future researchers can conduct primary based research work to understand the perception of the investors regarding ESG funds, which may also give them a different kind of results and findings. The researchers in future may get more number of ESG funds to study in a much broader area since such funds are increasing day by day and therefore, future researchers can also take more number of data sets to generate more accurate and better results for the overall benefit of the investors. Cross country analysis and geographical specific research of the current research work can also be conducted by future researchers such that the results can be compared among different countries across the globe which may give a different kind of picture of the concerned research work. The future researchers can also conduct related studies by applying more appropriate and suitable sophisticated statistical tools using various models to ascertain better results.

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