Challenges to Sustainable Investing and the Way Forward

Goutham Sabbani

MSc FinTech, UK

Abstract: ***In recent years, the global dialogue on sustainable development has gained significant traction and this has led governments and corporations worldwide to reevaluate their strategies concerning environmental, social, and governance (ESG) issues. India, as a significant global market player, is now viewing sustainability as both an ethical imperative and a strategic opportunity. Sustainable investing in India requires that companies are evaluated for their societal contributions in addition to their financial returns, urging investors to consider a broader spectrum of social, political, and environmental factors. Recent studies advocate the importance of good governance in attracting foreign direct investment (FDI), important for advancing sustainability goals. In this paper, we examine the current ecosystem of sustainability investment in India, characterized by a mix of challenges and opportunities.***

Keywords: Sustainable investments, ESG, Green Finance, CSR

Recent years have raised concerns over environmental damage, social inequalities, and corporate governance issues bringing the concept of sustainable investing to light. Both investors and corporations are recognizing that focusing on sustainable practices can generate long - term value, mitigate risks, and enhance reputations.

As defined by Stobierski (2021), sustainable investing involves a range of strategies where investors aim to book financial gains while keeping environmental and/or social benefits under check. This caused a shift in investors' approach to assessing companies not only on their immediate financial figures but also on their contributions to society.

Surging Growth of ESG Investments in India

If you look at the comparison between companies in the MSCI India ESG Leaders Index and their counterpart sector peers, you will see that the former index has outperformed their peers by a margin of 105.66 levels as of Dec 2020.

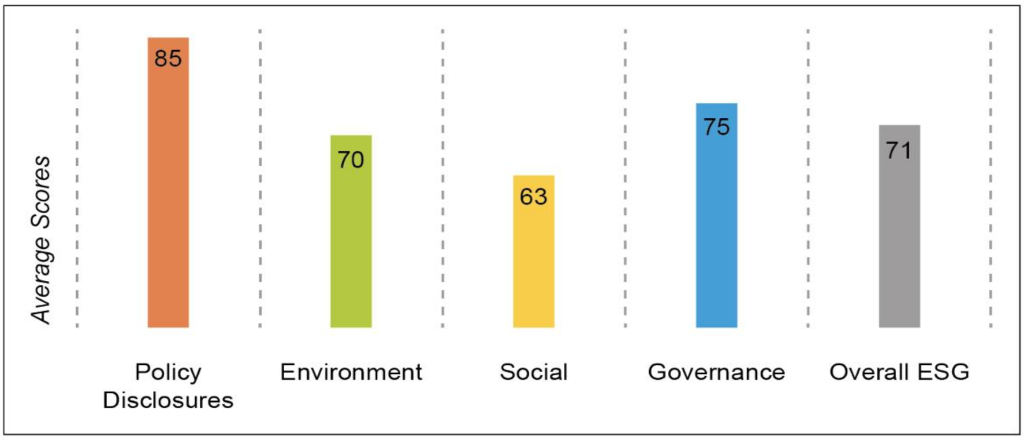
More importantly, during the COVID - 19 pandemic, indices that integrated ESG factors continued with better performance.

Source: MSCI (2021).

Source: ADB Institute

To provide context, consider a study that examined 50 publicly traded companies in India, which highlighted various aspects of their ESG performance (NSE 2020). The analysis showed that these companies generally performed better in disclosing policies compared to other ESG dimensions like governance, environmental, and social factors.

Among all the factors, policy disclosure followed by governance emerged as the most significant ESG component. And if you see the 50 companies, the leading three, excelling in ESG metrics, belonged to the automobile, chemicals, and consumer goods sectors. In contrast, companies in the metals and mining sector ranked lowest in terms of their ESG performance.

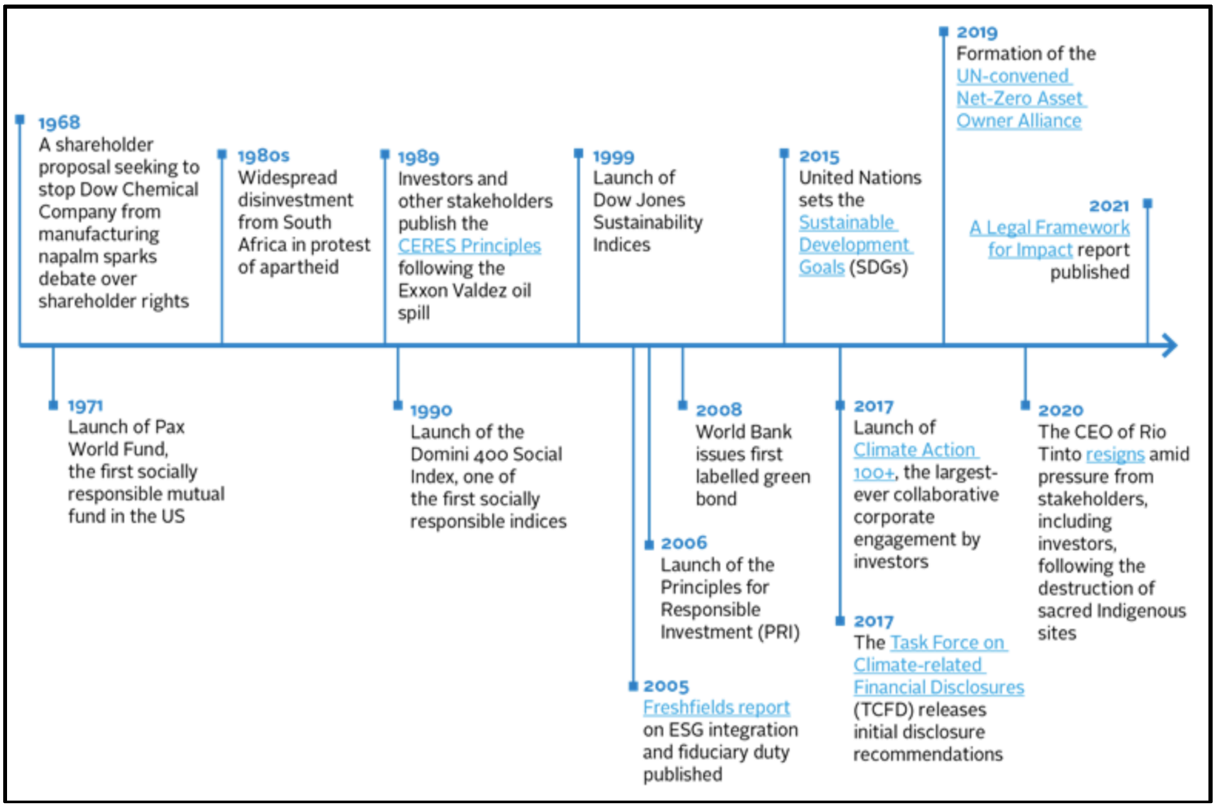


Source: NSE (2020).

Source: ADB Institute

Sustainable investing, often called responsible investing has a long history dating back from the mid of the 20th century. Over the years, various significant global events have shaped the evolution of this investment approach.

Milestones in the evolution of responsible investing



Source: UNPRI

Environmental, Social, and Governance (ESG) Framework

The latest Schroders' 2023 report highlights a significant shift toward sustainable investing as the world is looking up to deglobalization and decarbonization. While climate change and carbon footprints remain central to investor concerns, the scope of sustainability is broadening.

With the introduction of ESG regulations, there have been standardized frameworks for ESG reporting and disclosure. As a result, it is now easier for investors to compare companies' ESG performance. Also, Securities and Exchange Board of India (SEBI) guidelines have evolved from voluntary to mandatory ESG disclosures, significantly influencing ESG investment in India.

In addition to this, in 2020, the Reserve Bank of India (RBI) mandated banks to include ESG - related data in their annual reports, covering their strategies for managing climate risks, sustainable finance, and social responsibility. Also, banks are required to report on their contributions to social and environmental programs as per the RBI's directive.

Sustainable Investing Growth in India

As of June 2019, India boasted over 50 sustainable mutual funds and ETFs, mostly focusing on domestic firms, although some invest internationally in companies with strong ESG profiles. Equity funds remained the most prevalent type of sustainable fund, followed by debt funds. These funds with the asset value of ESG funds reached approximately 124 billion Indian rupees at the end of FY2022.

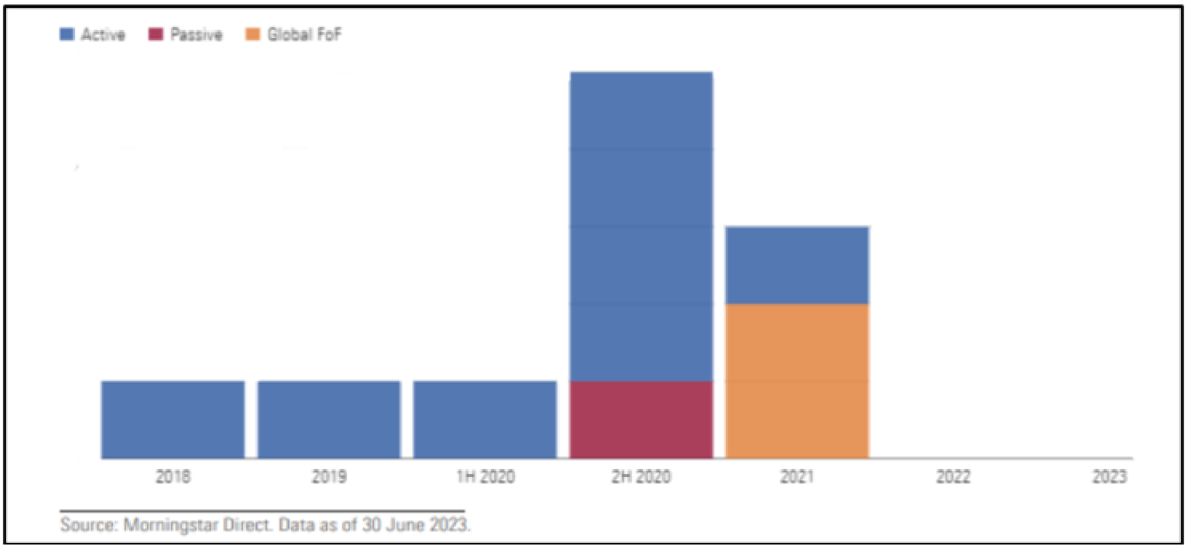
Between 2016 and 2018, the market for sustainable investments in India surged by 34% to $11.6 billion, driven by heightened awareness of environmental sustainability, the importance of UN Sustainable Development Goals, and a general increase in responsible investing interest, according to the Global Sustainable Investment Alliance. Government initiatives also play a crucial role, with the Indian government emphasizing sustainability and committing to meet its Paris Agreement climate targets and founding the International Solar Alliance.

Significant corporate contributions include pledges from major Indian companies like the Aditya Birla Group, which aims to achieve carbon neutrality by 2040, and Hindustan Unilever's commitment to responsibly source all its agricultural raw materials by 2020.

Challenges in Sustainable Investments in India

Needless to say, investors always have their specific areas of interest and product preferences to engage in sustainable practices. Nonetheless, several challenges remain. Sustainable investments may not always yield returns comparable to traditional investments and often diverge from conventional market behaviours.

Despite the regulatory push, the ESG funds are losing sheen in India. Indian sustainable funds have seen continued outflows, with Rs 10.6 billion exiting year - to - date as of June 30, 2023, following a similar trend in the previous year which recorded outflows of Rs 10.2 billion.



Source: Morningstar

One of the main hurdles in India is the inconsistent and unreliable ESG data. Many companies fail to disclose comprehensive ESG information, making it difficult for investors to assess their sustainability performance accurately. The lack of uniform ESG reporting standards further complicates the ability to compare and analyse these investments effectively.

Despite the increasing interest in ESG investing, India currently lacks a diverse range of ESG - focused investment products. Expanding the variety of options available, such as ETFs, ESG funds, and other sustainable investment vehicles, is essential to cater to different investor preferences. Greenwashing poses another significant challenge. It involves companies misleading consumers about their environmental efforts or the environmental benefits of their products and services.

The Way Forward

Despite these challenges, the outlook for sustainable investing in India remains optimistic. Companies and investors are encouraged to integrate ESG factors into their investment decision - making processes. Over time, this approach will not only make them more resilient and reduce risks but also open up new opportunities, enhancing their reputation and attracting more investors.

According to a 2021 study by the CII on sustainable investing, a five - dimensional model—encompassing Policy, Finance, Promotion, Facilitation, and Impact—is recommended. This model advocates for investments in technology that enhance health and safety, with a particular focus on specific sectors.

Final Thought

In a nutshell, ESG investing in India offers a pathway for aligning financial goals with broader societal and environmental objectives. Despite challenges like data limitations and evolving regulations, the growing appetite for ESG investments is propelling progress. India is actively pursuing sustainability, aiming to lead in renewable energy with ambitious goals to reduce emissions and boost green energy capacity. The country's commitment is evident in its policies and the recent 125% surge in renewable energy investments, positioning India to achieve energy independence by 2047 with a focus on sustainability and inclusivity.

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