An Overview of ESG Funds and Its Relevance

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Abstract:

There is shift of investors at global level in the direction of business which is sustainable from the conventional profit-oriented. Investing with an eye on environmental, social, and governance (ESG) criteria has recently gained popularity. A company's environmental and social impact, as well as its corporate governance, should be favorable if it is to receive investment from an ESG fund. The goal of ESG investment is to reward businesses that are responsible stewards of the natural environment and human communities' i.e. social environment in which they operate. This paper discusses about the relevance of ESG funds. Further it also discusses various advantages, disadvantages and risks associated with ESG funds. It is concluded that ESG investment will unquestionably play a more major role and alter the way companies in India and elsewhere operate in the new normal. In the long run, this is beneficial for businesses and society as a whole.

Keywords: Environmental, Social, and Governance ESG, Investors, Risks, Funds

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Introduction:

Profitability, returns, cash flow creation, solvency etc. are major financial considerations for investors. Non-financial factors, such as business dedication for ensuring environmental protection, having social conscientiousness and good governance, are now progressively more acknowledged by investors in the choice of investments. This is because there is shift at global level in the direction of business which is sustainable from the conventional profit-oriented. Investing with an eye on environmental, social, and governance (ESG) criteria has recently gained popularity.

Funds with a focus on environmental, social and governance (ESG) aspects are different from traditional investment vehicles. A company's environmental and social impact, as well as its corporate governance, should be favorable if it is to receive investment from an ESG fund. Creating value for the investors simultaneously having favorable societal and environmental impact is the goal. There are a plethora of ESG funds that may be used to make investments in equity, real estate and bonds stock. More and more people are looking to connect their investments with their beliefs and values, therefore ESG funds have become more popular in the present scenario. While the United States and the United Kingdom each have more than 500 ESG funds, Japan has 182, and China has 119, India, the world's fifth biggest economy, has just 23.

Global warming records have been broken every year over the last few decades. The melting of glaciers may be directly attributed to global warming, and in turn, to the businesses that emit greenhouse gases. It is of the highest importance to ensure sustainable development as the growing economies use extra resources to reach new heights of growth. The goal of ESG investment is to reward businesses that are responsible stewards of the natural environment and human communities' i.e. social environment in which they operate.

Common financial market practices tend to go where the money is. As a result, the goal of ESG investment is to incentivize ethical and environmentally responsible company behaviour. Stocks with strong environmental, social, and governance (ESG) ratings are gaining attention from institutional investors.

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Review of Literature:

When compared to investing in conventional funds, Xiao-Guang Yue et al. (2020) discovered that investing in sustainable funds carries a lower risk. Based on their analysis of available data, Helena Naffa and Máté Fain (2020) concluded that sustainable funds generated superior returns to the market across the board over the research period.

Sarkar(2022) reports that the study's main results suggest that Indian investors are becoming more interested in ESG funds, however this trend is progressing more slowly than in other developed countries. Maybe this is because Indian investors aren't yet sold on the concept of ignoring ESG considerations while putting up their portfolios. In spite of this, things are predicted to change in the next years because to measures by market regulator SEBI to encourage environmental, social, and (corporate) governance aspect to assess firms, as well as the attractive return possibilities. Quant ESG Equity Fund and Invesco India ESG Equity fund, both of which are quite newer to the market, are the greatest performances thus far, according to the research of current ESG funds. The oldest of these funds, SBI Magnum Equity ESG Fund, has, sadly, fallen short of investors' hopes and dreams. Despite the fact that Kotak and ICICI underperformed the market portfolio in 2021 and overall, the other six funds did much better. Even after accounting for risk, the returns are substantial. This demonstrates that, even after accounting for risk, ESG funds are highly rewarding investment choices that should be pursued further by investors in order to get long healthy returns in the long run.

Objectives of the Study:

1. To know about ESG Funds
2. To discuss advantages and disadvantages of ESG Funds
3. To discuss risk associated with investing in ESG Funds

Research Methodology:

Secondary data such as reports available on web portals, annual reports, articles in dailies, papers in journals are adopted for this study.

ESG Funds:

Equity mutual funds with a focus on environmental, social, and governance (ESG) best practices are known as ESG equity funds. ESG investments are made with the intention of supporting firms that are actively working to improve the world around them. Similarly, many ESG funds will avoid investing in businesses that produce harmful goods or services, such as cigarettes or nuclear weapons.

The financial year 2021 was a watershed moment for ESG investments throughout the world. The number of mutual funds and the total value of assets under administration for such funds had almost doubled during the preceding three years. Global investors have been cautious in their approach to investing, with many now seeking to invest in a socially responsible manner. The fact that ESG funds finally break even as the epidemic sweeps the world is sensitive justice.

Although ESG investment is a relatively new initiative in India, it is gaining popularity among investors. This is particularly true in the wake of the COVID-19. The proliferation of environmental, social, and governance (ESG) theme funds in the last several years, led by firms like Kotak, ICICI Prudential, AXIS AMC and Quantum India AMC, is evidence of this trend. It's worth noting that SBI Mutual Fund has also converted its equities fund to an ESG Fund.

There is a common belief that ethical businesses will reap financial benefits in the form of increased sales and brand recognition. Company revenues and customer loyalty may both benefit from ESG strategies in the long term. In the long run, a business that prioritizes ESG factors will be more likely to succeed. That's the main reason why sustainable investment is another name for ESG investing.

ESG Funds and Traditional Mutual Funds:

There are significant distinctions between ESG mutual funds and conventional mutual funds. The company prioritizes initiatives that benefit the country's infrastructure, population, and overall quality of life. Not only that, but they may use varying weighting techniques and investment screens in making their selections.

In order to maximise profits, conventional mutual funds often ignore environmental, social, and governance concerns. This implies that conventional mutual funds could finance corporations with a poor track record when it comes to protecting the environment or society. Mutual funds that focus environmental, social and governance (ESG) issues aim to generate profit while simultaneously improving society. Investing in such firms may include choosing those with the smallest carbon footprints or the most progressive employment policies. Furthermore, ESG mutual funds often avoid investing in firms involved in questionable industries like tobacco production.

Equity investments in ESG firms are consistent with the goals of ESG funds which include green business practices, an improvement in society as a result of the company's goods or procedures and discipline in business ethics and corporate governance

ESG funds' investments one strategy may be to simply avoid investing in "sin" stocks such those that promote harmful products. Impact investment is another method that should be considered. One of the main goals of impact investing is to incentivize beneficial changes in either the environment or society with financial gains. Providing financial resources to solve societal issues with broad effect is the core of impact investing.

Methodologies for evaluating firms and selecting those that will be included in ESG funds are created in-house. ESG funds often skip the oil, mining, and other utilities industries but are in favor of the technology, consumer segment and financial services. Sector exposure standards are not enforced for these types of investments. To counter this, the majority of ESG funds prioritize a company's compliance with carbon emission standards, resource efficiency, and corporate responsibility.

Types of ESG Funds:

There is a wide range of ESG investment options available. Here are some typical examples:

1. Green funds put their money into businesses that are doing their part to protect the planet.
2. Funds with a focus on social good make investments in organisations that are making a difference in the world in some way, whether it's by expanding way in to healthcare or education.
3. Ethical funds prioritize businesses that do not engage in unethical practices like the use of child labour or contamination of environmental
4. Investment funds focused on accomplishing the United Nations' Sustainable Development Goals (SDGs), such as those related to reducing greenhouse gas emissions and expanding gender parity, are known as "sustainable development goals" (SDG) funds.

Advantages and Disadvantages of ESG Funds:

Environmental, social, and governance funds (ESG funds) are a kind of investment vehicle that prioritizes these three areas.

Long-term, ESG funds have also been shown to outperform their more conventional equivalents. Additional social and ecological advantages may be gained by investing in ESG-focused vehicles. One would support good change in the world through investments in firms that are industry leaders in ESG principles. In addition, your money is going to businesses that care about doing the right thing for the environment and their employees and have good internal practices.

Investors may find it useful to use ESG funds in order to better coordinate their financial decisions with their personal beliefs.

When compared to traditional investment options, ESG funds may provide higher returns for the same level of risk.

Investors may diversify their portfolios and lessen their exposure to risk by using ESG funds.

Disadvantages of Investing in ESG Funds:

It is not uncommon for an analyst or a fund manager to be the source of information on a company's social, environmental, or governance performance. Such information may also be found in the sustainability report of a certain organisation. Annual reports, press releases, etc., are other credentials that may be used to get more information about ESG. It may be time-consuming and misleading for investors to look for specific information on the ESG practices of a certain firm. As a result, the lack of trust in the information currently accessible remains a barrier to expanding ESG investments in India.

One problem is that there are no established metrics by which ESG investment performance can be evaluated in the Indian market. Impact investment, socially responsible investing, and sustainable investing are all terms used by

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investors. Standardization in data collection, measuring standards, and reporting methods is necessary for the development of this kind of investment.

Those with more conventional worldviews, such as many investors and fund managers, may see ESG as superfluous spending. This slows down ESG investment in India.

ESG funds in India have begun over the last couple of years; therefore they don't have much of a track record. Therefore, many potential investors may be discouraged by the fact that ESG funds don't have much of a track record.

Even though ESG investment is becoming more popular, not many people are aware of it. To expand the reach of ESG investment, more investors should be aware of its merits.

How well ESG funds do is heavily reliant on the businesses and sectors in which they invest.

Fees are a major issue for many ESG funds and may significantly reduce profits over time.

Most businesses have some exposure to environmental or social challenges, making it difficult to locate entirely "green" investments.

Risks Associated with Investing in ESG Mutual Funds

Investing in an ESG mutual fund requires careful consideration of a number of issues. Certain fantastic benefits may be gained from these funds, but they also carry some dangers. There are a few things to keep in mind before investing in an ESG mutual fund:

1. Due to their exclusive focus, ESG mutual funds may not be as diversified as other funds available to investors. Lack of diversification may raise the overall risk and volatility of a portfolio.
2. Investors should be aware that the investment opportunities accessible to you through an ESG mutual fund may be more restricted than those offered by a traditional mutual fund. As a consequence, investors may have a more difficult time finding the best assets for investors portfolio, and investors may even miss out on certain opportunities.
3. Finally, it's important to understand that ESG mutual funds often have greater costs than other investing vehicles. As a consequence of their specialist nature, these funds often have higher operating expenses.

Conclusions:

In today's global economy, ESG is relevant to all firms, and its value is being recognized by to a greater extent. Presently investors and other stakeholders are increasingly demanding more information on how ESG investments are made. ESG investment will unquestionably play a more major role and alter the way companies in India and elsewhere operate in the new normal. In the long run, this is beneficial for businesses and society as a whole. As more individuals explore for ways to put their money to work, investments in firms with which they agree are gaining appeal. The key to success when investing in ESG funds is to do your homework and choose the best option. An informed investor is one who is aware of the potential gains and losses associated with ESG investments. Investors with a long-term perspective will definitely benefit from ESG Fund investment.

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