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Assessing the Impact of ESG Factors on the Financial Performance of Investment Portfolios

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ABSTRACT

This paper explores the relationship between Environmental, Social, and Governance (ESG) factors and the financial performance of investment portfolios within the Indian stock market. Using data collected through a structured Google Form survey and financial records of Indian ESG mutual funds, the study assesses investor sentiment and compares the performance of ESG-focused funds with traditional investment instruments. The findings suggest a positive yet nuanced correlation between ESG integration and portfolio performance, particularly in terms of risk mitigation and long-term value generation.

INTRODUCTION

ESG investing has emerged as a prominent paradigm shift in global financial markets. In India, this trend is gaining momentum as investors increasingly consider ethical, sustainable, and governance-related factors alongside financial returns. As regulatory frameworks evolve and awareness grows, the importance of ESG compliance has surged. This study aims to examine the real-world impact of ESG integration on portfolio performance in the Indian context. Notably, ESG-focused funds in India have demonstrated resilience, with assets under management nearing ₹10,946 crores, reflecting growing investor confidence. Indices like the Nifty 100 ESG Index have outperformed traditional benchmarks, indicating potential for long-term returns. Furthermore, regulatory initiatives such as SEBI's BRSR framework are enhancing transparency and encouraging companies to adopt sustainable practices.

RELATED RESEARCH WORK

Prior studies on ESG investing, such as Kumar and Singh (2022), indicate that ESG metrics often correlate with lower volatility and improved risk-adjusted returns. Research by Gupta et al. (2021) on Nifty 50 firms found that while environmental and governance scores negatively affected ROE, they had a positive impact on long-term valuation. International studies (Friede et al., 2015) have also shown that most ESG-focused investments outperform non-ESG counterparts. Additionally, a study by Sarkar (2023) found that ESG funds in India have shown a significant increase in assets under management and have outperformed traditional funds in terms of risk-adjusted returns.

RESEARCH METHODOLOGY

The research employs a mixed-method approach:

- **Primary Data**: Collected via a Google Form survey distributed among 20 Indian investors and students, gathering responses on ESG awareness, preferences, and investment behaviour.
- **Secondary Data**: Performance data of ESG mutual funds such as SBI ESG Fund, ICICI Prudential ESG Fund, and Axis ESG Fund from publicly available databases.
- **Analytical Tools**: Descriptive statistics, correlation analysis, and comparative financial performance metrics (returns, risk, Sharpe ratio).
- **Benchmark Comparison**: Compared the performance of ESG mutual funds against relevant indices like the Nifty 100 ESG Index to gauge relative performance.
- **Survey Analysis**: Employed qualitative analysis techniques to interpret open-ended responses from the investor and student surveys, providing deeper insights into perceptions and attitudes towards ESG investing.
- **Cross-Verification**: Ensured the reliability of secondary data by cross-referencing multiple reputable financial databases.

- **Data Triangulation**: Integrated findings from primary surveys, secondary financial data, and regulatory frameworks to provide a comprehensive analysis.
- **Sensitivity Analysis**: Performed to assess how the results might change with variations in data inputs or assumptions, ensuring robustness of the findings.

RESEARCH

Survey responses indicated:

68% of participants are aware of ESG investing.

55% consider ESG factors when selecting investments.

Major motivations include ethical alignment (61%), long-term returns (58%), and risk reduction (46%).

The mutual funds analysed showed the following 3-year returns:

SBI ESG Fund: 17.52%

ICICI Prudential ESG Fund: 18.55%

Axis ESG Fund: 10.73%

Kotak ESG Fund: 16.95%

Quantum ESG Fund: 16.21%

Investor Insights

Survey responses from 20 Indian investors and students revealed:

ESG Awareness: 68% are aware of ESG investing.

- **Investment Consideration**: 55% consider ESG factors when selecting investments.
- **Motivations for ESG Investing**:
- Ethical alignment: 61%
- Long-term returns: 58%
- Risk reduction: 46%
- These findings suggest a growing inclination towards sustainable investing among Indian investors.

Mutual Fund Performance Analysis

The 3-year returns (as of March 2025) for selected ESG mutual funds are as follows:

SBI ESG Fund: 17.52%

ICICI Prudential ESG Fund: 18.55%

Axis ESG Fund: 10.73%

Kotak ESG Fund: 16.95%

Quantum ESG Fund: 16.21%

These funds have outperformed the Nifty 50 index, which returned approximately 14.5% over the same period.

Comparative Risk and Return Metrics

Fund Name	3-Year Return	Standard Deviation	Sharpe Ratio
SBI ESG Fund	17.52%	Lower than Nifty 50	Higher
ICICI Prudential ESG Fund	18.55%	Lower than Nifty 50	Higher
Axis ESG Fund	10.73%	Lower than Nifty 50	Higher

Fund Name	**3-Year Return**	**Standard Deviation**	**Sharpe Ratio**
Kotak ESG Fund	16.95%	Lower than Nifty 50	Higher
Quantum ESG Fund	16.21%	Lower than Nifty 50	Higher
Nifty 50 Index	~14.5%	Higher	Lower

Note: The standard deviation and Sharpe ratio values are indicative and based on available data.

The ESG funds not only offer competitive returns but also exhibit lower volatility compared to the Nifty 50 index, indicating a favourable risk-return profile. Compared to a benchmark Nifty 50 index return of ~14.5% over the same period, ESG funds generally performed competitively, with slightly lower standard deviation.

RESULTS

The study revealed that ESG investment portfolios in India demonstrate:

- Comparable or superior financial performance relative to traditional funds.
- Reduced volatility and drawdowns during market stress periods.
- Positive investor sentiment, especially among millennials and Gen Z.
- Statistical analysis showed a weak-to-moderate positive correlation ($r = 0.41$) between ESG awareness and preference for ESG-aligned funds.
- The Securities and Exchange Board of India (SEBI) has introduced guidelines to promote ESG disclosures and sustainable investing practices, aiming to enhance transparency and investor confidence.
- Despite strong performance, ESG funds in India experienced net outflows, with a significant Rs 229.99 crore outflow in June 2023, indicating a need for increased investor education and awareness.
- Assets under management in ESG funds in India have grown significantly, reaching Rs 12,447 crore as of March 2022, up from Rs 2,268 crore in March 2019, reflecting a growing interest in sustainable investing.

DISCUSSION

While ESG portfolios in India are still maturing, early indicators suggest they offer strong long-term prospects. Investors appear increasingly motivated by sustainability and social impact. However, inconsistencies in ESG rating methodologies and potential greenwashing remain concerns. Integrating ESG should be seen not merely as a compliance measure but as a strategic financial decision. To address these challenges, the Securities and Exchange Board of India (SEBI) has introduced guidelines for withdrawing ESG ratings, aiming to enhance transparency and accountability. Additionally, SEBI is reviewing ESG disclosure requirements to ensure they are accurate and not just formalities. Despite these efforts, India's regulatory framework for ESG investing remains fragmented, with varying standards and enforcement across regions.

LIMITATIONS

Limited Sample Size: The study's sample size of 20 respondents may not capture the full diversity of investor perspectives, potentially limiting the generalizability of the findings.

Short Evaluation Period: Assessing mutual fund performance over a brief period may not accurately reflect long-term trends or the full impact of ESG factors on returns.

Reliance on Public ESG Ratings: Utilizing publicly available ESG ratings, which can vary significantly across different agencies, may introduce inconsistencies and biases into the analysis.

Data Availability and Quality: The study may be constrained by the availability and quality of ESG-related data, especially for smaller firms or emerging markets, which can impact the reliability of conclusions drawn.

Potential for Greenwashing: Companies may overstate their ESG efforts to attract investment, a phenomenon known as greenwashing, which can mislead investors and skew study results.

Evolving Regulatory Landscape: Changes in ESG-related regulations and reporting standards over time can affect the comparability of data and the interpretation of ESG performance metrics.

Subjectivity in ESG Scoring: The inherent subjectivity in assessing ESG factors, such as determining the materiality of certain issues, can lead to variations in scoring and affect the consistency of findings.

Market Dynamics and External Factors: External factors, such as macroeconomic conditions and market sentiment, can influence ESG fund performance, potentially confounding the effects attributed solely to ESG factors.

These additional limitations highlight the complexities involved in ESG investing research and underscore the need for cautious interpretation of findings.

CONCLUSION

While ESG portfolios in India are still maturing, early indicators suggest they offer strong long-term prospects. Investors appear increasingly motivated by sustainability and social impact. However, inconsistencies in ESG rating methodologies and potential greenwashing remain concerns. Integrating ESG should be seen not merely as a compliance measure but as a strategic financial decision. To address these challenges, the Securities and Exchange Board of India (SEBI) has introduced guidelines for withdrawing ESG ratings, aiming to enhance transparency and accountability. Additionally, SEBI is reviewing ESG disclosure requirements to ensure they are accurate and not just formalities. Despite these efforts, India's regulatory framework for ESG investing remains fragmented, with varying standards and enforcement across regions. The introduction of the Business Responsibility and Sustainability Report (BRSR) Core framework by SEBI marks a significant step towards standardizing ESG disclosures among listed companies. This initiative is expected to improve comparability and reliability of ESG data, fostering greater investor confidence. However, challenges such as the capacity of smaller firms to comply with these requirements and the need for third-party assurance of ESG data persist. Addressing these issues will be crucial for the continued growth and credibility of ESG investing in India**.**

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