

ESG INVESTING

INTRODUCTION

*The key to understanding the future is one word:
Sustainability*

ESG (Environmental, Social & Governance) Investing has been gaining momentum in recent years. Also referred to as Socially Responsible Investing or Impact Investing, it involves allocating and investing capital in organizations that strive for a better world. The core premise is that there exist certain environmental, social and corporate governance factors that influence and impact a company's performance. These factors are as follows:

Environmental - This includes the impact that a company creates on the environment, and can be measured through parameters like its carbon footprint, sustainability efforts in the company's supply chain, etc.

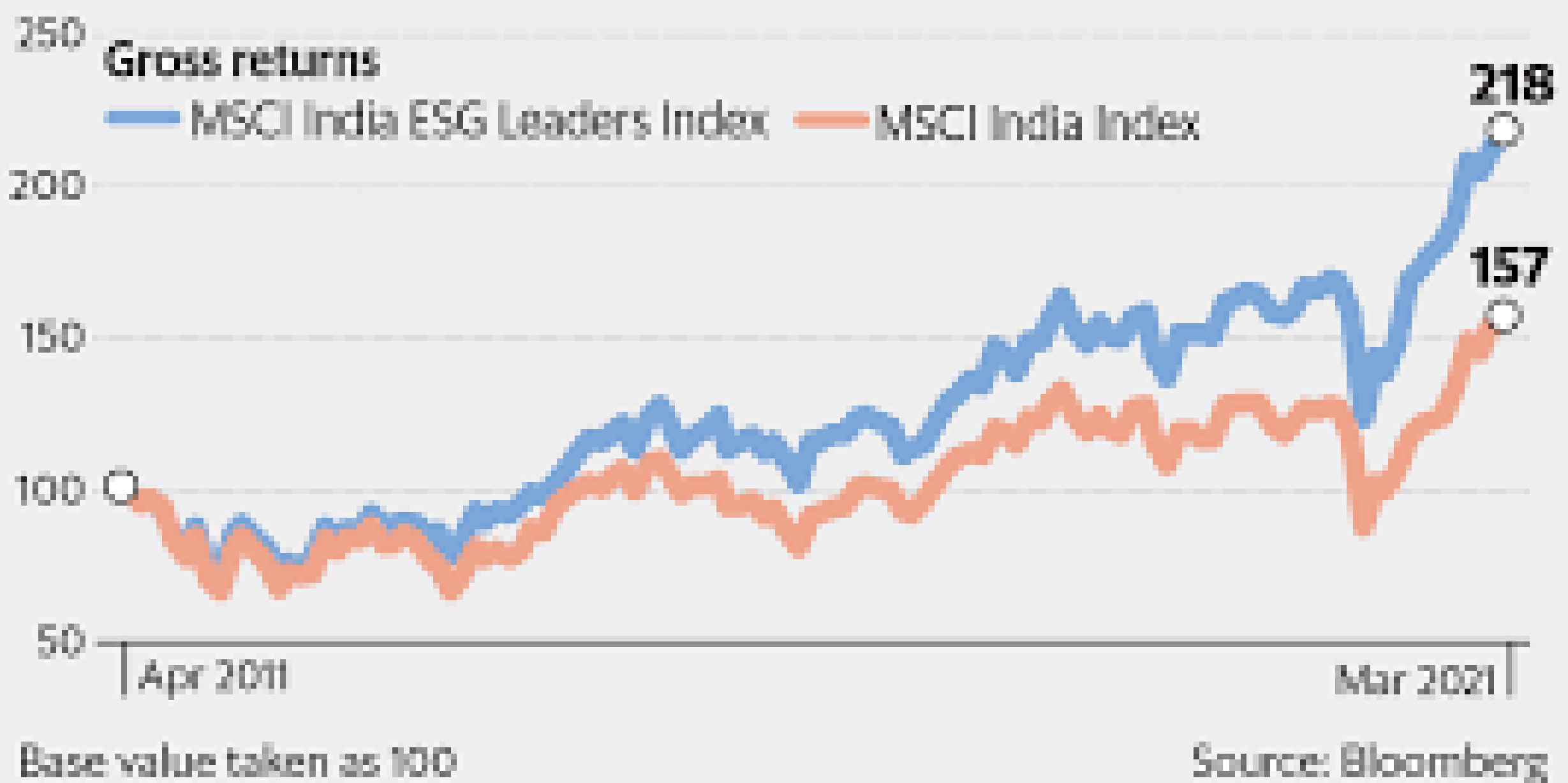
Social - This includes the company's contribution and impact both within the company and towards humanity as a whole. It encompasses the company's impact on the LGBTQ+ community, racial diversity through its hiring systems, its products, its marketing, and other activities.

Governance - This includes the role of the company's top management and its Board of Directors, the leadership of the company, and the integrity and honesty of the people in charge.

There has been rising acknowledgement of investing, putting assets into creating economies, specifically in the midst of increasing international vulnerabilities attributable to the COVID-19 pandemic. Organizations with solid ESG credentials are believed to perform well monetarily with a noticeable expansion in the offer costs versus their rivals. This shows the expanded incorporation of ESG into resource evaluation. Curiously, the gamble and return compromise for financial backers have additionally changed after the beginning of the pandemic.

Sustainable growth

There is early evidence to suggest that adherence to sustainability factors is a key source of alpha generation.



BLUEPRINT FOR ESG INVESTING

1. Government-controlled funds

Government-controlled funds like pension funds are prominent players in the investment field. They are pressured by citizens and activist groups to adopt investment policies that urge ethical corporate behaviour, respect the rights of workers, give consideration to environmental concerns, and do not violate human rights. An amazing endorsement of such policies is The Regime Pension Fund of Norway, which is mandated to avoid investments that constitute an absolutely unacceptable risk of a Fund potentially playing a role in perpetuating unethical behaviour or omissions, for example, violations of basic humanitarian principles, serious violations of human rights, corruption or severe environmental damages.

2. Mutual funds and ETFs

ESG investing has provided a great pathway for mutual funds and ETFs. A shift in focus towards sustainable investing has been observed in today's investors. ESG assets in India have grown at 22% from 2006 to 2021 when the Principles of Responsible Investing (PRI) network was established. However, although ESG investing has been steadily gaining momentum in the last five years, efforts are still in the nascent stage. It has been estimated that inflows in ESG mutual fund schemes in India have increased by 76 per cent in 2021, from Rs 2,094 crore to Rs 3,686 crore in the time period 2019-20. The Nifty 100 ESG Index has specifically been designed to track the performance of companies on the Nifty 100 based on ESG scores. This index has outperformed its parent, Nifty 100, across multiple timeframes. The Nifty 100 ESG Index also outperformed the Nifty 50.

3. Community investing

Community investing, a subset of socially responsible investing, allows for investment straight into community-based organizations. Community investing institutions employ investor capital to finance or assure loans to individuals and organizations that have historically been replaced by old-fashioned financial institutions. These loans are utilized for the housing, microscopic trade creation. Education or personalized development in the US and UK are accessible to local financial institutions abroad to finance international community development. The community investing institution typically supplies training and other types of support and expertise for ensuring the success of the loan and its returns for investors.

4. ESG Integration

ESG integration is an approach for long-term sustainability that aligns with environmental, social, and governance goals. It is an investment technique in which environmental, social, and governance (ESG) considerations and risks are systematically studied and used to determine whether or not to acquire or hold an asset, and to what extent. Such considerations, on the other hand, may also lead to the liquidation of a security from a portfolio.

More investors are considering relevant and material ESG factors, as well as other financial and non-financial considerations, in their buy/hold/sell decisions or when deciding on position weightings within a portfolio, guided by the belief that these factors, along with other financial and non-financial considerations, can have an impact on an entity's performance over time, including stocks and bonds. Furthermore, ESG considerations are in line

with investors' increasing desire to make a positive social effect.

It is helpful to all stakeholders, not just corporations. Investors also benefit in terms of long-term returns, brand value, and reduced investment risk. With ESG integrated portfolios, investors' reputations remain good. Better staff attraction, retention, engagement, and productivity are all benefits of ESG integration.

In the long run, ESG-integrated businesses remain ethical, accountable, and transparent.

BENEFITS

1. Competitive Returns:

Companies investing in ESG initiatives have reaped great returns. According to a 2020 report by Oxford University, it is in the best interest of managers and businesses to implement sustainability considerations into their decision-making process. This has augured well for their investors also.

Moreover, enterprises like Coca-Cola have implemented ESG compliance by steps like reducing 20% water intensity in their production process and generating great returns. Companies investing in ESG initiatives have reaped better returns.

2. Diversification:

Investors can categorize companies that score high on ESG norms and do away with companies that are performing badly. This will subsequently enable investors to diversify their portfolios.

3. Contributes to Nature:

Investing in ESG funds boosts the climate-conscious activities of all organizations, as it acts as an incentive to adopt environment-friendly and better social practices.

It generates healthy competition in companies to score better so as to rank higher on the ESG list. This leads to environmentally sustainable practices.

CHALLENGES

1. Keeping up with ESG Regulatory Changes:

Regulatory bodies have been working to achieve a global standard definition of “environmental” , “social” and “governance.” With that standardization comes a fresh wave of regulations and compliance requirements. For instance, you cannot just label any business as “sustainable” or ‘green’ because your institution or firm unilaterally decided so. For example: To avoid ‘greenwashing’ practices a company needs to meet strict requirements as set out by the European Commission.

2. Setting Internal ESG Investing Standards and Goals:

ESG investing has a different meaning for different institutions and finance professionals. The definition of environmental, social, and governance will thus vary to some extent between one financial institution or firm and another. It may additionally vary within the institution itself depending on the targeted investors.

Banks and investment firms will therefore need to conduct a thorough audit

and risk assessment to determine ESG investment goals. These institutions must also establish the criteria that will be used in order to ensure portfolios and the investments included therein meet the stated goals. For instance, the efficiency of an organization in balancing ESG credentials with the management of factors, such as credit risk, cost reduction, and consolidation.

3. Getting Reliable Data:

ESG analysis has been growing in importance as part of the ESG investment process. Each company and industry has its own specific ESG risks and opportunities. The application of ESG criteria in the process of due diligence is of pivotal importance in evaluating potential operational, reputational, or regulatory risks. This can only happen, however, when there is access to accurate, reliable, and relevant ESG data. One of the biggest challenges for investors is that this information is collected in various aspects and requires an assortment of sources that must be continually updated. Examples include a business's financial data, operational and organizational data, environmental impact metrics, and market data. These measurements simply start to expose what's underneath.

CONCLUSION

ESG is the buzzword in financial markets in 2022. ESG or Environment, Social and Governance parameters are used by the new generation of investors for judging companies and choosing where to put their money. In other words, today's investor prefers to invest in companies that act responsibly towards the environment and the community in which they function while ensuring ethical governance within their corporate structures.

The COVID-19 pandemic has given a big push to the ESG theme. There has been a shift in investor values and sentiments towards socially responsible investing (SRI) and impact investing. In addition, there has been a greater focus on climate change and its impact on our lives worldwide, leading to the theme of “conscious investing” gaining traction in 2022.

ESG investing represents a good opportunity for financial institutions and investment firms to reduce investment risk, while simultaneously catering to values-driven investors and promoting higher ethical standards. While there are certainly challenges to ESG investment integration that need to be addressed, the long-term benefits of ESG will touch both the companies and the wider society and they certainly outweigh the costs to be incurred.

In conclusion, ESG investment is a win-win for both businesses and investors. Better ESG ratings have a positive impact on stock performance, which is great for all stakeholders.

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