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Investing in socially responsible mutual funds as a means of sustainable development.

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Abstract

Most of the business organizations are devising their business strategies by considering the social responsibility concepts for their sustainable development and development of the economy. Sustainable development has become the necessity of the world in terms of protecting nature, natural resources, the welfare of society, and living things to maintain economic balance. Over the past few years, environmentalists and socialists have expressed strong opposition to companies producing harmful products, polluting the environment, and destroying natural resources by creating awareness through conferences and seminars.

Socially responsible investing or impact investing is not a new concept. It is a concept of corporate social responsibility which evolved in many phases like community engagement, socially responsible production, and socially responsible employee relations. Many social structures like religions, non-government organizations, and the ideals followed in different religious systems also played a major role in promoting the concept.

This article gives clear-cut information on the concept of socially responsible investing, its origin, and its importance in the sustainable development of the economy with respect to the ESG funds of the mutual fund industry in India and the world. The data is purely based on secondary sources of information.

Keywords: Socially responsible investing, Impact investing, Ethical investment, ESG mutual funds.

Meaning of SRI

Sustainable, responsible and impact investing (SRI) is a relatively new discipline that speaks to investors' need to balance financial performance with core values. As an investment strategy, SRI considers environmental, social and corporate governance (ESG) criteria to generate sustained growth while maintaining a positive social impact.

THE GROWING SOCIALLY RESPONSIBLE INVESTING MARKET

ESG criteria, as defined by MSCI, is outlined in the chart below:

Environmentally Responsible	Socially Responsible	Responsible Governance
Carbon Intensity	Affordable Real Estate	Board Flag
Fossil Fuel Reserves	Education	Board Independence
Water Stress	Major Disease Treatment	Board Diversity
Energy Efficiency	Healthy Nutrition	Entrenched Board
Alternative Energy	Global Sanitation	Overboarding
Green Building	SME Finance	Shareholder Rights
Pollution Prevention	Human Rights Violations	Fund Ownership
Water Sustainability	Labor Rights Violations	Poison Pill
	Customer Controversies	Executive Compensation
	UN Principles Violations	Accounting Flags
	Catholic Values	
	Sharia Compliant Investing	
	Adult Entertainment	
	Alcohol	
	Gambling	
	Nuclear Power	
	Tobacco	
	Weapons Involvement	
	Firearms	
	Predatory Lending	
	GMO Involvement	

ORIGIN OF SOCIALLY RESPONSIBLE INVESTING (ETHICAL INVESTMENT)

Socially responsible investing is not a new concept as it can be traced back long ago in history in different parts of the world in different forms like a religious rule, the management or administration principle in maintaining business activities or in the form of culture. In spite of a consensus that ethics had been a vital consideration for funding decisions, the applying of the precept varied; some businesses used it as a guideline, others required it by law. The idea for SRI varies between spiritual groups, resulting in many various interpretations of the subject. This has been shown in the following figure 1.1.

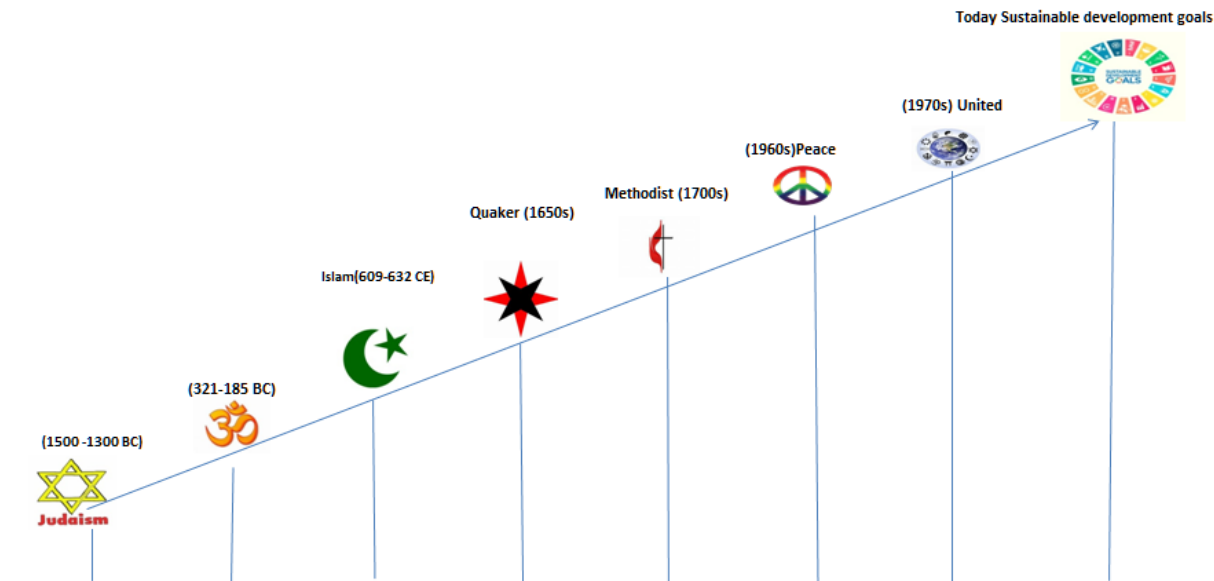


Figure 1.1

Religious sources that have driven towards the rise of the concept of socially responsible investing.

JUDAISM (1500-1300BC)

Judaism as shown in the above diagram as the premise of the origin of moral or impact investing sought a necessity for justice/equity in all facets of economic activities. Jewish Law states that it's a righteous act of property owners to make the best use of their holdings to prevent expeditious and possible harm.

Most of the Biblical and rabbinic sources conferred with the ethics of single house owners or limited partnerships. Jewish non-secular figures ultimately addressed the ethics of shareholder responsibility. Since shareholding is a type of ownership, traders should give consideration to thinking about the moral obligations of an organization earlier than investing. This prevented followers from investing in "immoral" firms like oil, coal, and gas which impact human health.

Hinduism (32-185 bc)

The idea dates to the "**Mauryan**" history of India in the form of corporate social responsibility in administrative affairs, where philosophers like **Kautilya** emphasized ethical practices and principles while conducting business. Many Indian scriptures mentioned the importance of sharing one's earnings with the deprived section of society for social welfare.

ISLAM (609-632CE)

The guidelines surrounding investments called Shariah-Compliant Finance in Islam were based on the teachings of the **Quran** which aims to govern the relationship between risk and profit, along with individuals and institutional responsibilities by forbidding them from investing in alcohol, pork products, immoral goods, gold silver, and weapons. Quran states that money should be a medium of exchange, not an asset that grows over time. And "**Riba**" mentioned in the Quran aims to prevent exploitation from the use of money by prohibiting the payment or receipt of all forms of money, including all sorts of interest payments, gambling, or uncertainty.

QUAKER (1650S)

“Quakers” who were the members of the Religious Society of Friends, a group based in England since the 1650s, were primarily interested in Christianity for their opposition to slavery and war. In 1758, the Quaker Philadelphia Yearly Meeting prohibited its members from participating in the slave trade, which was one of the first occurrences of SRI in its current form. Eventually, some Quakers went on to establish two of the largest financial institutions in modern history: Barclay’s and Lloyd’s.

METHODIST (1700S)

The Methodist movement led by John Wesley in 1703 is a prelude to the modern exclusionary investment screening in the form of SRI. He strongly opposed investing in industries and business practices that caused potential harm to workers and surrounding neighbors under the title called "The use of the money" during the sermon. His followers eventually started resisting investment in “sinful” companies involved in tobacco, firearms, and alcohol. This way Methodists were articulated as early adopters of SRI.

The earliest forerunner of socially responsible investing goes back to the Pentateuch – the primary five books by the Bible believed to have been written by Moses as early as 1500 BC. The books ask a Jewish concept called Tzedek (justice and equity) and the way it should govern all aspects of life. Tzedek aimed to correct the imbalances that humans inevitably generate, including the advantages one would receive from ownership. Owners had rights and responsibilities in how their holdings were used, one of which was to stop any immediate or potential harm. This principle formed the genesis of socially responsible investing, providing religious and indigenous cultures with a group of criteria on the way to generate financial returns ethically and sustainably.

MODERN ERA: THE RISING POPULARITY OF SRI

In America in the mid-1900s, investors began to avoid investing in “sin” stocks. In 1928, the Boston-based Pioneer Fund was founded by Philip L. Carret which in the year 1950 embarked on its journey with the rise of modern socially responsible investing by strictly avoiding sin stocks—companies that dealt in alcohol, tobacco, or gambling and each decade brought forth an influx of socially concerned investors:

THE '60S

Socially responsible investing in the 1960s was largely driven by politics, student, and trade union concerns about the Vietnam War which arouses dissatisfaction among students and other young people. These led to protests against the Vietnam War and the boycott of companies that provide weapons used in the war. Meanwhile, civil rights and racial equality rose in prominence.

Community development banks that were established in low-income or minority communities were part of a movement that produced the Civil Rights Act of 1964 and the Voting Rights Act of 1965.

THE '70S

During the seventies, social activism spread to labor-management issues at corporations, while protection from 20 million Americans convened for the first Earth Day celebration, opening the door for a cascade of environmental and consumer protection legislation. It also became a consideration for more investors in early 1970s. As the decade wore on, concerns that many activists had over the threat of pollution from nuclear power plants were heightened with the accident at the Three Mile Island nuclear power plant.

Society at large reacted to the war, emerging environmental issues, and racial inequality, human trafficking, and a number of other political and cultural issues. Socially responsible investing along with religious beliefs influenced socially responsible investors.

A significant breakthrough for socially responsible investing occurred in 1970, when Ralph Nader—a consumer advocate, environmentalist, and later independent candidate for president of the United States—succeeded in getting two socially based resolutions on the annual meeting proxy ballot of General Motors, it was the first time that the federal Securities Exchange Commission permitted social-responsibility issues to appear on a proxy ballot even though being both votes failed.

THE '80S

During 1980, a standardized approach to SRI investing was made by avoiding investments in alcohol, tobacco, weapons, gambling, and environmental pollution. This avoidance was paired with a commitment to shareholder activism by investment firms, and, as a result, a practice allowed shareholders to leverage their own to improve a company's behavior.

1990S

By 1990 the SRI mutual funds and socially conscious investing popularity necessitated the need for a performance measure which made The Domini Social Index (which is now the MSCI KLD 400 Social Indexes) launch in 1990. Many potential investors thought that SRI returns would have lower returns than traditional ones, but this index disproves those claims.

2000S ONWARDS

By early 2000, SRI's continued to gain popularity all over the world through a number of initiatives in funds and supporters.

In 2006, the United Nations Principles for Responsible Investment was launched which established guidelines for mainstream investors to incorporate ESG (environmental, social, and governance) issues into investment practices.

This made SRI Investors prioritize a positive impact, sparking a rise in ESG and impact investing. This forward-thinking approach was reinforced by the UN Sustainable Development Goals in 2015. These goals, backed by all 193 UN Member States, are an urgent call to solve the world's most pressing development challenges.

Present days, acceptability of positive approaches to sustainability challenges and concerns about social issues (income and wealth inequality, climate change, pollution, and corruption) worldwide have made corporations and businesses to continue to address their impact on social issues and strengthen their stances going forward.

An increasing number of socially responsible investors and their accompanying growth in demand in the proliferation of funds and strategies made companies to integrate ethical considerations into the investment process. Environmental, social, and governance (ESG), socially responsible investing (SRI), and impact investing are industry terms used interchangeably by clients and professionals as they all match in meaning and approach. However, distinct differences exist to the extent of the client's portfolio structure and investments that are suitable for meeting social impact goals.

THE IMPORTANCE OF ESG FACTORS AND ANALYSIS PAVES THE WAY FOR SUSTAINABLE DEVELOPMENT OF THE COUNTRY AND INVESTORS.

The importance of ESG funds and its analysis is listed below:

1. COMPONENT OF QUALITY:

ESG factors play a crucial part in the investment process by accessing the quality of a company. Long-term investors invest in companies after paying attention to company management, competitors, and suppliers and conducting a thorough analysis of companies' existing business fundamentals, which determines the competitive advantage and sustainability of a company. Companies concern especially on good corporate governance, financial strength through high returns on invested capital, high margins, strong cash conversion, low capital intensity, and low leverage,. Etc., and its concern for environmental or social well-being determines it's a competitive advantage as being an important component of quality.

2. ESG FACTORS IMPACT INVESTMENT RISK AND REWARD.

In a global economy each country is dependent on cross-border trade, complex supply chains and diverse workforces extending around the globe and at the same time companies are increasingly confronted with environmental issues, such as climate change, water scarcity and pollution, as well as social factors including product safety and relationships with regulators and the communities in which they operate. In this context, ESG can directly impact a company's competitive positioning. Therefore, managing environmental and social factors is simply part of sustaining competitive advantage in today's economy.

3. ESG EXTERNALITIES MAY NOT BE NOT FULLY PRICED INTO THE VALUE OF COMPANIES.

Companies externalizing the price of environmental and social issues earn excess profits and the cost of externalities is paid by the investors hence investors should analyse companies esg factors.

BACKGROUND AND PERFORMANCE OF ESG FUNDS IN INDIA

ESG funds are evolving funds in India whose main focus is to pick quality companies by incorporating Environmental, Social, and Governance (ESG) factors and with environment-friendly and ethical practices. They invest in companies that score high on environmental, social, and governance parameters. This concept has gained popularity in developed countries and is gaining momentum in India recent when SBI Mutual Fund converted its SBI Magnum Equity Fund into a ESG theme fund in 2018.

SBI Magnum Equity ESG Fund became the first ESG fund in India and in 2019 Quantum Mutual Fund launched the first ESG Fund NFO and introduced Quantum India ESG Equity Fund, followed by Axis ESG Equity Fund (February 2020), and ICICI Pru ESG Fund (October 2020).

As of now there are only 4 ESG funds having a combined AUM of around Rs 6,000 crore; with 2 new additions to the list in India, and some more are on the verge of launch.

SBI Magnum Equity ESG Fund-Growth

Investment Objective

The scheme seeks to provide investors with opportunities for long-term growth in capital through an active management of investments in a diversified basket of companies following Environmental, Social and Governance (ESG) criteria.

quant ESG Equity Fund, Mirae Asset ESG Sector Leaders ETF, and Mirae Asset ESG Sector Leaders Fund of Fund are the new ESG Fund .

Quant ESG Equity Fund

Quant ESG Equity Fund is an actively managed open-ended thematic fund that will focus on investing in companies identified based on the ESG theme.

The **investment objective** of the scheme is to generate long-term capital appreciation by investing in a diversified portfolio of companies demonstrating sustainable practices across Environmental, Social, and Governance (ESG) parameters.

- The fund offers Regular Plan and Direct Plan having Growth Option and Dividend Option (Dividend Re-investment and Dividend Pay-out facilities).
- The scheme's performance will be benchmarked against Nifty 100 ESG TRI (Total Return Index).

Mirae Asset ESG Sector Leaders ETF

- Mirae Asset ESG Sector Leaders ETF is India's first ESG ETF.
- It will be a passively managed fund that will be replicating/tracking Nifty 100 ESG Sector Leaders Total Return Index.
- The **investment objective** of the scheme is to generate returns, before expenses that are commensurate with the performance of the Nifty 100 ESG Sector Leaders Total Return Index, subject to tracking error. The Scheme does not guarantee nor assure any returns.
- **Investment Strategy - Mirae Asset ESG Sector Leaders ETF**
 - Mirae Asset ESG Sector Leaders ETF will be managed passively with investments in stocks constituting the Nifty100 ESG Sector Leaders Index.
 - It will endeavor to track the benchmark index and invest in the similar proportion (weightage) as in the Nifty100 ESG Sector Leaders Index.

- Under normal circumstances, 95% to 100% of the funds portfolio will be invested in Securities included in the Nifty100 ESG Sector Leaders Index.
- Notably, Nifty100 ESG Sector Leaders Index aims to track the performance of select companies within each sector of the Nifty 100 that have scored well on management of ESG risk and do not have involvement in any major controversies.
- The index tracks a portfolio of select large cap stocks within each sector performing well on ESG parameters. It excludes companies involved in any major Environmental, Social, or Governance controversy, or those engaged in the business of tobacco, alcohol, controversial weapons, and gambling.
- The investment strategy of the fund would revolve around reducing the tracking error to the least possible through regular rebalancing of the portfolio, considering the change in weights of stocks in the Index as well as the incremental collections/redemptions in the scheme.
- A part of the fund's portfolio may be invested in debt and money market instruments to meet the liquidity requirements.
- It can invest up to 5% of its assets in Money market instruments / debt securities, Instruments and/or units of debt/liquid schemes of domestic Mutual Funds.
- The fund will not invest in ADR/ GDR / Foreign Securities / Securitized Debt/ structured obligation/ Repo in Corporate Debt Securities nor will it engage in short selling.

Mirae Asset ESG Sector Leaders Fund of Fund

- Mirae Asset ESG Sector Leaders Fund of Fund is an open-ended fund of fund scheme that will invest predominantly in Mirae Asset ESG Sector Leaders ETF.
- The **investment objective** of the scheme is to provide long-term capital appreciation from a portfolio investing predominantly in units of Mirae Asset ESG Sector Leaders ETF. There is no assurance that the investment objective of the Scheme will be realized.

Investment Strategy - Mirae Asset ESG Sector Leaders Fund of Fund

- Mirae Asset ESG Sector Leaders Fund of Fund will predominantly invest in units of Mirae Asset ESG Sector Leaders ETF, the portfolio of which will be mostly based on stocks forming part of Nifty100 ESG Sector Leaders Index.
- Under normal circumstances, 95% to 100% of the fund's portfolio will be invested in Units of Mirae Asset ESG Sector Leaders ETF.
- It can invest up to 5% of its assets in Money market instruments / debt securities, Instruments, and/or units of debt/liquid schemes of domestic Mutual Funds.
- The fund will indirectly benefit from the underlying exposure to stocks scoring high on Environmental, Social, & Governance parameters.
- Notably, the underlying Mirae Asset ESG Sector Leaders ETF endeavors to track the Nifty100 ESG Sector Leaders Index that carries a portfolio of select large cap stocks within each sector performing well on ESG parameters.

Both the funds intent to directly and indirectly replicate the portfolio and track the performance of the Nifty100 ESG Sector Leaders Index (TRI).

The index comprises true to the label ESG focused portfolio with underlying research by Sustainalytics, one of the leading ESG research provider globally. It excludes companies with significant on-going controversy and therefore reduces the risk associated with such companies.

Accordingly, the underlying exposure of both the funds will be in companies that are sustainable from an environmental and social perspective along with having the best governance practices.

Being a passively managed fund, Mirae Asset ESG Sector Leaders ETF will closely track the performance of Nifty100 ESG Sector Leaders Index TRI by mirroring its portfolio, without any deep analysis on stocks. Accordingly, the fund's portfolio will be restricted to stocks that are the constituents of the index.

Notably, Mirae Asset ESG Sector Leaders Fund of Fund too will be exposed to the above index. Its performance will rely solely on the performance of the underlying Nifty100 ESG Sector Leaders Index TRI, subject to tracking error of the underlying ETF.

Both the Mirae ESG funds are suitable for investors looking to hold passive exposure in Nifty100 ESG Sector Leaders Index TRI. Being passively managed, one should not expect the fund manager to generate alpha over the benchmark index.

The underlying drive behind ESG theme-based investing lies in generating returns from socially responsible, environment friendly and ethical firms. It reduces the company-specific risk associated with ESG controversies.

CONCLUSION:

The growing concern towards ESG factors all around the world has initiated the many investors including mutual fund investors to look for more ethical, impact investment or SRI stocks in companies which made them to consider the valuation, sustainability and fundamental risks inherent in every portfolio position. The trend to invest in SRI funds initially started in developed countries but awareness is gradually increasing among mutual fund investors of developing countries including India this is evident from the launch of 2 new funds- Quant ESG Equity Fund and Mirae Asset ESG Sector Leaders .SRI investing not only boost up economic development but also good for long term mutual fund investors to speed up their capital appreciation if planned accordingly.

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