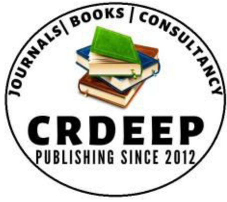

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International Journal of Research in Engineering and Management (ISSN: 2456-1029)
A Peer Reviewed UGC Approved Quarterly Journal

SJIF: 3.39

Research Paper

Sustainable Investing in Practice, ESG Challenges and Opportunities

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ARTICLE DETAILS

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Key words:
Conceptual framework, ESG investing, Impact investing, Sustainable investments, Socially responsible investing.

ABSTRACT

It is widely accepted in research and practice that sustainable entrepreneurship and start-ups play a key role in accelerating the transformation of society and business towards a sustainable development. Environmental, social and Governance can help identify companies that are likely to face challenges due to environmental and technological trend, and changing regulatory demographics. Incorporating ESG practices into business operations can help improve risk management, enhance reputation, and to increase stakeholder engagement. The article examined three widely accepted approaches to sustainable investing: The first section examines Environmental, Social and Governance (ESG), and impact investing. The second section explains the ESG challenges facing businesses and manufacturers in India and discusses strategies for overcoming them. The final section explores on ESG future opportunities. The findings of this study reveal overlapping conceptual frameworks of ESG and impact investing. The paper recommends the development of a consistent conceptual framework for sustainable investing.

1. Introduction and Background

In a world where people are becoming more aware of how our actions impact our climate and this planet, unions and regulations are formed to help halt worsening the situation. Sustainable frameworks are being put into practice to ensure that companies are acting according to certain regulations, and investing in such practices are becoming increasingly popular. ESG - which stands for Environmental, Social and Governance, is therefore becoming an important part of financial markets all over the world. Businesses focus more energy towards making sure their business is sustainable as investors generally believe that ESG can be used as a benchmark in order to determine how your organization positively affects the world. Over the past few decades, mounting worries about environmental degradation, social injustice, and corporate governance problems have given rise to the idea of sustainability investments. Investors and companies are becoming more aware of how a focus on sustainable practises may result in the production of long-term value, a reduction in risks, and an improvement in reputation. (Stobierski, 2021)Sustainable investing denotes to a variety of practices under which an investors intends to gain financial returns by endorsing long-term environmental or social value. By integrating environmental, social, and corporate governance (ESG) ideas with conventional investment methodologies, investors are able to provide more thorough evaluations and make better investment decisions. With sustainable investing, businesses are assessed on its overall contributions to humanity afore just its immediate monetary success. Investors need to carefully assess the potential effects of their decisions on the social, political, and environmental spheres. (Damodaran, 2022)According to a survey by Benori Knowledge, Indian PE and VC firms expect their investments in sustainable projects to reach $125 billion by 2026. Government legislation, consumer demand for socially responsible brand conduct, and the explosive rise of cleantech and green initiatives are the main drivers of this growth.

The concept of a social economy has existed globally for decades. Only more recently, a specific market segment in finance has been developed targeted at generating both societal and environmental returns (Nicholls, 2021). To this end, sustainable investing has fundamentally disrupted the financial industry's traditional value chain and ecosystem by challenging finance's core premise, wealth maximisation. The innovations presented by the sustainable finance model

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Received: 11-02-2025; Sent for Review on: 16-02-2025; Draft sent to Author for corrections: 24-02-2025; Accepted on: 28-02-2025; Online Available from 06-03-2025
DOI: 10.13140/RG.2.2.31534.01603
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bring into play constructs such as "shared value" and "blended value propositions" (Dyllick& Muff, 2016). These concepts imply the integration of ESG considerations into financial decision-making and analysis, which serve as financial innovations to generate financial and societal returns (Yue, Han, Teresiene, Merkyte, & Liu, 2020). These sustainable investment strategies are closely aligned with the attainment of sustainable development, which is typified by humanity's ability to meet the needs of the present generation without compromising future generations (Talan & Sharma, 2019). However, these studies used one database to collect related articles.

Sustainability Investing in Practice

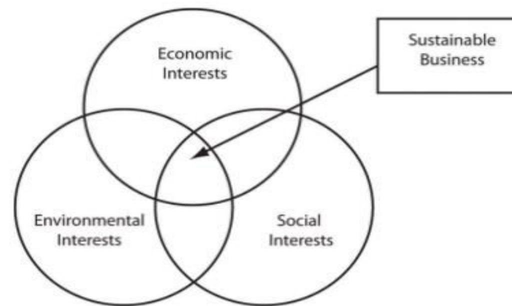

Fig 1.1 Sustainable Business

Sustainable investing refers to a range of practices in which investors aim to achieve financial returns while promoting long-term environmental or social value. Combining traditional investment approaches with environmental, social, and corporate governance (ESG) insights has led to investors generating more comprehensive analyses and making better investment decisions. Sustainable investing ensures firms aren't judged solely on short-term financial gains but on a broader picture of what and how they contribute to society. Investors must think critically about investments' potential impacts as they relate to environmental, political, and societal landscapes. (Tim Stobierski 14 July 2022).

In recent times, there has been an increase in the popularity of sustainable investing in India as more investors seek to match their investments with their ideals. In response, asset managers have introduced several sustainable investment options.(majorsustainability, n.d.) A wide range of methods in the field of sustainable investing, suggesting a change in investment tactics to take environmental, social, and governance (ESG) aspects into account. (Ezeokoli, 2017)The report bring following approaches in sustainable investing. It includes Negative screening, positive screening, ESG integration, impact investing.

1. ESG Integration: This entails adding ESG components to conventional financial analysis. Along with its financial metrics, investors analyse a company's performance based on its ESG practises. Stocks, bonds, and funds are just a few of the asset classes that might benefit from ESG inclusion. The incorporation of ESG opportunities and hazards into conventional financial analysis and investment choices. ESG data and analysis are a crucial aspect of the due diligence process even though ESG outcomes are not what decide outcomes

2. Impact Investing: The express goal of impact investing is to bring about quantifiable social or environmental effect along with financial rewards. These expenditures frequently go towards initiatives or endeavours that specifically address problems, including the lack of affordable housing or access to clean water. This method of sustainable finance is motivated by the creation of favourable social and environmental results. While financial returns are essential, there is more tolerance for returns that are lower market value as much as the preferred impact is judged to have been achieved.

3. Negative screening: Negative screening entails avoiding investments in businesses or sectors that are deemed detrimental to society or the environment. Tobacco, firearms, fossil fuels, and certain human rights violators are examples of frequent exclusions. Investment decisions are based on the investor's desire to avoid certain undesired social and/or environmental effects. Product categories (such as tobacco, firearms), actions (such as animal testing), or behaviours (such as corruption, labour rights violations) can all be used as exclusion criteria.

4. Positive screening: Actively choosing investments based on their favourable ESG characteristics is known as positive screening. Investors look for businesses that meet particular ESG standards, such using renewable energy, promoting gender diversity, or using sustainable supply chains. This approach chooses investments centred on what an investor prefer or want to as opposed to making decisions based on what and investor dis approve or do not want (negative screening). Investments are chosen in comparison to industry peers based on priority ESG variables and desired social and/or environmental results.

5. Thematic and Index Based: The focus of thematic investing is on particular sustainability issues or topics. Investors provide money to industries that are tackling problems like renewable energy, water scarcity, innovative healthcare, or education. Building an investment portfolio around a particular impact theme (such as gender equity or clean water) or a recognised index, like MSCI or the Dow Jones Sustainability Index, which ranks and rates businesses based on their environmental and social responsibility

2. Sustainable Investing in India

A recent report by the Reserve Bank of India (RBI) highlights that up to 4.5% of the country's GDP could be at stake by 2030 due to lost labour hours caused by climate change issues, extreme heat and humidity. Surprisingly, 50% of India's GDP comes from sectors that work in excess heat. Considering the impact of the annual cycle of pollution generated from such sectors, the drain of economic productivity would be much greater. Failure to not meet sustainable development goals extends beyond economic challenges. This article explores the importance of sustainable development while highlighting the challenges and how to move beyond them to reward sustainable development for India.(Annapoorna Nov 18 2024).

In recent years, Environmental, Social, and Governance (ESG) investing has gained significant traction worldwide, including in India. As investors recognize the need to align their financial goals with sustainable development, ESG investing has emerged as a powerful tool for creating positive impact alongside financial returns. This article explores the growing importance of ESG investing in India, highlighting its key drivers, current trends, and the potential it holds for a sustainable future. (Kuldeep singh Chauhan June 01 2023). Understanding ESG Investing: ESG investing involves considering a company's environmental, social, and governance performance alongside traditional financial metrics. It focuses on assessing a company's sustainability practices, its impact on society, and the effectiveness of its corporate governance. By incorporating ESG factors into investment decisions, investors aim to generate long-term value while supporting companies that contribute positively to the environment, society, and governance practices.

1. Regulatory Support: The Securities and Exchange Board of India (SEBI) has played a crucial role in promoting ESG investing by introducing guidelines that require the top 1,000 listed companies to disclose their ESG-related activities. These guidelines enhance transparency and encourage companies to improve their ESG practices.

2. Investor Demand: Investors in India, including institutional investors, asset management companies, and retail investors, are increasingly recognizing the potential of ESG investing. The demand for sustainable investment options is driven by the growing awareness of climate change, social issues, and corporate governance scandals.

3. Business Opportunities: ESG investing presents significant business opportunities for companies in India. By adopting sustainable practices and focusing on ESG factors, businesses can enhance their operational efficiency, reduce risks, attract capital from responsible investors, and gain a competitive advantage in the market.

4. Integration of ESG Factors: Indian investors are integrating ESG factors into their investment strategies across various asset classes. From equities and bonds to private equity and venture capital, investors are actively seeking opportunities that align with their sustainability goals.

5. ESG Data and Ratings: With the increasing demand for ESG investing, there is a growing emphasis on reliable and standardized ESG data and ratings. Indian companies are improving their ESG disclosures, and rating agencies are developing comprehensive frameworks to evaluate and rank companies based on their ESG performance.

6. Green Bonds and Sustainability-Linked Instruments: India has witnessed a surge in green bond issuances, which are used to fund environmentally friendly projects. Additionally, sustainability-linked instruments, where

7. The Potential for a Sustainable Future: ESG investing in India has the potential to drive positive change and contribute to a sustainable future in several ways:

8. Climate Change Mitigation: By directing capital towards renewable energy projects, sustainable infrastructure, and clean technologies, ESG investing can help India transition to a low-carbon economy and reduce its carbon footprint.

9. Social Impact: ESG investing promotes companies that prioritize social issues such as gender equality, diversity and inclusion, labor rights, and community development. This creates positive social impact and contributes to a more equitable society.

10. Governance Enhancement: ESG investing encourages companies to adopt robust corporate governance practices, ensuring transparency, accountability, and ethical behavior. This fosters investor confidence and helps prevent corporate fraud and misconduct.

3. Environmental, Social, and Governance (ESG)

The three main subheadings under sustainable investing are environmental, social, and governance. They represent the different types of investment areas that fall under sustainable investing. Environmental investments closely examine the way a company considers non-renewable resources, climate, and the move toward clean energy. Social aspect of sustainable investing looks at causes that consider human rights and diversity concerns. They include topics like gender equality and support for underprivileged communities. Governance aspect of sustainable investing looks to companies that promote business ethics, as well as trust, transparency, and compliance in the marketplace. They are companies that perhaps make ethical business practices one of their top priorities. In such companies, ethics are a central focus, and profits are not the central theme of their corporation or institution.

The insights from latest Schroders' 2023 report shows that there is a significant shift towards the sustainable investing as world transferences to Deglobulisation and decarbonisation. How an investor perceive and apply sustainability in investing differs and concept is still evolving. Though Climate change and carbon foot prints remain forefront in the investors thought process, sustainability has got wider spectrum. ESG is a novel approach for sustainability which gained popularity in recent. It's a structure used to evaluate an organization's business practices on numerous sustainability issues

The emergence of ESG rules has resulted in the creation of a legislative framework that lays out standards for firms to adhere to when it comes to ESG reporting and disclosure. By establishing a framework for ESG reporting, investors will find it simpler to compare the ESG performance of various businesses. The adoption of ESG disclosures to force businesses to go beyond conventional finance-centric models is one step towards attaining these goals. An organization's business practises and risk management in relation to environmental, social, and governance criteria are evaluated using the ESG framework's policies are gaining ground in India as a result of increased investor awareness of ESG potential and risks, a focus on business sustainability, and governmental pressure to adopt responsible investment practises. ESG investing has grown in popularity in India and the banking industry is likewise evolving in the direction of creating an ESG framework when conducting a credit valuation and incorporating climate risk into its risk assessment method. The RBI issued a circular in 2020 mandating that banks disclose their ESG-related data, including their approaches to managing climate risk, sustainable finance, and social responsibility, in their annual reports. Banks were also expected to report on how they have funded social and environmental programmes under the circular. Investors are looking for opportunities where their money can support larger societal and environmental objectives in addition to financial benefits. This is in line with a trend towards more ethical capitalism, in which achieving financial success is not sacrificed for moral and environmental goals.ESG investing offers patrons a optimal opportunity to increase their wealth by actively involved in the movement towards sustainable practices.

4. Sustainable Investing, ESG Challenges :

Investments in Environmental, Social, and Governance (ESG) have grown astoundingly in the last few years. A growing consciousness of environmental and social issues, such as corporate governance, inequality, and climate change, is responsible for this upsurge. Investors want to support businesses that exhibit responsible practices because they are becoming more aware of the wider impact of their investments. The environment is now the focal point of this changing landscape because addressing climate change is more urgent than ever. Countries all over the world have enacted a range of climate action plans or international accords such as the Paris Agreement, which set targets for cutting greenhouse gas emissions. Governments are now imposing stricter regulations on the extraction and production of fossil fuels, such as limiting the number of new coal-fired power plants and eliminating fossil fuel subsidies. Tailpipe emission standards are being tightened, and most European countries have set a deadline for the end of ICE (Internal Combustion Engine) vehicle sales. The United Nations Principles for Responsible Investment (UNPRI) reports that over 800 ESG policies have been developed, with 96 per cent of them post-2000. In 2021 alone, 225 new or revised policy instruments were introduced, doubling the changes seen in 2020.(Outlook Business Desk 6 march 2024).

According to ESGDS, which boasts a team of over 240 domain experts, institutional investors grapple with several major challenges:

1. Greenwashing: Some companies or funds may exaggerate their environmental or social credentials, making it difficult for investors to identify truly sustainable options.
2. Lack of standardization: The absence of universal ESG reporting standards can lead to inconsistent or unreliable data.
3. Performance measurement: Quantifying the non-financial impact of sustainable investments remains challenging, particularly for social and governance factors.
4. Short-term vs. long-term returns: The focus on long-term sustainability can sometimes conflict with pressure for short-term financial performance.
5. Data quality and availability: Obtaining comprehensive, accurate ESG data for all companies, especially in emerging markets, can be difficult.
6. Poor Data Quality: Inadequate research or controls often result in low-quality ESG data, making it difficult to make informed investment decisions.
7. Lack of Data Granularity and Provenance: Investors face challenges due to the absence of detailed data and clear data sources, hindering their ability to assess ESG risk and performance accurately.
8.Transparency Issues with Rating Providers: Current rating providers often fall short in providing the transparency required to evaluate ESG risk and performance effectively.
9.Technical Expertise: Effective ESG data collection and analysis require both domain expertise and technological capability. Public companies report their data periodically, but with evolving standards and frameworks, there is no consistency in reporting. Private companies, not mandated by regulators to report, further complicate matters. A mechanism for collecting and expertly guiding data collection is essential.
10. Measurement Discrepancies: A 2021 MIT study revealed that the correlation among six prominent ESG rating agencies averaged at 0.61, considerably lower than the near-perfect correlation of mainstream credit ratings at 0.99. This divergence creates mixed signals for companies and makes it challenging for investors to measure performance accurately.

Variations stem from differences in risk issues, sector classifications, materiality, weightings, and scales used by different assessment providers.

5. ESG Investment Strategies

(Harvard Business School Professor George Serafeim) explained Sustainable Investing that businesses are most successful in ESG and financial performance measures when efforts are pooled to focus only on factors that directly impact how a company operates—referred to by Serafeim as material ESG factors.For example, if you own a small technology company with 10 employees, data security would be considered a material ESG issue because your business handles user data. Other factors, like labor practices, would be considered immaterial to your business at its current startup stage and aren't worth your time, effort, and funds to pursue. "With the growing popularity of incorporating ESG criteria into the decision-making process, sustainable investors are asking for more credible and comparable ESG ratings to help them better understand a company's ESG performance," says HBS Professor Shawn Cole, (Cole Havard Business School), only about 30 firms worldwide conduct research to provide comprehensive ESG ratings. Leaders in this space include Morgan Stanley Capital International (MSCI), Sustainalytics, and Thomson Reuters. Although each firm has its own data processing model and classification system, ESG metrics can be extremely useful to investors aiming to make both a positive impact on the world and strong returns on their investments.

1. Negative Screening: Negative screening, also called exclusionary screening, is the process of excluding specific companies or sectors from a fund or portfolio. This is executed by determining the criteria for exclusion upfront based on a specific goal. For instance, if the goal is to decrease climate change's impact, you may exclude all fossil fuel companies from your portfolio.
2. Positive Screening: Positive screening, also called best-in-class screening, is the process of selecting a subset of top-performing companies from a defined industry and a set of characteristics to invest in.This can be thought of as the opposite of negative screening. Instead of setting criteria by which to exclude companies, you pre-determine which performance measures you'll use to select top performers. For example, you may invest in the 10 apparel companies with the lowest carbon footprint or the five appliance companies with the most diverse boards of directors.
3. Portfolio Tilt: A portfolio tilt strategy is one in which the investor "tilts" the percentage of ESG investments in a portfolio to be more than non-ESG investments while maintaining sector weights that match a target index. For instance, if you want to match the Russell 3000 index and employ a tilt strategy, you'd select investments from across the index to maintain the same level of risk as the index as a whole. You'd also want to ensure there are more highly rated companies on ESG metrics than low ones. You may choose this option as a relatively low-risk investment strategy that still prioritizes ESG goals. Positive and negative screening—while highly effective at targeting ESG goals—don't offer a wide industry variety and naturally exhibit more risk.
4. ESG Integration: ESG integration is a strategic lens that positions companies with high material ESG ratings as investment opportunities that can increase a portfolio's return. Rather than defining a specific set of requirements—like with positive and negative screening—this strategy embeds ESG considerations into a firm's existing investment process. It's another factor that helps provide returns.
5. Shareholder Action: Shareholder action, also referred to as engagement, is when investors use their power to encourage the companies they invest in to pursue material ESG opportunities.
6. Activist Investing: Activist investing is when an investor buys equity in a company to change how it operates and influence it to pursue ESG initiatives. This strategy is closely related to shareholder action; the two terms are sometimes combined into "shareholder activism." However, there's one key differentiator: Shareholder action takes place when an investor already owns a company's shares, and activist investing involves seeking out an investment to influence a company's ESG strategy.
7. Sustainability-Themed Investing: Finally, sustainability-themed investing is a strategy in which investors identify one issue relating to sustainability and invest in indexes of companies that address it.For instance, if you're specifically interested in waste management as it relates to the planet's health, compile an index of companies with exceptional waste management across an array of sectors and risk levels.

6. ESG Future opportunities

1.Emerging Trends and Future Directions: The future of ESG investing is poised for significant transformation. As environmental and social issues become increasingly urgent, investors will play a crucial role in driving corporate behavior and influencing business practices. The expansion of ESG and impact investing will likely lead to a more sustainable and equitable economy.
2. ESG Reporting and Standards: The adoption of ESG reporting standards such as the GRI framework, TCFD (Task Force on Climate-related Financial Disclosures), and EU Taxonomy will become more prevalent. These standards help investors assess the ESG performance of their investments and ensure greater transparency and accountability.
3. The Role of ESG Ratings and Assessments: ESG ratings and assessments, provided by agencies like Ecovadis and MSCI, offer valuable insights into a company's ESG performance. Understanding these ratings helps investors make informed decisions and align their portfolios with their sustainability goals.
4. Expanding Impact Investing Opportunities: The shift towards ESG investing opens new avenues for businesses and investors alike. Emerging sectors such as renewable energy, green technology, and sustainable transportation are gaining traction. The Global Impact Investing Network (GIIN) 2022 survey highlights that 88% of impact investors experienced returns exceeding their expectations, underscoring the potential for long-term gains despite initial lower returns.

5. Policy Support and Market Growth: Government policies and regulations are also fostering the growth of ESG investing. For example, India's SEBI (Securities and Exchange Board of India) has authorized social venture funds, enhancing the investment climate. These regulations promote ESG investments and ensure that capital flows into sustainable ventures.

7.Conclusion:

ESG investing is not just a passing trend but a fundamental shift in how investment decisions are made. By focusing on environmental sustainability, social responsibility, and effective governance, investors can contribute to a more sustainable future while achieving financial returns. As the ESG landscape evolves, staying informed about trends, regulations, and reporting standards will be crucial for maximizing the impact and effectiveness of ESG investments.

ESG investing in India is experiencing a significant surge, driven by regulatory support, investor demand, and the recognition of business opportunities. As the country strives for sustainable development, ESG investing can play a vital role in creating a positive impact on the environment, society, and corporate governance practices. By embracing ESG investing, India can pave the way for a sustainable future that balances financial returns with social and environmental well-being.

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