Sustainable investment funds in India: a synthesis of the academic literature

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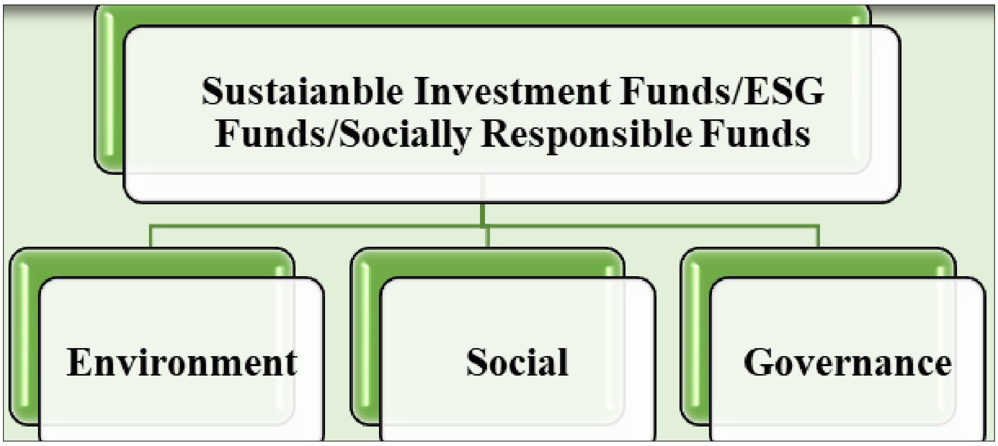
Abstract

Sustainable Investment Funds offer investors alternatives to invest their savings in shares of companies from a different perspective, extending the conventional medium of investing. These mutual funds encourage investors to consider the environment and society in which they live while investing in the stock market. This paper aims to review the existing literature on sustainable investment funds. Sixteen research papers selected from different countries are thoroughly studied. The findings reveal that the concept of SIFs is continuously increasing and gaining popularity. SIFs outperformed conventional funds, particularly in the wake of the COVID-19 outbreak. Some studies have supported the notion that non-SIFs outperform SIFs. However, when investors consider societal and environmental factors while making an investment, they are willing to sacrifice commercial or economic benefits in favor of social benefits.

Keywords: Sustainable Investment Funds, Thematic funds, Environment, Social, Governance

Introduction

The Sustainable Development Goals were developed by the United Nations in 2015 to achieve a sustainable environment and society. These goals can be achieved relatively easily through Sustainable Investing (Sharma & Garg, 2024) [15]. Mutual funds are investment vehicles that pool money from multiple investors to invest in a diversified portfolio of securities, including stocks, bonds, and money market instruments (AMFI, 2024) [1]. They are collective investment vehicles that collect and pool money from various investors. Open-ended schemes, Closed-ended schemes, Interval schemes, Equity funds, Debt funds, Hybrid schemes, Money market funds, Growth funds, Income funds, offshore funds, etc., are the types of mutual fund schemes (AMFI, 2024) [1]. Due to the consistent growth in mutual funds, particularly in green-related funds, every investor desires to comprehend the correlation between mutual funds and ESG. ESG stands for Environmental, Social, and Governance. It is also known as sustainable investing. ESG investing refers to an investment approach where funds are allocated to companies that adhere to ethical practices alongside profitability (IBEF, 2024) [4]. The fund aims to deliver decent financial returns while having a positive environmental impact. To comply with the ethical standards, ESG scores are assessed by research entities such as MSCI, Sustainalytics, and Morningstar. Environmental funds, social funds, governance funds, integrated ESG funds, and thematic ESG funds are the types of mutual funds that fall under the ambit of ESG investing (Press Trust of India, 2024). The SEBI has mandated that the top 1000 listed companies disclose their ESG efforts. In their research paper, Guimarães & Malaquias (2023) [7] revealed that ESG-related funds demonstrated higher risk-adjusted returns during periods of financial constraint. SBI Magnum Equity ESG Fund was the first ESG fund in India. It was launched in May 2018, and since then, the market has seen the introduction of several other ESG-themed funds. The ESG theme or responsible investing garnered popularity post-COVID. Between 2020 and 2021, eight new ESG funds were launched. Experts believe that such funds will attract greater attention in the years to come. ESG mutual funds invest in companies with high ESG ratings and sustainable growth, unlike traditional mutual funds, which focus on profitability and past performance. They also affect positive social and environmental change by investing in companies that reduce their carbon footprint or have good employee practices. ESG funds prioritize sustainability over short-term gains, unlike traditional funds, focusing on financial returns (Responsible Investing Tribune, 2024) [13]. An ESG controversy score measures the frequency and severity of a company's environmental, social, and governance (ESG) controversies. It's calculated and published by financial information providers.



Source: Authors' compilation

Literature review

S. N.	Author's name	Title	Objectives	Research methodology	Findings
1.	Vishali & Shafi M.K. (2024) [20]	Emerging paradigms in socially responsible investment (SRI)—A study with focus on ESG mutual funds in India	1. To explain the concept of Socially Responsible Investment (SRI) in the context of Indian financial markets. 2. To assess the performance of selected ESG mutual funds 3. To examine the opportunities and challenges associated with SRI and ESG funds within the Indian financial markets.	**Sample Data:** Secondary data **Time period:** April 2022 to March 2023 **Tools and techniques:** Four risk-adjusted portfolio performance metrics: the Sharpe ratio, Jensen's Alpha, Treynor ratio, and Sortino ratio	The study finds that Socially Responsible Investment (SRI) is gradually expanding in India, with the ICICI Prudential ESG Fund's Direct Plan-Growth option outperforming other selected ESG funds. In contrast, the Aditya Birla Sun Life ESG Fund's Direct Plan-Growth option ranked the lowest. Despite a growing trend, the expansion of ESG funds in India has been slow due to investor hesitancy about sustainability-focused portfolios, limited options, and higher costs associated with ESG analysis. Additionally, the Securities and Exchange Board of India (SEBI) has introduced a Social Stock Exchange (SSE), which facilitates capital access for social enterprises and promotes impact investing in India.
2.	Wong & Li (2024) [21]	Investigating ESG Funds in China: Management Fees and Investment Performance	1. To investigate the relationship between management fees, ESG scores, and the investment performance of ESG funds in China. 2. To analyze the performance of open-end funds in China. 3. To analyze the impact of ESG factors on fund performance.	**Sample Data:** Secondary data **Sample size:** 16530 open-ended funds in China **Time period:** 21 September 2001 to 30 June 2022 **Tools and techniques:** Comparative analysis and Regression analysis	The study reveals that funds with higher management fees yield higher annualized returns but experience greater volatility and maximum drawdown, indicating higher associated risks. However, these higher-fee funds do not show superior performance in risk-adjusted metrics. A specific management fee group (1.1%-1.2%) consistently shows exceptionally high returns. The study also finds that funds with moderate ESG scores, slightly above the median, demonstrate the best risk-adjusted returns. While high ESG scores may not necessarily lead to better investment outcomes, moderate ESG integration can contribute to superior risk-adjusted returns.
3.	Vilas et al. (2024) [19]	The limited role of sustainability in mutual fund investor decisions: A machine learning approach	1. Assess the importance of ESG (Environmental, Social, and Governance) performance in mutual fund investment decisions. 2. Develop predictive models to forecast mutual fund flows, financial returns, and ESG performance.	**Sample Data:** Secondary data **Sample size:** 3767 US mutual funds **Time period:** January 2015 to December 2021 **Tools and techniques:** Descriptive statistics, Correlation analysis,	The study examined the factors influencing mutual fund purchases, with a focus on the importance of past returns and ESG performance. Investors tended to favor funds with higher past returns, better ESG scores, lower volatility, smaller size, lower fees, and lower turnover ratios, with these variables showing statistically significant differences between funds with above-median and below-median flows. The analysis found that past returns and fund characteristics were more critical in attracting flows than ESG performance, despite ESG scores being statistically significant. Panel data regression confirmed that financial variables, such as fees and yield, had higher predictive power for fund flows than ESG scores, which played a lesser role in

				and Regression analysis	predicting fund flows. The study also employed machine learning models to predict fund flows, with random forests demonstrating the best accuracy, particularly when segmenting by fund type and investor class. Ultimately, while ESG factors were considered, traditional financial metrics continued to be the dominant drivers of fund flows.
4.	Momparler et al. (2024) [10]	Catalyzing Sustainable Investment: Revealing ESG Power in Predicting Fund Performance with Machine Learning	1. To test how financial performance indicators and combined ESG (Environmental, Social, and Governance) scores impact stock returns for large-cap firms. 2. To assess how firm size affects stock returns in Greek and French firms. 3. To study the relationship between ESG performance and stock returns, especially in Italian firms, where a significant negative correlation is identified.	**Sample Data:** Secondary data **Sample size:** 186 companies' data from six European countries **Time period:** 2010 to 2020 **Tools and techniques:** Regression Analysis and Herd Behavior Analysis	The study reveals that market capitalization has a negative impact on stock returns in Greece and France, suggesting a preference for smaller companies among investors. The price-to-book value (P/BV) and Sharpe ratio have a positive effect on stock returns in all countries except Portugal. ESG scores exhibit a significant negative correlation with stock returns in Italy, but not in other countries, suggesting that the importance of ESG factors varies across Europe. No evidence of ESG-related herding behavior was found in most countries, except during the COVID-19 outbreak in Portugal, Italy, and Greece. The study's findings align with previous research, which has shown a negative relationship between ESG performance and stock returns, particularly in Europe.
5.	Petridis et al. (2023) [12]	Measuring the efficiency of mutual funds: Does ESG controversy score affect the mutual fund performance during the COVID-19 pandemic?	1. Investigate the Influence of ESG Performance on Mutual Fund Efficiency 2. Evaluate Mutual Fund Performance Using DEA 3. Analyze the Impact of ESG Controversies Scores	**Sample data:** Secondary data **Sample size:** 17961 mutual funds worldwide **Time period:** July 2021 to July 2022. **Tools and techniques:** Data Envelopment Analysis (DEA) and hypothesis testing	The study demonstrates that mutual funds with higher ESG controversy scores, which indicate fewer ESG controversies, outperformed those with lower scores. Specifically, funds embroiled in fewer ESG controversies exhibited higher financial efficiency. ESG controversies could harm financial efficiency during health, environmental, or market crises. European mutual funds exhibit the highest risk, while U.S.-focused funds tend to have the lowest expenses, with returns generally consistent across regions, although there are notable outliers. The study suggests that incorporating ESG criteria, particularly ESG controversy scores, into investment strategies can enhance financial performance without sacrificing returns.
6.	Guimarães & Malaquias (2023) [7]	Performance of Equity Mutual Funds Considering ESG Investments, Financial Constraints, and the COVID-19 Pandemic	1. To classify mutual funds as ESG-related or conventional. 2. To analyze the risk-adjusted performance of ESG-related and conventional funds, particularly during financial constraints and the COVID-19 pandemic. 3. To compare the performance of ESG-related funds with conventional funds during the COVID-19 pandemic and periods of financial constraints.	**Sample data:** Secondary data **Sample size:** 3840 equity mutual funds **Time period:** January 2006 to December 2020. **Tools and techniques:** Four-factor Model and Returns-Based Style Analysis are used to classify funds.	The study reveals that ESG-related funds demonstrated higher risk-adjusted returns during periods of financial constraint. This implies that investors tend to achieve better returns by investing in green funds when faced with market downturns. The study suggested that, during market downturns, investors tend to obtain better risk-adjusted returns for investing in green funds (similar results were observed during the COVID-19 pandemic).
7.	Yerdian (2023) [22]	Analysis of the effects of the COVID-19 pandemic on mutual fund performance (using the Sharpe method)	1. To assess the impact of the COVID-19 pandemic on the performance of different types of mutual funds in Indonesia 2. To analyze the performance of these mutual funds using the Sharpe Ratio	**Sample data:** Secondary data **Sample size:** Four different types of mutual funds. **Time period:** 2018 to 2022. **Tools and techniques:**	The COVID-19 pandemic in Indonesia affected various mutual funds, with equity, balanced, and fixed-income funds experiencing significant declines in returns. Equity funds showed the highest volatility and risk but gradually recovered, showing improved returns over time. Money market funds remained the most stable, consistently providing positive returns throughout the pandemic. All mutual funds performed better after the pandemic than before, although none surpassed their

			as a risk-adjusted return metric. 3. To determine the best-performing mutual fund type during the pandemic.	Comparative analysis	values from early 2018. Fixed-income funds performed better before the pandemic, but the rise in global interest rates negatively impacted their returns. Equity mutual funds exhibited significant differences in returns between the pre- and post-pandemic periods, while money market funds performed the best throughout the entire period.
8.	Gavrilakis & Floros (2023) [6]	ESG performance, herding behavior, and stock market returns: evidence from Europe	1. To test the impact of financial performance indicators and combined ESG scores on stock returns for European large-cap firms. 2. To analyze the influence of ESG performance on investor behavior. 3. To examine the stock performance of large-cap firms in Europe.	**Sample Data:** Secondary data **Sample size:** 80% of the global market cap **Time period:** 1 April 2010 to 31 December 2020 **Tools and techniques:** Regression analysis and Herding behavior analysis	The study reveals that market capitalization has a negative impact on stock returns in Greece and France, suggesting that smaller companies may offer higher returns. The price-to-book value and Sharpe ratio have a positive influence on stock returns in all countries except Portugal, indicating that higher valuation and risk-adjusted returns enhance stock performance. ESG scores do not significantly affect stock returns in most countries except Italy. European stocks exhibit a significant negative correlation between ESG performance and returns, suggesting that investors may be willing to sacrifice returns for companies with strong ESG performance. Herding behavior motivated by ESG performance is evident in Greek and French markets but not in others. During the COVID-19 pandemic, herding behavior was observed in Portugal, Italy, and Greece, but not in Spain, France, or Germany.
9.	Rohilla (2023) [14]	Evaluation of Performance of Selected Indian ESG Funds	1. To analyze the performance of selected ESG funds in terms of annualized return and risk. 2. To assess the performance of ESG funds based on different ratios. 3. To analyze the interdependence of selected ESG funds using the Granger causality test. 4. To identify shocks in the selected ESG funds and their timing.	**Sample Data:** Secondary data **Sample size:** 3 ESG funds **Time period:** 29 December 2020 to 12 August 2022 **Tools and techniques:** Comparative analysis, Sharpe Ratio, and Granger causality test	The study reveals that as of August 12, 2022, India's mutual fund market had only 10 ESG schemes, compared to those of countries such as the USA, UK, Japan, and China. SBI was the only mutual fund company offering ESG funds in India until 2018; since then, nine more schemes have been launched. As of March 31, 2022, total ESG assets under management were ₹12,447 crore, with the ESG fund of fund at ₹140.64 crore and the ESG ETF at ₹166.73 crore. The inflow in ESG funds increased from ₹2,094 crore in 2019-20 to ₹4,884 crore in 2020-21, but declined to ₹315 crore in 2021-22. The Aditya Birla Sun Life ESG Fund was the best performer, with a 35.64% annualized return, but also had the highest risk and downside risk. All selected ESG funds showed significant intercorrelations, and no Granger causality was found among the funds. The study concludes that, despite low awareness, ESG funds in India can offer good risk-adjusted returns.
10.	He et al. (2023) [9]	Drifting from the Sustainable Development Goal: Style Drift in ESG Funds	1. Analyze the relationship between ESG drift and the sensitivity of fund flows and performance. 2. Compare the performance and characteristics of funds that adhere to their sustainability goals versus those that drift away. 3. Provide insights into the effects of ESG drift on fund performance and flows	**Sample Data:** Secondary data **Sample size:** 31 ESG-themed funds **Time period:** 2018 to 2022 **Tools and techniques:** Descriptive analysis, correlation, and funds flow calculation	The study examines the relationship between mutual fund ESG drift (deviation from stated ESG objectives) and fund characteristics. It finds that funds with higher ESG drift tend to invest more in lower-ranked ESG stocks and generally underperform compared to funds without ESG drift. ESG-drift funds are smaller, have lower returns, subscription rates, and fund flows, and exhibit higher turnover rates and lower industry concentration. Additionally, the study reveals that ESG drift enhances the sensitivity of fund flows to performance, particularly among individual investors, suggesting they are more influenced by ESG drift in their investment decisions. However, there is no substantial evidence that ESG-drift predicts future fund performance.
11.	Carlsson Hauff & Nilsson (2023) [2]	Is ESG mutual fund quality in the eye of the beholder? An	To examine the influence of ESG Investment strategies on perceived sustainable quality, financial quality, and the	**Sample size:** 261 participants (41% female) **Time period:**	The study indicated that the inclusion strategy was favored, with participants perceiving it as the best in terms of financial quality (M = 2.86) and overall quality (M = 3.22). Engagement was rated highest for perceived

		experimental study of investor responses to ESG fund strategies	overall quality of ESG-profiled mutual funds. To evaluate the impact of ESG strategy implementation	21 September 2001 to 30 June 2022 **Tools and techniques:** Mixed method approach and CFA	sustainable quality (M = 3.40), though differences between strategies were minimal. The multi-categorical mediation model revealed that the inclusion strategy had a significantly positive effect on overall quality, primarily through its impact on perceived financial quality. However, no significant mediating effect was found for sustainable quality or economic risk, resulting in the rejection of the related hypotheses. Overall, the findings underscore the importance of financial returns in shaping investors' perceptions of mutual fund quality, with the inclusion strategy being particularly effective in enhancing these perceptions.
12.	Gupta (2022) [8]	Growth and Performance Measurement of ESG-themed Mutual Funds in India: An Empirical Investigation	1. To assess the growth in the number and Assets Under Management (AUM) of ESG funds in India. 2. To evaluate the performance of ESG equity funds based on annualized returns, portfolio total risk, downside risk, beta, and risk-adjusted return measures such as Sharpe, Treynor, Jensen's alpha, and Sortino	**Sample Data:** Secondary data **Sample size:** 8 ESG-themed mutual funds in India **Time period:** 1 January 2021 to 31 December 2021 **Tools and techniques:** Descriptive analysis, Sharpe Index, Treynor Ratio, Sortino Measure, and Jensen's Alpha	The study demonstrated that the growth of ESG funds in India is in its early stages compared to global markets, with only eight ESG-themed funds by December 2021. Despite being a small market, India has experienced significant momentum in recent years, particularly since the launch of its first ESG fund in May 2018. The sector recorded a 76% increase in AUM from Rs. 2,094 crores in 2019-20 to Rs. 3,686 crores in 2020-21, reaching Rs. 11,651 crores by the end of 2021. While India's position is negligible globally, the rapid launch of new funds and substantial AUM growth highlight a growing interest in ESG investments among Indian investors.
13.	Steen et al. (2020) [16]	Is there a relationship between Morningstar's ESG ratings and mutual fund performance?	1. To analyze the relationship between Morningstar's ESG ratings and the performance of mutual funds in Norway. 2. To examine the existence of an ESG momentum effect.	**Sample Data:** Secondary data **Sample size:** 146 mutual funds in Norway **Time period:** January 2014 to December 2018 **Tools and techniques:** Descriptive statistics and the Fama-French three-factor regression model	The research indicated that sustainability funds typically yield an average annualized excess return of 7.6%, with a standard deviation of 9.1% and a market beta of 0.71. Portfolios with lower betas suggest reduced market risk. In contrast, high-sustainability portfolios often have higher betas, being influenced more by growth and small-cap stocks, whereas low-sustainability portfolios carry more unsystematic risk. The study noted a 0.3% monthly alpha disparity between high- and low-sustainability portfolios, especially in European funds, indicating superior risk-adjusted returns for the former. Additionally, an "ESG momentum" phenomenon was observed, where funds that improved their ESG scores achieved an annualized alpha of 3.6%, highlighting the potential benefits of enhancing sustainability ratings.
14.	Dorfleitner et al. (2020) [3]	ESG controversies and controversial ESG: about silent saints and small sinners	1. To examine the Relationship between Corporate Social Performance (CSP) and Corporate Financial Performance 2. To analyze the Impact of Controversies on CFP 3. To evaluate Portfolios Based on ESG Ratings	**Sample Data:** Secondary data (Thomson Reuters' ESG rating) **Sample size:** 2500 companies per month during the given time period **Time period:** 2002 to 2018 **Tools and techniques:** Regression analysis	The study reveals that equally weighted portfolios based on low Thomson Reuters (TR) scores and high controversy scores exhibit significant outperformance, particularly among smaller companies, indicating that investors may reward firms that avoid excessive ESG spending. While value-weighted portfolios show no consistent positive alphas, equally weighted strategies generate notable returns, especially in the worst TR score portfolios, supporting the trade-off hypothesis. Rank-weighted portfolios further amplify returns, and the performance remains robust across different market conditions, portfolio splits, and after accounting for transaction costs. Overall, the findings suggest that small companies with fewer controversies can achieve sustained stock performance, whereas large firms with high ESG scores do not consistently outperform their smaller counterparts.

15.	Friede et al. (2015) [5]	ESG and financial performance: aggregated evidence from more than 2000 empirical studies	1. To provide a comprehensive overview of the relationship between environmental, social, and governance (ESG) criteria and corporate financial performance (CFP) 2. To overcome the limitations of previous review studies	**Sample Data:** Secondary data **Sample size:** 2200 individual studies **Tools and techniques:** Vote-count studies and Meta-analysis	The study found that 90% of studies show a nonnegative relationship between Environmental, Social, and Governance (ESG) criteria and corporate financial performance (CFP). The correlation is strong, with 47.9% of vote-count studies and 62.6% of meta-analyses showing positive correlations. Nearly 50% of studies found positive ESG-CFP relations, while only 10% found hostile ties. Meta-analyses supported positive findings, with 74.9% showing significant positive correlations. However, portfolio studies, particularly those focusing on mutual funds, showed 15.5% positive results, possibly due to overlapping risks and costs. North America showed a higher share of positive results than Europe and Asia/Australia. Environmental and Governance studies showed slightly more positive results than Social, though the differences were marginal.
16.	Muñoz et al. (2014) [11]	Environmental Mutual Funds: Financial Performance and Managerial Abilities	1. To analyze the financial performance and managerial abilities of US and European socially responsible (SR) mutual funds. 2. To compare green fund managers' performance with conventional and other forms of SR mutual fund managers. 3. To investigate the effect of market conditions (crisis vs. regular periods) on the performance of SR funds in the US and Europe.	**Sample data:** Secondary data **Sample size:** 18 US and 89 European green funds **Time period:** January 1994 to January 2013. **Tools and techniques:** Multifactor model (four-factor Carhart model) and Treynor and Mazuy (TM) market-timing model	The study reveals that the financial performance of green funds in the US and Europe is generally similar to that of their conventional and ESG counterparts. In the US, green funds underperform during non-crisis periods but perform similarly during crises. However, they perform worse in non-crisis periods due to poor market-timing abilities. In Europe, green funds show no significant difference in performance compared to conventional and ESG funds, but underperform conventional funds during crisis periods. The study also indicates that managerial abilities, such as stock picking and market timing, are generally weak. However, unlike their European counterparts, US green fund managers show better timing abilities during crisis periods. Overall, the success of green fund managers depends on market conditions.

Conclusion

The study concludes that mutual funds with higher ESG controversy scores, which indicate fewer controversies, generally outperform those with lower scores, highlighting the financial benefits of incorporating ESG criteria into investment strategies. Specifically, funds with fewer controversies exhibit greater financial efficiency, even during crises such as health or environmental events. The research highlights the importance of considering ESG controversy scores to achieve enhanced financial performance without compromising returns. Additionally, the study finds that green funds, particularly in the US and Europe, exhibit higher risk-adjusted returns during financial constraints, notably during market downturns such as the COVID-19 pandemic. However, green funds underperform in non-crisis periods due to poor market-timing abilities. The study also highlights that sustainability funds, especially in Europe, yield superior risk-adjusted returns, driven by the "ESG momentum" phenomenon, where improving ESG scores leads to better financial outcomes. Despite the positive correlation between ESG criteria and corporate financial performance (CFP), the study suggests that in regions such as North America, the relationship is stronger than in Europe and Asia/Australia, with notable variations in the impact of ESG scores on stock returns across different countries. Lastly, the study indicates that India's ESG fund market, though in its early stages, has shown significant growth, with increasing investor interest reflected in the rapid launch of new funds and substantial growth in assets under management (AUM). India's ESG model is expanding due to regulatory scrutiny, corporate governance, and global sustainability goals. The expected growth in ESG-oriented AUM aligns with India's commitment to a greener future. ESG investments shape India's financial ecosystem, creating a more sustainable and resilient economy. Strategic sectors and regulatory frameworks support this trend. In conclusion, the concept of SIFs is continuously increasing and gaining popularity. SIFs outperformed conventional funds, particularly in the wake of the COVID-19 outbreak. Some studies have supported the notion that non-SIFs outperform SIFs. However, when investors consider societal and environmental factors while making an investment, they are willing to sacrifice commercial or economic benefits in favor of social benefits.

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