Performance Evaluation of ESG Funds in India

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Abstract— **The financial services in India have undergone revolutionary changes and had become more sophisticated, in response to the varied needs of the economy. Investment in mutual funds has helped in garnering the investible funds of investors in a significant way. Environmental, Social, and Governance (ESG) investing has emerged as a pivotal approach in aligning financial returns with sustainable and ethical practices. This study evaluates the performance of select ESG mutual fund schemes in India, focusing on their financial competitiveness, risk-adjusted returns like Sharpe and Sortino ratios. The findings of the study infer that ESG investing not only leads to the accomplishment of sustainability goals of investors but also provides them superior returns than the traditional route to investing.**

Index Terms— **ESG mutual funds, Sharpe index and Sortino ratio**

I. INTRODUCTION

Mutual Fund is considered as the most suitable investment for the common man as it offers an opportunity to invest in a diversified professionally managed securities at a relatively low cost. It allows the retail investors to beat inflation, derive capital appreciation and receive higher returns. In this way Mutual Fund industry contributes to the process of financial intermediation and also provide depth to the market. This has made Mutual Fund investment very popular in recent times.

Mutual funds have been steadily gaining widespread acceptance on a global scale, with the consistent growth in trade volumes serving as a clear testament to their popularity. Nevertheless, they are accompanied by a significant level of risk, characterized by heightened price volatility and a lack of robust regulatory measures. With the growing emphasis on sustainable investing worldwide, the Indian financial market has been witnessing a burgeoning interest in investment vehicles focused on environmental, social, and governance (ESG) principles. Despite this, ESG mutual funds have not fully harnessed their potential to contribute to the further evolution of financial markets due to several challenges. Among these challenges, one prevailing issue is ethical investment practices.

The growing environmental concerns, social responsibility, and increasing demand for transparency and ethical governance have led to the emergence and evolution of Environmental, Social, and Governance (ESG) investing in financial markets globally. In recent years, investors are no longer solely focused on financial returns; instead, they increasingly value non-financial factors such as environmental sustainability, corporate governance, and social equity as integral parts of their socially responsible investment decisions. ESG investing, therefore, has transformed into a powerful tool for aligning financial strategies with longterm sustainability goals. Within this context, mutual funds with ESG linkages have gained momentum worldwide as an investment vehicle that offers both financial returns and socially responsible investing opportunities. India, being a rapidly developing economy with a rising awareness of sustainable practices, has also experienced a growing interest in ESG-themed mutual funds, particularly post-2018 when regulatory frameworks and market sentiments began favouring green finance and ethical investing. Despite this progress, the Indian ESG mutual fund landscape remains relatively nascent compared to developed markets. Using NAV, AUM, and Sharpe Ratio as key metrics, this research investigates the dynamic relationship between fund size, net asset value, and performance across five-year period of study. The findings will help investors, policy-makers, and fund managers make informed decisions about the role of ESG integration in mutual fund selection, portfolio construction, and performance assessment. It also seeks to critically analyse whether ESG tagging in mutual funds translates into meaningful performance differentiation or remains a symbolic label without substantive financial impact. Environmental, Social, and Governance (ESG) investing has emerged as a pivotal approach in aligning financial returns with sustainable and ethical practices. This study evaluates the performance of select ESG mutual fund schemes in India, focusing on their financial competitiveness, risk-adjusted returns, and integration of ESG factors

II. REVIEW OF LITERATURE

Mosson (2022) studied the data from April 2019 to September 2021 and reported that ESG funds are cheaper and perform better than non-ESG funds. It was also reported that ESG funds are oriented towards large cap companies and developed countries. Not much literature is available in this field in the context of India. Through the present study we wish to add more to the existing body of literature

Sarkar, S. (2022). The research attempted a comparison between risk-adjusted returns with traditional market portfolios, aiming to assess whether ESG funds in India have delivered superior risk-adjusted returns compared to conventional market portfolios. The 91-Day Treasury bill yield is considered the risk-free rate, and the Nifty 50 index has been used as the market benchmark. The Sharpe Ratio, Sortino Ratio, Treynor Ratio, and Jensen's Alpha have been used as performance metrics. The study concludes that ESG mutual funds in India have grown in prominence and demonstrated competitive performance compared to traditional funds.

Gupta, S. (2022). This research presents an empirical investigation into the performance and growth of ESGthemed mutual funds in India. The study evaluates risk-return conditions by a comprehensive framework including the Sharpe Ratio, Sortino Ratio, Treynor Ratio, and Jensen's Alpha. The findings indicate that the ESG-themed mutual fund concept is still at the nuanced stage. It has exhibited positive momentum in terms of fund launches and asset accumulation since 2018. Importantly, all sampled funds exhibited positive Jensen's Alpha, suggesting superior performance relative to the market benchmark (Nifty 50), with the Quant ESG Equity Fund emerging as the top performer despite its relatively low AUM.

Dutta & Paul (2023) analyse the performance of select ESG-linked mutual funds during the pandemic period. This study evaluates four ESG funds using a range of financial metrics, including CAGR, SD, Sharpe ratio, Treynor Ratio, Alpha, Beta, and the coefficient of determination. The findings suggest that ESG funds demonstrated relatively defensive characteristics and satisfactory diversification; however, most of the funds underperformed in risk-adjusted metrics, and their CAGR also lagged behind expectations. This study concludes that although ESG funds may not always deliver superior returns in the short run, their defensive nature and alignment with the green goal make them a lucrative risk-averse and socially conscious investment opportunity.

Kumar & Mishra (2024) this study conducts an empirical analysis to evaluate the return performance of ESG-linked mutual funds, with a special focus on whether these funds offer superior or comparable returns relative to traditional benchmarks. The scope includes both performance trends and intra-category fund comparisons over a recent three-year period. The Sharpe Ratio, Sortino Ratio, Treynor Ratio, and Jensen's Alpha have been used as performance metrics. The result exhibits a heterogeneity in performance and suggests that ESG funds in India are still evolving and that performance is fund-specific.

Dr. S. Jayadev & Dr. Anupama R. (2024) this research evaluates the performance of ESG-themed mutual funds in India and attempts to understand their responsiveness to the NIFTY 100 ESG Index as a benchmark index. Study concludes that ESG mutual funds in India showed a positive relationship between selected funds and the benchmark index. Out of selected funds, the Quantum ESG Best in Class Strategy Fund emerged as the most sensitive and best aligned with the benchmark, while the Axis ESG Integration Strategy Fund showed the least sensitivity. The findings also affirm that, irrespective of risk perception, ESG benchmarks can serve as reliable indicators of fund behaviour.

Priya, & Sharma, K. (2024) this research adopts a cross-country approach and highlights a global comparative analysis of ESG mutual fund evolution, evaluating status and performance across both developed, developing, and underdeveloped economies. With a particular focus on India, this paper articulated that India has made considerable progress in ESG adoption. From 2019 onwards, Indian ESG-themed mutual funds have gained higher AUM compared to the rest of the world.

III. ELEMENTS OF ESG

ESG investing is about making investment choices that go beyond just profits. It evaluates companies based on three key factors

1. Environmental – How businesses impact the environment.
2. Social – How businesses treat their employees and the community as a whole.
3. Governance – Whether businesses maintain ethical leadership.

Unlike traditional investing, which focuses only on financial returns, ESG investing considers long-term sustainability and risk management.
Companies with strong ESG practices tend to have better reputations and lower risks. They focus on reducing carbon emissions, ensuring fair workplace policies, and maintaining transparent corporate governance. This helps them build resilience against regulatory changes and reputational damage. On the other hand, companies with weak ESG frameworks face higher risks, including financial instability and potential losses.

IV. TYPES OF ESG INVESTMENTS

Different types of ESG investments cater to various investor preferences. In India, ESG funds are primarily classified into the following types –

1. Exclusionary ESG funds
These funds avoid companies involved in harmful industries such as tobacco, alcohol, gambling, or fossil fuels. For instance, Quantum India ESG Equity Fund follows this approach by eliminating companies that do not meet its sustainability criteria.

2. Thematic ESG funds
These funds focus on ESG-related themes like clean energy, water conservation, and sustainable agriculture. One example is the Avendus India ESG Fund, which invests in businesses with environmental and social causes.

3. Best-in-class ESG funds
These funds invest in companies with top ESG ratings within their industry. They don't exclude entire sectors but pick the best-performing firms in terms of ESG compliance.

4. Impact investing funds
These funds target businesses that generate measurable positive environmental or social impact, such as renewable energy projects or microfinance initiatives.

V. TAX IMPLICATIONS OF ESG INVESTING IN INDIA

1. Short-term capital gains (STCG) are taxed at 20% if held for less than 12 months as per section 111A of the Income Tax Act, 1961 (the Act)
2. Long-term capital gains (LTCG) allow tax exemption up to specified limits for holdings over 12 months. If your returns are up to ₹1.25 lakhs, no LTCG tax will be applicable. However, if returns exceed ₹1.25 lakhs, the excess returns would be taxed at 12.5% as per section 112A of the Act
3. ESG funds do not offer additional tax deductions under Section 80C, unlike ELSS Mutual Fund schemes
4. Dividends earned from ESG funds or stocks will be taxed as per income tax slab rates applicable to the respective person

VI. OBJECTIVES OF THE STUDY

- To study the growth of assets managed under ESG mutual fund schemes
- To study the growth and market share of ESG mutual fund schemes
- To analyse the returns of ESG mutual funds.

VII. ANALYSIS OF THE STUDY

(A) ESG fund and Assets under Management:

The selected ESG fund schemes include Quant ESG Integration Strategy Fund, ICICI Prudential ESG Exclusionary Strategy Fund, Aditya Birla Sun Life ESG Integration Strategy Fund, SBI ESG Exclusionary Strategy Fund and Axis ESG Integration Strategy Fund

Fund Name	AUM Cr
Quant ESG Integration Strategy Fund	273
ICICI Prudential ESG Exclusionary Strategy Fund	1512
Aditya Birla Sun Life ESG Integration Strategy Fund	622
SBI ESG Exclusionary Strategy Fund	5769
Axis ESG Integration Strategy Fund	1224

It is inferred from the above table that SBI ESG Exclusionary Strategy Fund contributed Rs 5769 Crores as the maximum amount of funding towards ESG funds followed by ICICI Prudential ESG Exclusionary Strategy Fund, Axis ESG Integration Strategy Fund, Aditya Birla Sun Life ESG Integration Strategy Fund and Quant ESG Integration Strategy Fund

(B) ESG fund and NAV Annual returns:

Fund Name	1 year	3 years	5 years
Quant ESG Integration Strategy Fund	1.24%	14.12%	23.15%
ICICI Prudential ESG Exclusionary Strategy Fund	5.46%	19.24%	14.85%
Aditya Birla Sun Life ESG Integration Strategy Fund	3.49%	15.46%	12.88%
SBI ESG Exclusionary Strategy Fund	6.84%	14.29%	13.73%
Axis ESG Integration Strategy Fund	2.3%	13.98%	10.2%

It is inferred from the above table that over a five year period the NAV returns in terms of ESG fund investment is maximum with Quant ESG Integration Strategy Fund followed by ICICI Prudential ESG Exclusionary Strategy Fund,SBI ESG Exclusionary Strategy Fund, Aditya Birla Sun Life ESG Integration Strategy Fund and Axis ESG Integration Strategy Fund

(C) ESG fund and Risk-Adjusted Returns:

Fund Name	SD	Beta	Sharpe Ratio	Sortino Ratio
Quant ESG Integration Strategy Fund	16.46	1.16	0.51	0.87
ICICI Prudential ESG Exclusionary Strategy Fund	12.20	0.92	0.95	1.52
Aditya Birla Sun Life ESG Integration Strategy Fund	12.85	0.98	0.62	0.91
SBI ESG Exclusionary Strategy Fund	11.54	0.91	0.62	0.96
Axis ESG Integration Strategy Fund	11.84	0.87	0.61	0.91

It is inferred from the above table that the ESG performance based on Sharpe ratio is maximum with ICICI Prudential ESG exclusionary strategy fund indicating good performance followed by Aditya Birla Sun Life ESG Integration Strategy Fund, SBI ESG Exclusionary Strategy Fund, Axis ESG Integration Strategy Fund and Quant ESG Integration Strategy Fund. A higher Sortino Ratio means more return for less risk of loss. It is inferred from the above assessment of ESG funds, ICICI Prudential ESG Exclusionary Strategy Fund contributes with a higher Sortino ratio.

(D) ESG fund and Expense Ratio

Fund Name	Fund Age (Years)	Expenses Ratio
Quant ESG Integration Strategy Fund	5	2.43%
ICICI Prudential ESG Exclusionary Strategy Fund	5	2.15%
Aditya Birla Sun Life ESG Integration Strategy Fund	5	2.46%
SBI ESG Exclusionary Strategy Fund	19	1.93%
Axis ESG Integration Strategy Fund	5	2.25%

It is inferred from the above table that SBI ESG Exclusionary Strategy Fund has consistently reduced its expense ratio to the minimum of 1.93% and operating for a period of 19 years followed by ICICI Prudential ESG Exclusionary Strategy Fund, Axis ESG Integration Strategy Fund, and Quant ESG Integration Strategy Fund

VIII. CONCLUSION

It is found that the share of different ESG schemes in AUM of the Mutual Fund industry stands highest with SBI ESG Exclusionary Strategy Fund. In terms of the NAV returns Quant ESG Integration Strategy Fund has shown significant performance as compared to other ESG funds. ESG performance based on Sharpe ratio is maximum with ICICI Prudential ESG exclusionary strategy fund indicating good performance. Higher Shape ratio signifies that the fund is capable of generating high returns to investors.

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