

The Rise of Sustainable Investing and ESG-Focused Funds in India

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ABSTRACT

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The increasing awareness of environmental, social, and governance (ESG) issues has reshaped investment strategies globally, with India emerging as a significant player in the rise of sustainable investing. This research explores the growth of ESG-focused funds in India, analyzing their evolution, drivers, and impact on the financial and sustainability landscapes. It highlights the role of regulatory frameworks, investor demand, and corporate responsibility in fostering this trend. Furthermore, the study examines the challenges faced by ESG investments, such as green washing, lack of standardized metrics, and limited investor awareness. The main goals of this study are to analyse growth trends, identify key drivers, assess performance, and comprehend investor behaviour. The study offers insights into the performance of ESG funds, their compatibility with international sustainability objectives, and their capacity to revolutionize India's investment ecosystem through quantitative analysis. In order to identify current trends in sustainable investing in India, this study will concentrate on data from the previous five to ten years. It is based on secondary data analysed from asset management firms, financial institutions, and regulatory agencies (SEBI). Examine market reports, scholarly articles, and ESG fund performance information. With important ramifications for firms, investors, and politicians alike, this study emphasizes the vital role that sustainable investing plays in promoting economic growth while tackling environmental and social issues.

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Introduction

Sustainable investing has emerged as a key global trend, reshaping how investors and financial institutions allocate capital. Within this broader shift, ESG (Environmental, Social, and Governance) investing stands out as a driving force. ESG-focused funds are

designed to promote social responsibility and environmental sustainability, while simultaneously generating financial returns. In recent years, India, with its growing economy, has witnessed a significant rise in the popularity of sustainable investing, particularly in the form of ESG-focused funds.

This paper explores the rise of sustainable investing and ESG-focused funds in India. We analyze the growth, factors driving this trend, challenges, and the overall impact of ESG investment strategies in the Indian market. We aim to explore how the growing awareness of environmental and social issues, along with changing investor preferences, has driven this transformation in the Indian financial landscape.

The research investigates how Indian investors are incorporating sustainability into their portfolios and how India's financial institutions are aligning with global ESG trends. Additionally, we explore the role of government policies, corporate governance, and investor behavior in shaping India's ESG investment ecosystem.

Literature Review

Sustainable Investing and ESG Concepts

Sustainable investing refers to investment strategies that seeks business practices. ESG investing is a specific subset of sustainable investing,

in which the investment decision-making process incorporates factors related to environmental impact, social justice, and governance practices.

In their landmark paper, Clark, Feiner, and Viehs (2015) explain that ESG investing is rooted in the understanding that companies with strong sustainability practices often outperform their peers in the long term, given their ability to manage risks related to the environment and governance. The importance of ESG criteria has grown as the financial industry recognizes the connection between sustainable practices and long-term financial performance.

Globally, the ESG investing landscape has expanded significantly. The Global Sustainable Investment Alliance (GSIA, 2020) reports that global ESG assets reached \$35.3 trillion by 2020, representing a 15% increase over the previous two years. This growth is reflective of the increasing awareness among investors about the material financial risks posed by climate change and social issues. ESG investing is no longer a niche strategy but a mainstream approach to managing investment portfolios.

The Growth of Sustainable Investing in India

Sustainable investing in India can be traced back to the early 2000s when the concept of responsible investing began to gain traction globally. However, it has accelerated significantly over the past decade. According to a report by the *Morningstar*, assets under management (AUM) in ESG-focused funds in India grew by 36% in 2022 alone, reflecting an increasing interest in this investment approach (*Morningstar Direct*, 2023). The rising importance of sustainability, in tandem with a growing middle class and the country's economic development, has resulted in increased demand for ESG-aligned investment products.

A key factor behind the growth of sustainable investing is the growing awareness of the risks associated with unsustainable business practices. For instance, industries like coal and mining, which have historically been significant to India's economic growth, are now increasingly seen as posing financial risks due to regulatory changes, environmental concerns, and reputational damage. On the other hand, sectors like renewable energy, technology, and green infrastructure

have garnered attention from ESG-focused investors as they offer long-term growth potential and alignment with global sustainability goals.

ESG Investing in India

In India, the concept of ESG investing is gaining traction, though it remains relatively new compared to Western markets. The Indian government has made significant strides in aligning with global sustainable finance trends. The launch of India's National Action Plan on Climate Change (NAPCC) and its focus on green energy, low-carbon infrastructure, and climate adaptation is one of the cornerstones for ESG growth. Furthermore, the Securities and Exchange Board of India (SEBI) has mandated ESG disclosures for top-listed companies, ensuring better transparency regarding their sustainability practices.

The rise of ESG-focused mutual funds in India has been particularly noteworthy. According to the Association of Mutual Funds in India (AMFI, 2021), the number of ESG-focused funds has increased in recent years, driven by a combination of regulatory pressure, market demand, and the increasing interest of Indian

investors in socially responsible investment options. Leading asset management companies have launched ESG mutual funds that focus on companies with strong environmental, social, and governance practices.

However, the adoption of ESG investing in India has been slow compared to more mature markets such as Europe and North America. One major challenge is the lack of standardized ESG reporting by Indian companies. A report by KPMG (2019) points out that many Indian companies still fail to disclose comprehensive ESG data, and there is no unified framework for measuring ESG performance.

Challenges in ESG Investing in India

Despite the positive trends, several challenges hinder the widespread adoption of ESG investing in India. One of the major obstacles is the lack of reliable and comparable ESG data. According to KPMG (2019), India's corporate governance frameworks have lagged in terms of integrating ESG factors, making it difficult for investors to assess companies' true sustainability performance.

Moreover, the perception that ESG investing may lead to lower returns has been a significant barrier to its growth in India. Many Indian investors are still skeptical about the financial performance of ESG funds and consider them to be more costly and less profitable than traditional funds. This skepticism is compounded by the perceived short-term nature of many investors in India, who are more focused on immediate financial returns rather than long-term sustainability.

Research Methodology

This research follows a qualitative approach to understanding the rise of sustainable investing and ESG-focused funds in India. The study relies on secondary data sources, including academic literature, government and industry reports, market surveys, and ESG fund performance reports. This methodology is appropriate because it allows for the examination of existing data and provides insights into the trends and dynamics of ESG investing in India.

Data Collection

The data collected for this study includes:

- Reports and guidelines from SEBI, India's capital market

regulator, which has played a central role in promoting ESG investments.

- Industry reports from financial institutions, mutual funds, and consulting firms like KPMG, PwC, and Franklin Templeton.
- Academic literature on ESG investing, sustainable finance, and corporate governance practices in India.
- Data from ESG-focused funds in India, including their performance and growth trends over the past few years.

Data Analysis

The collected data is analyzed using thematic analysis. The key themes explored in this study include:

- The growth trajectory of ESG-focused funds in India.
- The role of government regulations in promoting sustainable finance.
- Investor preferences and behavior related to ESG investing.

- The financial performance of ESG funds relative to traditional investment funds in India.
- The challenges and barriers to the adoption of ESG investing in India.

Interpretation

The analysis is interpreted in light of India's evolving financial system, with particular emphasis on the country's efforts to incorporate sustainability into its economic growth model. By examining both the opportunities and challenges of ESG investing in India, we can identify the factors that are likely to drive its future growth and impact.

Growth of ESG-Focused Funds in India

In recent years, India has witnessed substantial growth in ESG-focused funds. According to the AMFI (2021), the ESG-focused mutual fund category has seen a significant rise in assets under management (AUM). The number of mutual funds that incorporate ESG criteria has increased, with many large asset management companies such as HDFC Mutual Fund and ICICI Prudential Mutual Fund launching their own ESG-focused schemes.

This growth can be attributed to several factors, including increasing awareness about climate change and social issues, government initiatives, and the growing preference for sustainable investments among Indian investors. The launch of green bonds and ESG-themed exchange-traded funds (ETFs) further indicates the market's shift toward sustainable finance.

Regulatory Support and Government Initiatives

The Indian government has introduced several measures to support ESG investing. SEBI's guidelines on ESG disclosure are a key regulatory initiative aimed at enhancing transparency in corporate governance and sustainability practices. In 2020, SEBI mandated that the top 1,000 listed companies disclose ESG-related information, a move that is expected to increase the flow of capital toward responsible and sustainable investments.

Additionally, the National Action Plan on Climate Change (NAPCC) outlines India's commitment to addressing environmental issues, which has provided a solid foundation for ESG

investment strategies. The government's push for renewable energy projects and green bonds has further encouraged the growth of ESG investments in the country.

Investor Behavior and Preferences

Indian investors are increasingly interested in sustainable investments, especially in the context of rising concerns over climate change, pollution, and social inequality. A survey by Franklin Templeton (2020) found that a significant proportion of Indian investors are now aware of ESG investing and express interest in funds that focus on sustainable businesses. However, despite this awareness, the adoption of ESG funds remains low, as many investors still prioritize short-term returns over long-term sustainability.

The growing middle class, which is more informed and educated, is likely to drive future demand for ESG investments. However, there is a need for more investor education to bridge the knowledge gap surrounding ESG investing. Financial institutions must work to explain the potential benefits and long-term returns of ESG funds.

Financial Performance of ESG Funds in India

The financial performance of ESG funds in India has been a point of contention. Some studies suggest that ESG funds perform on par with or even better than traditional funds, particularly in sectors such as renewable energy, clean technology, and sustainable agriculture. For example, the MSCI (2021) report on ESG investing in India shows that ESG-focused indices have demonstrated resilience during periods of market volatility, suggesting that companies with strong ESG practices are better equipped to weather market downturns.

However, the cost associated with ESG funds remains a concern. ESG funds typically incur higher management fees due to the additional research and screening processes involved in assessing ESG performance. This can lead to lower short-term returns compared to traditional funds, which may deter price-sensitive investors.

Research Outcome –

Growth Trends of ESG-Focused Funds in India

The study revealed a significant upward trend in the growth of ESG-focused funds in India over the last decade. Assets under management (AUM) in ESG mutual funds increased by 36% in 2022 alone. The research identified key contributing factors such as rising environmental awareness, government policy shifts, and an evolving middle-class investor base that is increasingly interested in sustainable investing. The growth has been particularly pronounced in sectors aligned with sustainability goals, such as renewable energy, technology, and green infrastructure.

Evaluation of the Performance of ESG Funds in India

The study found that ESG-focused funds in India have demonstrated competitive financial performance, with returns generally in line with or even outperforming traditional investment funds, particularly in sectors like clean technology and renewable energy. ESG funds exhibited resilience during market volatility, supporting the view that companies with strong ESG practices are better equipped to manage

risks. However, ESG funds were found to carry slightly higher management fees due to the additional screening and research costs involved, which may affect short-term returns for price-sensitive investors.

Understand Investor Behavior and Preferences in ESG Investing

The study revealed that Indian investors are increasingly aware of ESG investing, with a growing segment expressing interest in sustainable investment options. Despite this awareness, the adoption of ESG funds remains relatively low, as many investors still prioritize immediate financial returns over long-term sustainability. A notable challenge is the lack of understanding regarding ESG investment benefits, which leads to hesitation in adopting ESG principles into portfolios. The research emphasized that the rising educated middle class could drive future growth in ESG investments, with further investor education necessary to bridge existing knowledge gaps.

Examine the Role of Regulatory Frameworks and Corporate Governance in ESG Adoption

The study concluded that regulatory frameworks, especially the Securities and Exchange Board of India (SEBI)'s ESG disclosure guidelines, have played a pivotal role in fostering the adoption of ESG practices. The mandatory ESG disclosures for top-listed companies have increased transparency, allowing investors to make more informed decisions. Additionally, India's National Action Plan on Climate Change (NAPCC) and focus on green energy have laid the foundation for integrating sustainability into corporate governance and investment strategies. However, further improvements in regulatory enforcement and standardization of ESG reporting are necessary to accelerate the adoption of ESG investing.

Investigate the Challenges Facing ESG Investments in India

The research identified several significant barriers to the widespread adoption of ESG investments in India. Key challenges include the lack of standardized ESG data, which makes it difficult to compare companies'

sustainability practices, and concerns over greenwashing, where companies exaggerate or mislead about their environmental practices. Another challenge is the skepticism surrounding the financial returns of ESG funds, with many investors perceiving them to be less profitable than traditional funds. Additionally, the relatively low investor awareness and understanding of ESG concepts have hindered broader adoption.

Evaluate the Alignment of ESG Funds with Global Sustainability Goals

The study concluded that Indian ESG funds are increasingly aligning with global sustainability goals, particularly the United Nations Sustainable Development Goals (SDGs). Many ESG funds in India are investing in sectors such as renewable energy, clean technology, and sustainable agriculture, which contribute directly to global sustainability efforts. However, the alignment is still developing, with room for greater integration of global best practices and international sustainability frameworks. The study also

highlighted that India's ESG funds have potential to play a larger role in global sustainable finance, provided there is greater adherence to standardized ESG reporting and practices.

Policy Recommendations for Enhancing Sustainable Investing in India

This study provide several policy recommendations to enhance sustainable investing in India. These include:

- **Standardizing ESG Data:** Developing a unified framework for ESG reporting across Indian companies, with clear and comparable metrics to improve transparency.
- **Strengthening Investor Education:** Launching awareness campaigns and educational initiatives aimed at improving investor knowledge of ESG investing and its long-term financial benefits.
- **Regulatory Enhancements:** Encouraging SEBI to enforce stricter ESG disclosure guidelines and ensure better compliance across listed companies.
- **Incentivizing Sustainable Investments:** Providing tax incentives or subsidies for investors and companies that prioritize ESG factors in their portfolios and business practices.

These recommendations aim to create a more robust and transparent ESG investment ecosystem in India, aligning it more closely with global sustainability goals.

Key Drivers Behind the Rise of Sustainable Investing in India

This study identified several key drivers behind the rise of sustainable investing in India:

- **Environmental Awareness:** Increasing recognition of the financial risks posed by unsustainable business practices, particularly in sectors such as coal, mining, and fossil fuels.
- **Government Initiatives:** The Indian government's commitment to climate action, as seen in policies such as the National Action Plan on Climate Change (NAPCC) and the promotion of renewable energy, has been a significant catalyst.
- **Growing Middle Class:** India's rising middle class, particularly younger and more educated investors, has shown a strong preference for sustainable investment options.
- **Regulatory Support:** The introduction of SEBI's ESG disclosure mandates and

other supportive measures has improved transparency and investor confidence in ESG investments. These factors collectively create a conducive environment for the growth of ESG investing in India.

Overall Research Outcomes:

The study confirms that ESG investing in India is on an upward trajectory, supported by favorable regulatory frameworks, growing investor awareness, and increasing demand for sustainable investment options. While challenges such as data standardization and investor skepticism remain, there is considerable potential for ESG investing to reshape India's financial landscape, especially with the increasing integration of ESG principles into corporate governance, policy frameworks, and investor behavior.

Conclusion

The rise of sustainable investing and ESG-focused funds in India marks a significant shift in the country's financial landscape. While ESG investing remains a relatively new phenomenon in India, it is gaining traction due to growing awareness, supportive regulatory frameworks, and

evolving investor preferences. The Indian government's policies, such as mandatory ESG disclosures and support for green finance, are key drivers behind this trend.

Despite challenges such as the lack of standardized ESG data, investor skepticism, and higher costs associated with ESG funds, there is considerable potential for growth in the ESG investment space. The growing middle class, along with the increasing focus on long-term sustainable practices, will likely continue to drive the adoption of ESG strategies in India.

As India seeks to address its environmental and social challenges, ESG-focused funds will play an increasingly important role in mobilizing capital for sustainable development. Future growth in ESG investing will require overcoming challenges related to data transparency, investor education, and cost-efficiency. Nonetheless, the rise of ESG investing in India is a promising sign of a more responsible and sustainable financial system.

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