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Investing with a Focus on ESG: The Way Forward for India

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ABSTRACT

The growing threats posed by environmental and climate crises have recently become a significant force for the nations to engage investors as key players in pursuing sustainable growth. This involves integrating Environmental, Social, and Governance criteria into investment strategies. As sustainability and responsible practices gain prominence, Environmental, Social and Governance (ESG) investing is increasingly recognized as a transformative force on global financial markets. In India, ESG investing is gaining importance, fuelled by increasing regulatory demands, investor interest, and a growing recognition of responsible business practices. This research paper aims to thoroughly examine and critically assess the concept of ESG investing along with ESG in action. The study explores the evolution, recent regulations, strategies, challenges, and future prospects of ESG investing in India. Additionally, it seeks to address the pertinent question of whether ESG investments yield higher returns and investigates the correlation between strong ESG performance and stock price appreciation. The researchers have employed a doctrinal research methodology to carry out this study. Previous studies have produced mixed conclusions regarding the correlation between ESG investments and their financial returns. However, the authors of this research, after accounting for the country's commitment and the companies' dedication to sustainable growth, along with recent data supported by ongoing regulations such as mandatory CSR & BRSR and rising investor demand, have identified a positive relationship between ESG performance and financial outcomes. This correlation is demonstrated across various metrics including risk, stock returns, profitability, and long-term performance. However, despite these progressions, challenges remain, such as the necessity for stronger regulatory frameworks, uniform ESG measurement standards, and improved corporate transparency.

Keywords: ESG, CSR, BRSR, SEBI, Companies Act 2013.

I. INTRODUCTION

With a shift in tide, there has been a global transformation from traditional investing towards investing with a focus on ESG, emphasizing the sustainability and long-term impact of

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investments. Today, we find ourselves in an era where our actions significantly impact the environment, demanding a heightened focus towards betterment of those actions. Investment decision making and analysis are increasingly prioritizing compliance to ESG criteria. This shift involves a nuanced balance between traditional profit maximization and profit maximization integrated with ESG considerations. Since the early 21st century, investments aligned with ESG principles have seen significant growth. The investors are moving way forward than the conventional fiscal disclosure of companies and placing greater importance on ESG metrics in their investing decisions. The increasing perils of the environmental and climate related crisis have recently emerged as compelling factors for countries to mobilize private investors as important stakeholders in achieving the sustainable development goals by incorporating ESG factors into investment processes and investment decision making systems.³

The fusion of investment with ESG factors has become radically relevant in recent times but its history traces back to the 1970s when socially responsible investing surfaced as a way for investors to make parallel investments with their ethics and therefore, started to avoid investing in companies operating in tobacco or in South Africa during apartheid.

The notion of “ESG” was first introduced in 2004 by the UNGC in a report titled “Who Cares Wins”. ESG refers to Environment, Social and Corporate Governance. Consequently, ESG focused investing is a systematic investing strategy that integrates sustainable growth factors, environment, social impact and governance into investment analysis and decision making process. Although in India, ESG focused investments are until now in their early stages. They are steadily building momentum. Recent policies have notably intensified focus on climate-conscious investments and the contributions to green energy projects. The 2020-21 Economic Survey by GOI also underscored the importance of aligning sustainability and economic policies, highlighting various measures of promoting ESG investments in the country.

II. UNDERSTANDING ESG INVESTING

Environment, Social and Corporate Governance widely known as ESG investing, unlike conventional financial investing, is an investment strategy that focuses to achieve financial returns by considering environmental and social impact of a company, along with its corporate behaviour. It represents an investment strategy focused on sustainability and responsibility, incorporating diverse approaches aimed at achieving various objectives that contribute to a sustainable future. It is a broad term for investments in companies that follow sustainable

³ Gopal K. Sarangi, Resurgence of ESG Investments in India: Toward a sustainable economy, ADBI Working paper, No. 1284, Page no. 2, (2021), <https://www.econstor.eu/bitstream/10419/249463/1/adbi-wp1284.pdf>

practices while creating financial gains. Terms like Sustainable investing, Impact investing and socially conscious investing are sometimes synonymously used with ESG investing. The subtle distinction is that ESG focused investing thrusts upon incorporating ESG factors in identifying growth opportunities and preventing risks. With the changing dynamics, “socially responsible investing” has evolved into ESG investing, which focuses on how companies incorporate ESG criteria in their business models. ESG investing strives to encourage ethical and sustainable corporate practices while reducing risks and identifying opportunities for long term growth with a sustainable future. The objective is to foster responsible corporate approaches while achieving competitive fiscal returns.

(A) Criteria of ESG Investing

The three key criteria used for evaluating organizations for ESG investing are- Environment, Society and Corporate Governance.

1. *Environment*: An investor before investing gauges what impact a company creates on the environment, which includes its carbon footprint, greenhouse gas emissions, contribution to air, water pollution and management of waste products etc.
 - Climate change: assessing how organizations manage their greenhouse gas emissions, whether it incorporates low carbon footprint methods in functioning or not.
 - Energy efficiency: efforts to reduce energy consumption and increase efficiency
 - Resources conservation: assessing the utilization and preservation of resources such as water and aquatic systems
 - Waste and pollution management: management of waste products and efforts to reduce pollution.
 - Biodiversity loss: what is the impact of an organization’s functioning on ecosystem and diversity.
2. *Society*: A responsible investor also assesses what and how a social impact is created within the company and the community, beyond the limited business spheres. Social factors in ESG investing focus on how companies manage relationships with their shareholders, employees, suppliers, customers and community where they function.
 - Customer satisfaction: product safety, quality, ethical marketing practices, after services and handling customer grievances.
 - Stakeholder engagement: Addressing stakeholder concerns and feedback effectively, maintaining transparency with stakeholders including employees etc.

- Labour laws: ensuring fair wages, benefits, employee rights and workplace safety etc.
 - Community relations: interaction and impact on local communities.
 - Human rights: ensuring policies and practices regarding human rights with the company.
3. *Corporate Governance*: Governance in ESG investing focuses on how a company is directed and controlled. The factors such as its principles and systems by which a company is governed ensure accountability and transparency in its relationship with stakeholders, employees, customers, competitors and suppliers.
- Board Structure: the structure and autonomy of the board of directors.
 - Shareholder rights: policies ensuring shareholder rights and just practices.
 - Business ethics: whether a company incorporates ethical behaviour or unethical practices like corruption and bribery are followed.
 - Transparency: disclosure of company operations, financials and ESG practices.

III. THE JOURNEY OF ESG INVESTING

ESG investing in India has been on an ascendant path and the demand for ESG funds has surged in response to the Covid-19 pandemic. The main cause of the inflow of ESG investing is mainly due to the stakeholders becoming more aware consciously, socially and ethically. With the rise in growing concerns about the environment, investors started to invest in ESG. There was a shift in the minds of the stakeholders from making profit for their organization to giving back to their society. Investors no longer look for a high rate of return on their investments but look towards how a company is investing in building a better present and a better future. Thus, it has become an important requisite for the businesses in India.

The evolution of ESG investing is a long-drawn history. Businesses used to prioritize profit making variables. But now there was a change in the way of doing business. Corporations started aligning their profit-making goals with environmental, social and governance goals. There was a growing need to incorporate sustainable development goals (SDGs) into their companies' goals. In 2011, the Ministry of Corporate Affairs, Government of India, issued National Voluntary Guidelines on Social, Environmental, and Economic Responsibilities of Business (NVGs). These guidelines provided a path for the companies to walk towards sustainable development. It was considered as a beacon of light to guide towards the goal of an ethically driven company. Now, it was the obligation of the businesses to promote CSR initiatives. Thereafter, at the end of 2011, the Ministry of Corporate Affairs, introduced

National Voluntary Guidelines on Social, Environmental and Economical Responsibilities of Business. In these strategies, three principals were incorporated to make sustainable growth of the company a reality.

Afterwards, SEBI, Securities Exchange Board of India, in 2012, made it compulsory for the top 100 listed companies to provide for the Annual Business Report (ABRR) and for those which were listed in the stock exchange, listing agreements were changed. It was done to make a comprehensive approach towards the growth of the company. Later, ABRR was changed to BRR i.e. Business Responsibility Report, in which report provided by the company was to be based on the National Voluntary Guidelines.

The Companies Act, 2013, was introduced which stressed on the importance of good ethical practices and their relation with high profits. Now, the stakeholders do not think of social development just as any other obligation on them but it became one of their goals. In this way, India became one of the countries which emphasized the companies to contribute 2% of their earnings to the CSR goals. Subsequently, to empower the environmental and social development goals, BRR reporting was changed into Business Responsibility and Sustainability Report (BSBR). Under this, the companies were to provide their performance report based on the National Guidelines on Responsible Conduct Principles. It became obligatory for the top 1000 listed companies to make disclosures in India from FY 2022-23. Later-on, BRSR Lite Framework was incorporated for unlisted companies.

In march, 2023 BRSR core framework was introduced by the SEBI. It is a new supervisory framework which requires ESG disclosures by the 1000 listed companies. The implementation of BRSR was to be done in four phases i.e., it was to be applicable to top 150 entities during FY 2023-2024, to 250 listed entities in 2024-25 and so on till it covers top 1000 listed companies in financial year 2026-2027.

IV. ESG POLICY REFORMS IN INDIA

On one side there were growing concerns regarding the effect of industries environmentally and socially and on the other side investors, customers demanded good ethical behaviour from the companies. This was the main reason that led to the emergence of practices that not only focuses on profit making but also on good ethical business activities. Also, in the meantime, it had become clear that to earn long term benefits and to reduce risk, they had to invest in ESG policies in consonance with the regulations. In 2008, the first investable index was launched by CRISIL and KLD Research and Analytics which features companies that show great commitment to the required ESG standards. Later, in 2009, the Ministry of Corporate Affairs

published CSR guidelines. One major step towards the regulation of ESG policies was in 2013, when MSCI India ESG leaders Index was launched.

In 2018, SEBI launched Green Bond guidelines that made India the Second country to provide guidance at national level. These are a type of instrument the proceeds of which are used to invest or reinvest Green Projects which are eligible to use such proceeds. On 27th June, 2023, SEBI took another step towards reforming ESG policies. They amended the SEBI (Mutual Funds) Regulations 1996. The main reason behind these was to prevent the companies from selling a false image of their organisation. Earlier mutual funds can be launched in one scheme along with ESG investing, however after 2023, it can be launched in six categories. The breakthrough in the ESG policy reforms was this time when the Union Budget of 2024-2025 referred to the terms such as “ESG” and “green economy”. It provided a guiding path for India towards the goal of ‘Viksit Bharat’.

V. ESG INVESTMENT STRATEGIES

ESG investments can be classified into different strategies based upon how it incorporates ESG factors into the investment process. Some mainstream ESG investments are:

1. Exclusionary screening: this approach excludes companies from investment based upon the criteria that they do not meet sustainable or ethical standards. Example: a fund that excludes investments in tobacco or firearms etc.

2. Positive Screening: this strategy considers companies that perform the best on ESG criteria within their industry. Instead of excluding entire sectors, it focuses on identifying and investing in top performers. Example: selecting a company with high ESG score within the technology sector.

3. ESG integration: It involves incorporating ESG factors into decision making along with analysing financial metrics. For example: an investment fund that evaluates a company’s carbon footprint and greenhouse gases emission in addition to financial health.

4. Thematic investing: this approach focuses upon specifically ESG themes or issues such as sustainable agriculture, clean technology or renewable energy etc.

5. Impact investing: according to this approach, investments are made with an intention of creating a positive difference. It aims to generate considerable environmental or social impacts alongside financial returns.

6. Norms based screening: with this approach, investments are screened based upon a company’s adherence to international norms and standards, such as those set by OECD

guidelines or UNGC. For instance: excluding companies that violate human rights or labour standards as defined by global norms.

Each type of ESG investment allows investors to parallel their investment decisions with their values and sustainability goals. The choice of strategy depends on individual or institutional preferences, risks, opportunities, and investment objectives.

VI. ESG FUNDS AND FINANCIAL PERFORMANCE

ESG factors are inherently non-financial and therefore challenging to quantify directly. The assessment of a company's compliance to sustainable factors is typically determined by ESG ratings, assigned by different research organizations like Morningstar, MSCI, Bloomberg, Sustainalytics etc. Each of these organizations employs its own distinct scoring methodology. The ESG compliance levels are dynamic in nature, therefore constantly evolving in response to shifting standards, corporate initiatives and regulatory developments. These scores are crucial for socially responsible investors seeking to invest in companies that exhibit robust moral and sustainable practices. It provides an understanding about a company's sustainable long term returns and viability. Indices such as Nifty 100 ESG, MSCI India, and BSE 100 ESG are used to benchmark actively managed funds, with Nifty 100 ESG being the most widely followed index in India. These indices provide a reliable standard for assessing the performance of funds that prioritize environmental, social and governance criteria.

Global studies indicate that organizations with strong ESG scores often outperform traditional investments, particularly when viewed over extended periods. Additionally, numerous studies and reports indicate that companies with robust ESG strategies typically exhibit lower risk profiles, better financial performance and enhanced resilience during periods of market instability. A pertinent question that arises is whether integrating ESG criteria into investment decisions leads to higher returns compared to traditional funds. To address this question, it is essential to analyze the link between good ESG performance and financial outcomes of a corporation through various metrics such as risk, stock returns, profitability, long term performance etc.

Risk Management and Stability: Effective ESG practices enable companies to proactively identify and mitigate a range of potential risks. This can also lead to more stable financial performance. According to a 2024 report by ESMA during Covid-19 pandemic, non-active funds centered on ESG principles outperformed non-ESG active funds but also delivered superior returns throughout the period compared to those with lower ESG scores.

Cost savings: The impact of ESG practices on costs can be though viewed from two

perspectives, cost savings on one hand and increased expenses, on the other.

Primarily, companies that implement strong ESG practices often achieve cost efficiencies in various domains. For example, the adoption of energy-saving technologies can reduce utility expenses and initiatives aimed at minimizing waste can lower disposal costs. Furthermore, companies that prioritize social and governance aspects such as fostering positive employee relations and ensuring transparent governance may benefit from reduced employee turnover, minimized legal risks and enhance reputations, all of which can lead to significant cost savings in the long term.

Conversely, incorporating ESG practices can initially result in higher costs. This may include investments in sustainable technologies, compliance with stringent environmental regulations, and maintaining high labour standards. Additionally, the expenses associated with monitoring, reporting and auditing ESG metrics can be considerable. However, in summary, while ESG practices may incur higher initial costs, they tend to offer long-term advantages, including cost reductions, better risk management and improved financial performance.

Market Valuation and perception: Adopting sustainable practices unlocks expansive new market opportunities. Companies with robust ESG practices are increasingly favoured by investors, which often leads to higher stock valuations and strengthened investor confidence.

Long-term returns: Unlike traditional investments that may focus on short-term profits, companies committed to ESG practices are better equipped to achieve sustainable long-term returns, owing to their ability to adapt to evolving regulations and market expectations.

Numerous studies also indicate a positive link between high ESG factors performance and stock price appreciation. Studies indicate that companies with high ESG ratings generally experience lower volatility and more favourable financial results and higher stock returns over the long run. Research from credible sources like MSCI suggests that ESG-focused indices frequently match or surpass the performance of traditional indices. For example, MSCI India ESG Index has outperformed the MSCI India Index during certain periods. The ESG index has outperformed the traditional index particularly during the periods of market volatility or increased investor focus on sustainability. However, this outperformance is not uniform across all sectors and can depend on the specific ESG criteria employed as well as prevailing market conditions. While ESG investments generally offer competitive returns, it is crucial to account for the broader market context and the investment time horizon. In essence, companies with high ESG scores often exhibit superior financial performance, especially when considering risk-adjusted returns and long-term financial stability. This trend highlights the growing global

pattern where ESG investments tend to outperform traditional investments over extended periods.

VII. ESG IN ACTION

For a company to invest in Environment and social activities it is important to find a correct balance between them. Therefore, to begin with the companies first identify key ESG metrics i.e. where a company should keep its focus. Later, strategies are developed by the core committee which is specially made for this purpose. After developing a road map, the next thing to do is to walk on these well-defined roads and continuously monitor them. Another duty of the committee is to keep a check on the activities and collect data along with it, which helps them to improve their performance. To comprehend the ESG strategies of top performing companies, we have examined recent ESG initiatives of three unicorn organizations and their future ESG prospects.

(A) Mahindra & Mahindra

The sustainability report of Mahindra & Mahindra 2023-2024, shows that they have a commitment to become a Planet Positive company. Their key players are employees' health, their well-being and safety and development. They focus on making their operations greener and the planet healthier. From 2001, Mahindra & Mahindra have been a committed member of UNGC i.e. United Nation Global Compact. It is a strong community of 20,000 companies which are dedicatedly working towards building a sustainable planet. In Bengaluru, they have launched India's first Net Zero Energy homes. Their major ESG commitments include- Renewable energy by 2030, to be carbon neutral by 2040, to become water positive at group level, zero waste to landfill by 2030. Along with this they are also focused on women empowerment and to support 1 million women per year and additionally they have a project called 'Nanhi Kali' which calls for educating 1 million year girls per year. They have a goal to achieve world-wide leadership, by 2030, in Environmental, Social, and Governance (ESG) standards. Recently, they have launched i.Riskman, whose main function is to evaluate ESG risk related activities. It also provides the customers first hand knowledge regarding the data, companies activities and enables them to make greener decisions.

(B) Adani Green Energy Limited

The focus of Adani Green is to build a future where new technological innovations, climate related risks and the idea of a sustainable planet can co-exist. The integrated annual report of 2023-2024 talks about how they are taking effective action to lessen the impact caused by activities of corporations. Their main idea is "Growth with Goodness", which itself shows that

only growing is not sufficient to be in the game for long run, it is also important that you grow with ethics, you grow with sustainability. Their key ESG commitments include- to become Net Water neutral certified company by 2026, to become a company that is Zero waste Landfill for their 100% renewable energy generation plants by 2024-2025 and to conduct business with no less to biodiversity by 2025. Their ESG policy structure focuses on various goals across E, S and G facets. Their 'Environmental' goals include energy management policy, resource conservation policy, sustainable procurement policy, biodiversity policy and water stewardship policy. Their 'Social' initiatives include policies on human rights and diversity, equity and inclusion, corporate social responsibility policies. Lastly 'Governance' includes board diversity policy, code of conduct and anti-corruption, anti-bribery and conflict of interest policies.

(C) Tata Consultancy Services

Tata is basically a consulting organization that offers business solutions and has been operating for over 56 years. Their ESG commitments has led this company to become the first company in 2022 to publish the Business Responsibility and Sustainability Report (BRSR) which provides the stakeholders knowledge about their ESG practices. To follow the commitments, they are intensively researching green hydrogen and biofuel. Their major 'Environment' themes include carbon footprint mitigation, water conservation and recycling, waste reduction and preserving biodiversity. They aim to achieve a reduction in greenhouse gas emissions by 70% by 2025 and net zero emission by 2030. Their 'Social' initiatives focus on maintaining a financially strong, viable business solution which can change with the change in technology. For their employee wellbeing and engagement, they have occupational health and safety measures. Their focus is to adopt methods which can help in preventing work-related accidents. Along with this to promote equity and diversity their targets are to embrace nationality, ethnicity, gender to create a workforce that works well. For their 'Governance' themes their philosophy is to oversee business strategies and ensure ethical behaviour and equality to all people.

VIII. FUTURE TRENDS IN ESG INVESTMENT IN INDIA

The shift towards sustainable growth offers vast opportunities for businesses and investors. A potential investment of Rs. 83 trillion is expected in India by 2030 focusing on sectors like electric vehicles, renewable energy, green buildings and sustainable agriculture, as indicated in a report by IFC (International Finance Corporation). India's renewable energy sector is a prime ESG investment opportunity. Meeting these goals will necessitate significant

investments in infrastructure for renewable energy, innovation and technology. India has also reinforced its climate action objectives, aiming for GHG neutrality by 2070. Also, a report by an Indian investment bank, Avendus Capital indicates that soon sustainable growth factors, i.e. ESG will become crucial while making decisions within the Indian capital market. The report projects that by 2051, ESG investments might constitute roughly 34% of all domestic assets under management (AUM). In the upcoming 5-10 years, the growth in ESG-focused AUM in India is likely to follow the same trajectory as the Asia-Pacific region, which is around 30%, and is anticipated to level off at 15-20% by 2051. Moreover, a considerable share of this growth will come from the reclassification of current assets into ESG categorization, particularly within companies that are progressively incorporating ESG factors into their business practices.

(A) Not a Cake Walk

Although it is very important for a company to invest in ESG practices but it is easier said than done. It is not a cakewalk. First and the foremost challenge is the lack of regulations and guidelines to assess the ESG metrics. Even though various steps have been taken by SEBI and MCA, there is a lack of universally accepted guidelines because of which companies fail to measure and report their goals. Thus, it complicates the whole process. Another challenge is the concept of “Greenwashing” where a company in order to look good in books falsifies their data and shows a hoax positive image. They try to sell an image of a company which does not exist. The main reason behind is to get a competitive edge over their competitors and to attract more customers.

Also, adopting the ESG practices requires companies to address issues ranging from environment sustainability to social fairness and to corporate governance. To excel in each of these categories, the company requires handmade strategies and plans to move forwards, which can increase more complexities within the company. It also requires deep knowledge about these variables in order to maintain a balance between them and thus leads to more financial burden. Moreover, ESG obligations are continuously changing and companies need to keep themselves up to date to ensure compliance. Thus, it leads to more financial and administrative burden. It is important for businesses to flourish to integrate these practices into their core strategies rather than treating them as a separate issue.

In a nutshell, it is necessary to have a bird’s-eye view approach on these issues. It is not a bed of roses. The implementation and compliance of ESG regulations provides a complex landscape which is marked with both opportunities and various challenges.

IX. CONCLUSION

The publication of the report “Fiduciary Duty in the 21st Century” by UN agencies and PRI highlighted that neglecting ESG considerations in financial decisions could be seen as a breach of fiduciary duty and that integrating ESG criteria into investment practices is now essential, as these concerns have become financially material and current policy and regulatory frameworks increasingly mandate their consideration. ESG investing in India is rapidly growing due to regulatory support, rising investor demand, and the recognition of new business opportunities. As the nation pursues sustainable development, ESG investing is crucial in fostering positive impacts on the environment, society, and corporate governance. By adopting ESG investing, India can lead the way towards a sustainable future that harmonizes financial returns with social and environmental well-being. India has gradually built an institutional and legal framework to support ESG adoption, aiming to encourage ethical business practices and foster long-term value creation. From 2012 to 2020, India launched six ESG funds. At present, India offers eleven ESG funds, which include one passive, two global feeder and remaining actively managed funds. Recent regulations from SEBI allow the formation of ESG funds using six distinct approaches, such as impact investing, positive screening, inclusion, exclusion etc. Several key factors are fuelling the growth of ESG investing in India. These include the country’s ambitious target to achieve Net Zero emissions by 2070, necessitating an estimated \$9 trillion in investment in next 50 years; implementation of BRSR requirements establishes a legal framework to encourage sustainable growth among listed companies; while United Nations SDGs act as a benchmark for assessing appeal and ability of a company to attract investment. India’s dedication to sustainable growth is reflected in its regulatory framework. A company’s revenues can be significantly affected by a negative ESG incident that damages its reputation, such as emissions violation or pollution issue or poor governance. As a case in point, Yes Bank’s stock saw a sharp decline during 2018-2020 as a result of multiple governance failures, such as poor risk management, dubious lending practices, and insufficient transparency in financial reporting. These problems eroded investor confidence, ultimately pushing the bank to the brink of collapse and necessitating a government-led rescue. After accounting for the country’s current commitments and the companies’ dedication to sustainable growth, along with recent data supported by ongoing regulations such as mandatory CSR & BRSR and rising investor demand, the researchers have identified a strong relationship between ESG performance and financial outcomes. This correlation is demonstrated across various metrics including risk, stock returns, profitability, and long-term performance. However, despite these progressions, challenges remain, such as the necessity for stronger regulatory frameworks, uniform ESG measurement standards, and improved corporate transparency.

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