

ESG-Labelled Mutual Funds in India: Performance, Investor Flows and Market Implications

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Abstract

Since 2018, the sharp rise in ESG funds in India has left a huge gap which needs to be researched urgently. The total global ESG assets under management crossed US\$ 35 trillion in 2020. While ESG has become mainstream in the global mutual fund industry, in India, it has taken more than a decade for ESG assets under management (AUM) to cross Rs. 25000 crores in 2023. Any empirical investigation of Indian ESG funds is negligible in the emerging academic literature. The authors analyze the financial performance and the environmental, social and governance performance of ESG mutual funds in India. We analyze research published in reputed international and India-specific journals to identify five key gaps in existing literature. Empirical studies were taken into consideration to come up with the 4 hypotheses that are testable in nature. Our hypotheses state the following: H1 risk-adjusted performance of ESG vs conventional funds; H2 investor flow sensitivity to ESG rating and controversy; H3 greenwashing effect through portfolio characteristic comparison; and H4 the impact of ESG on market pricing. We suggest a multi-method secondary data analysis plan post-2018-23 for the ESG-labeled equity mutual funds active in the Indian market.

Keywords: *ESG investing, sustainable finance, mutual funds, greenwashing, investor behavior.*

1. INTRODUCTION

One of the major trends in investment globally is ESG investing. Around the globe, ESG assets were over \$35 trillion in 2020, accounting for more than a third of professionally managed assets globally (Bloomberg Intelligence, 2021). According to worldwide proof, companies complying with ESG are not only more responsible corporate citizens, they are less risky and deliver better risk-adjusted returns (Friede et al., 2015). In the long run, a company will perform better when valuing the environment and the community in which it operates.

India's ESG investing landscape has grown rapidly. In 2021, SEBI made BRSR mandatory for top 1,000 listed companies in the country. The assets of ESG Equity mutual funds rose from negligible in 2018 to more than ₹25,000 crores in 2023 (AMFI, 2023). We still lack answers to the fundamental questions. Are the risk-adjusted returns of ESG funds superior to those of non-ESG funds? Are the investor flows driven by genuine ESG preferences or by momentum chasing? In the end, does the ESG label signify actual ESG investing or is it merely a marketing gimmick?

In India, it is unique and difficult. The economy is growing rapidly with severe environmental destruction and social problems. Impact investing and ESG ideas are advancing in India. The investor base consists mainly of retail investors with mixed awareness.

2. LITERATURE REVIEW

2.1 Theoretical Foundations

The ESG-performance relationship is one subject to disagreement that our analysis uncovers. According to the shareholder primacy doctrine by Friedman (1970), ESG constraints negatively impact portfolio diversification, which results in depressed returns. The Freeman theory, which advocates for stakeholder theory whereby firms create superior long-term value when they manage their relationship not just with shareholders but also with multiple stakeholders, reduces regulatory risk, enhances reputation and improves operational efficiency.

According to Khan et al. (2016), the bottom-two views may be reconciled by materiality. Those ESG issues that relate to a materially relevant subset of particular industry sectors and are financially material should not reliably influence performance, it is argued. As a result, the perspective explains the varying ESG-performance empirical findings within and across industry sectors as well as geographical regions.

The tests of incidence and returns for the materiality of the Giese et al. (2019) null are successively bent to demonstrate that ESG factors can charge a premium through an idiosyncratic risk channel as well as a systematic risk channel. They also present empirical proof of economic mechanisms and a moderator that reconciles variable effects by time.

2.2 Empirical Evidence: Global Studies

The empirical literature is mixed on ESG fund performance. The varying methodologies, time frames, and definitions of ESG distinguish the studies. As an illustration, Friede et al. (2015) conducts a meta-analysis on over 2,000 studies and documents that around 90% report non-negative ESG-performance relations. Recent evidence from larger samples is disconcerting. According to Hartzmark and Sussman (2019), high-sustainability U.S. mutual funds have attracted much larger inflows but do not earn higher returns. This is consistent with sustainability-minded investors being willing to trade-off some return for sustainability.

According to the investor behavior literature there are distinct fund-flow patterns for ESG. Riedl and Smeets (2017) conduct an experiment that documents non-pecuniary utility in investor utility when it comes to ESG investing; moreover, ESG fund demand would be sustained absent a financial premium.

Berg et al. (2022) show that the use of comprehensive ESG rating data reveals extensive disagreement amongst ESG-ratings agencies, which weakens the relation between ESG performance and makes it more difficult for investors to identify “good” ESG investments. Gibson Brandon and others document 2022.

2.3 ESG Investing in India: Current State and Gaps

Indian research is generally atypical. Bansal et al. (2021) report that listed Indian firms with better ESG scores exhibit an improvement in their operating performance and a lowering of their cost of capital at the firm-level. According to Kumar et al. (2022), Indian fund managers exhibit extensive heterogeneity in their ESG interpretations and implementations. SEBI’s BRSR disclosure framework of 2021 creates a natural experiment to assess the impact of regulation on market development, as it causes a major structural break in the quality of disclosure. (AMFI, 2023).

There is virtually no empirical research that examines the systematic patterns of ESG mutual fund performance, investor patterns, and greenwashing in India. A majority of studies attempt to characterize the features of the fund. This is a notable oversight. India’s investor base is retail-dominant, and the lack of ESG awareness varies widely across the retail-institutional spectrum. The present study seeks to study the correlation between the nature of cash flows and arbitrage patterns for ETF markets. India’s ESG data

structure and benchmark indices are still at an early-stage, facing its own measurement challenge of performance.

3. IDENTIFIED KNOWLEDGE GAPS

The foregoing review reveals five critical gaps that motivate this research:

Gap 1 — Performance evidence: No systematic risk-adjusted performance evaluation of Indian ESG mutual funds exists, leaving open whether the global ESG-performance literature translates to India's market structure.

Gap 2 — Investor behavior: Flow dynamics of India's retail-dominated, ESG-awareness-heterogeneous investor base are entirely unstudied; behavioral patterns documented in developed markets may not apply.

Gap 3 — Greenwashing detection: Empirical methods for identifying greenwashing in fund labels are underdeveloped for markets with limited ESG data infrastructure; portfolio-level comparisons for Indian funds have not been conducted.

Gap 4 — Market-level pricing effects: Whether ESG fund growth creates valuation premiums for high-ESG Indian equities (a 'greenium') or influences corporate cost of capital remains untested.

Gap 5 — Regulatory impact: India's rapidly evolving SEBI regulatory framework (BRSR, potential fund classification standards) constitutes a natural policy experiment whose effects on ESG market development have not been leveraged empirically.

4. RESEARCH OBJECTIVES AND HYPOTHESES

Four research objectives and corresponding testable hypotheses are derived directly from the identified gaps. Each hypothesis is stated in null form to facilitate standard statistical testing.

Objective 1: Performance Attribution

H₁₀: ESG-labelled mutual funds in India do not deliver statistically significant risk-adjusted outperformance relative to conventional equity funds over the 2018–2023 period, after controlling for market, size, value, and momentum factor exposures.

Objective 2: Investor Flow Dynamics

H₂₀: Investor flows into Indian ESG mutual funds are not more sensitive to changes in ESG ratings or ESG-related corporate controversies than to lagged fund financial performance.

Objective 3: ESG Label Integrity (Greenwashing)

H₃₀: ESG-labelled mutual funds in India do not exhibit materially superior weighted-average ESG scores or lower carbon intensity in their portfolio holdings compared to conventional funds from the same fund families.

Objective 4: Market-Level Pricing Effects

H₄₀: Growth in ESG-labelled mutual fund assets under management is not positively associated with valuation premiums for high-ESG-rated stocks in Indian equity markets.

5. PROPOSED METHODOLOGY

For the period 2018 to 2023, this research uses a secondary data analysis from (1) Association of Mutual Funds in India (AMFI) for monthly fund return, Assets Under Management (AUM), investor flow and quarterly portfolio holding (2) MSCI Inc. and Sustainalytics for monthly corporate Environmental, Social and Governance (ESG) scores and monthly controversy flag (3) NSE/BSE for daily market prices and index return

(4) Securities and Exchange Board of India (SEBI) for quarterly regulatory filing and (5) corporate Business Responsibility and Sustainability Reports (BRSR) for disaggregated environmental and social indicators. The study period is unique as it encapsulates the life cycle of Indian ESG fund market from its genesis.

By adding an ESG factor to the multi-factor performance models tested by Carhart (1997) as well as the Sharpe, Sortino and Information ratios, they test H1. Bootstrap inference is used to adjust for non-normality in return distributions. We conduct dynamic panel regressions of investor flows on lagged performance, ESG rating upgrades/downgrades and controversy flags as well as event study to analyze H2.

6. EXPECTED CONTRIBUTIONS AND CONCLUSION

The findings of this research are: From a scholarly point of view, it is the first detailed empirical research into performance of ESG mutual funds from India. This study will first extend the theory of sustainability finance to an emerging market which remains under explored in the literature. It will test whether established evidence from developed markets generalize. From a policy perspective, the insights on greenwashing trends and performance attribution will help SEBI, in its specific effort to formulate standards for ESG fund classification and disclosure requirements. According to the study, investors may analyse their allocation between ESG funds, the expected fee adjusted return, and authenticity of the ESG label among others, which are backed by evidence. The study looks at whether ESG allocation of capital flows to the firms that are enhancing India's climate pledges and SDGs from a sustainable development (SD) perspective.

The unique characteristics of India--a significant retail and institutional investor base, continuous evolution of its regulatory framework, very nascent ESG data ecosystem and development of the country being threatened by environmental and climate risks--make India a valuable laboratory for ESG market development. ESG fund AUM is growing rapidly in India, while the regulatory ecosystem around ESG fund in SEBI is still evolving. This makes empirical evidence of the kind which this lab.

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