

ESG Investing: Can Ethics and Returns Go Hand-in-Hand?

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ABSTRACT

Rising concerns around climate change, social equity, and corporate accountability—combined with evolving regulatory frameworks—have accelerated the growth of sustainable investing. At the forefront of this shift are Environmental, Social, and Governance (ESG) funds, which integrate ethical principles into financial decision-making. These funds are gaining momentum as investors increasingly seek portfolios that not only generate competitive returns but also align with their personal values. This research explores whether ESG investing successfully balances ethics with financial performance and assesses its potential to redefine traditional investment priorities in a rapidly changing global landscape.

Keywords: ESG Investing, Sustainable Finance, Ethical Investing, ESG Performance, ESG Funds vs Traditional Funds, ESG Returns, ESG in India, ESG Scores and Ratings, Sector Allocation, Greenwashing

Research Question: The paper attempts to understand what is ESG investing? The growth of ESG investing over the last decade. How ESG funds perform compared to traditional funds? Can ethical investing be as profitable as traditional investing? What are its risks and limitations? What are the common criticism of ESG investing like Greenwashing? These and many such questions will be answered in the course of this paper.

1. Introduction

In today's investment landscape, the concept of 'value' is evolving rapidly. Traditionally tied solely to financial performance, value is now being increasingly defined by the integration of Environmental, Social, and Governance factors. Forward-thinking investors, especially the younger generation, are recognizing the long-term financial implications of climate change, social equity, and corporate ethics. Keeping these elements in mind, they are reshaping capital allocation and redefining corporate responsibility. ESG investing involves putting money into

companies or funds that prioritize sustainability and ethical practices. Investors use ESG scores or filters to evaluate a company's sustainability and ethical impact and choose where to invest aligning their financial objectives with personal values. ESG investing is a broader and more structured framework than just Green Investing, which focuses primarily on the environment. It's an approach that includes social justice, equality, fair labour, transparency, tighter regulations, responsible governance, etc. ESG investing is growing rapidly across the world, including in India. Major companies and financial institutions now publish ESG reports. However, there is a perception that doing good for the environment or society may come at a cost in the form of lower financial returns. This paper explores whether investing ethically means sacrificing financial returns? Is there always a trade-off or is it possible to align values and profitability?

2. What is ESG Investing?

ESG investing incorporates environmental, social, and governance principles into decision-making. Alongside assessing a company's financial health, it involves choosing companies or funds based on non-financial factors such as its ethical benchmarks, environmental impact, governance systems, and social footprint. Each of the three ESG criteria has specific focus areas:

- **Environment** - Environmental factors assess a company's sustainability performance by measuring emissions, energy usage, water consumption, waste management practices, and overall environmental conduct.
- **Social** – It examines employee and community relations, including human resource policies, employee welfare, gender equality, diversity, labour rights, and other human rights considerations.
- **Governance** - It evaluates how a company is managed, focusing on board structure, executive compensation, paying fair taxes and transparency with stakeholders.

This approach aims to align financial decisions with ethical and sustainable values. The rationale behind it is that the companies with strong ESG profiles can demonstrate resilience and long-term value. Investors increasingly believe companies that perform well on ESG are less risky, better positioned for the long term and better prepared for uncertainty. ESG measures the sustainability of the company. It focusses on how companies make money rather than just how much they make.

Figure 1: How ESG Measures the Sustainability of the Company



Source: Axis AMC Analysis, Schroders

2.1. Types of ESG Investments

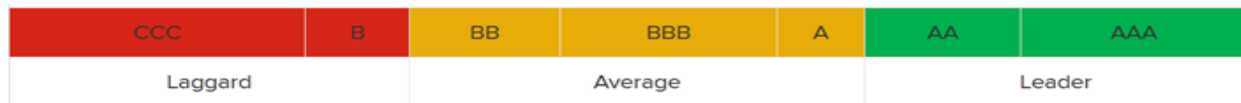
- ESG Mutual Funds and ETFs (Exchange Traded Funds): ESG Mutual Funds are a subset of Thematic Mutual Funds that focusses on investing in socially responsible companies. These funds evaluate potential investments and screen companies based on ESG scores. By aligning with companies that adhere to ESG principles, these funds aim to generate long-term wealth for investors by selecting companies with robust business models capable of meeting sustainability criteria.
- ESG-themed bonds: ESGs bonds are credit-rated fixed-income instruments issued by the central government, PSUs, NBFCs, local governing authorities, corporates, etc., to raise capital for projects that align with the principles of ESG criteria. These bonds allow issuers to finance initiatives that have positive impacts in areas such as renewable energy, social equality, and corporate governance.
- Direct stock selection: Investors can directly invest in ESG-compliant companies like Infosys, Nestle.

2.2. What are ESG Scores and How Are They Calculated?

An ESG score is an objective measurement or evaluation of a given company, fund, or security's performance with respect to ESG issues. ESG scores are generated by third-party rating agencies – including MSCI ESG Research, Sustainalytics, Moody's where analysts evaluate corporate disclosures, conduct management interviews, and review publicly available information about an organization to provide an objective rating of the organization's performance. ESG rating platforms determine a weighting for each measurement criterion; then, they assess an organization's performance against each criterion. For example - a company with high carbon emissions may get a low environmental score or a company. Each agency uses its own complex

algorithms and methodologies to evaluate companies, making the process more objective and less susceptible to bias. Following is an example of MSCI scale:

Figure 2: MSCI ESG Scale



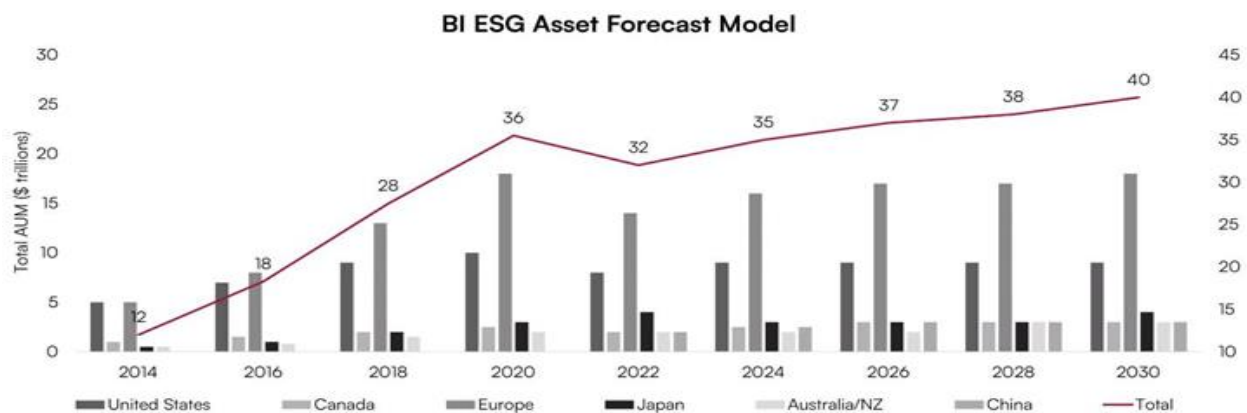
Source: MSCI

A comparison of the scores can give an investor an idea about which fund is better rated while deciding to invest in an ESG Fund. While there's a general agreement on the ESG factors to consider, the weighting of these factors varies between rating agencies, which leads to differences in the ESG scores provided by different agencies for the same company.

3. The Rise and Growth of ESG Investing

There has been growing support in recent years for the concept of stakeholder capitalism and a recognition of the importance of creating long-term value. Stakeholder capitalism is a philosophy based on the belief that companies have an obligation that goes beyond simply providing returns for shareholders. And perhaps this is the reason ESG has become the most powerful driver of growth in asset and wealth management. Global ESG assets exceeded \$30 trillion in 2022 and are expected to grow past \$40 trillion by 2030, over 25% of projected \$140 trillion assets under management (AUM) according to a Feb 2024 ESG report from Bloomberg Intelligence. This trend reflects a growing investor shift toward responsible capitalism.

Figure 3: ESG AUM Growth Across Key Markets



Source: Bloomberg

3.1. Key Drivers Behind ESG Investing Growth

- Rising awareness of global issues - Climate change, social inequality, and environmental degradation have become major concerns for investors.
- Institutional influence - Major investment firms like BlackRock and Vanguard have adopted ESG integration strategies. These firms believe that companies with strong ESG performance are better managed and more resilient.
- Government regulations - Several countries around the world have implemented mandatory ESG reporting requirements, with the EU, UK, Australia, Canada, India, and others taking the lead. These regulations aim to enhance transparency and accountability regarding companies' sustainability practices.
- Shift in investor mindset - Investors are no longer focused only on profits—they care about impact and responsibility. ESG is seen as a way to avoid reputational, legal, and climate-related risks.
- Youth-driven momentum - Millennials and Gen Z prefer investing in line with their values. A 2021 Morgan Stanley survey showed that 70% of young investors consider ESG factors important when making investment decisions.
- Mainstream adoption -What started as a niche is now a mainstream strategy, adopted by both retail and institutional investors worldwide.

Figure 4: ESG Survey of Nearly 800 Business Decision Makers



Source: Bloomberg Media's Sustainable Future Study, 2022

3.2. Why ESG Investing Is Gaining Traction in India

As per a report by IDFC First Bank, ESG funds in India hold a growing AUM of nearly ₹10,946 crores. A survey by the CFA Institute found that 60% of Indian investors consider ESG funds for their higher risk-adjusted returns, compared to just 29% globally. ESG investing in India is gaining traction due to growing investor awareness and policy reforms.

1. **Prioritising environmental sustainability** - As the country shifts towards a greener economy, sustainability has become a priority. Under the Paris Agreement, India pledged to invest \$2.5 trillion between 2015 and 2030 to meet climate goals. Additionally, India is committed to the Sustainable Development Goals (SDGs), ensuring economic growth without harming the environment.
2. **Popularity among international investors** - Global investors are also eyeing India's ESG potential. The Global Sustainable Investment Alliance (GSIA) reports that 41 international ESG funds have allocated an average of 25% of their investments to Indian equities. This indicates growing confidence in India's sustainable business landscape.
3. **Innovations by Indian companies** - Domestically, major players like Quantum Asset Management have launched ESG-focused funds. In 2019, Quantum introduced India's first open-ended ESG fund, and Avendus followed with another ESG-based fund. These developments highlight the rising interest in responsible investing.
4. **Government policies** - Government policies are further driving ESG adoption. India has introduced reforms to boost renewable energy investments and ensure ethical corporate behaviour. SEBI has also mandated filing of Business Responsibility and Sustainability Reporting (BRSR) reports for the 1000 largest listed companies by market capitalisation as part of the annual reports from FY 2022-23 onwards, increasing transparency and accountability.
5. **Ease of tracking performance** - Tracking ESG performance has become easier with sustainability indices like the NIFTY 100 ESG Index and the S&P BSE 100 ESG Index. These benchmarks help investors measure companies' environmental and social impact, making it easier to make informed decisions.

But while ESG investing has clearly gained popularity, one question remains: Does it perform as well as—or better than—traditional investments?

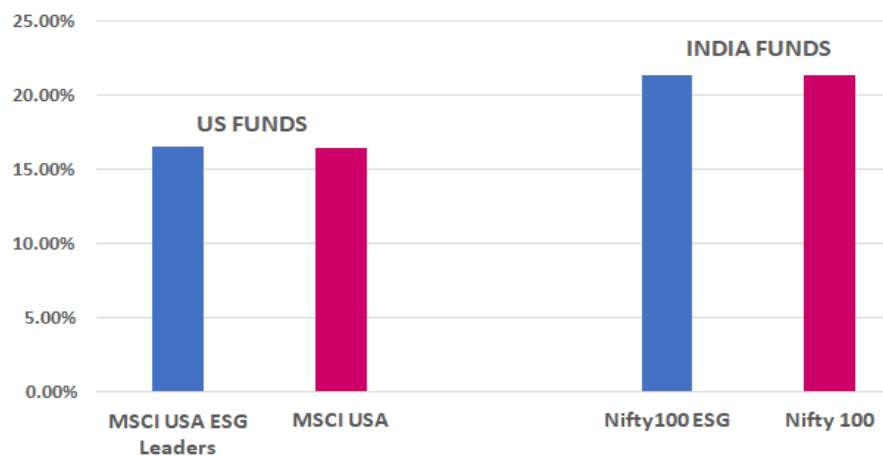
4. Ethics vs Returns — What Does the Data Say?

In the dynamic landscape of financial decision-making, the importance of non-financial objectives – encapsulated in ESG criteria – has become central for governments, corporations and investors. Even though there has been a significant increase in ESG-related AUM, concerns about the potential impact on returns persist. The benefits of incorporating ESG factors in the investment process are still being debated by some in the investment community. There are those that believe that an ESG strategy involves accepting a trade-off, receiving lower returns in exchange for ‘doing good’. There is evidence across many time periods and regions (especially in emerging markets) that integrating ESG into the investment process, and investing in companies with better ESG scores, can add to performance. ESG factors can have a positive effect on corporate financial performance – with evidence showing that higher-quality companies tend to make better profits. Companies that are well-managed, and which consider long-term risks and opportunities around ESG issues, should outperform over the long term.

4.1. Performance Comparison – ESG vs Traditional Funds

Recent data from both global and Indian markets challenges the idea that ESG investing involves sacrificing returns in favor of values. ESG-aligned funds have delivered returns that are largely comparable to those of traditional benchmarks over the past five years. For example MSCI USA ESG Leaders Index returned 16.56%, while the MSCI USA delivered 16.48%—a slightly higher return by ESG index. These figures suggest that ESG investing in the U.S. does not come at the cost of financial performance.

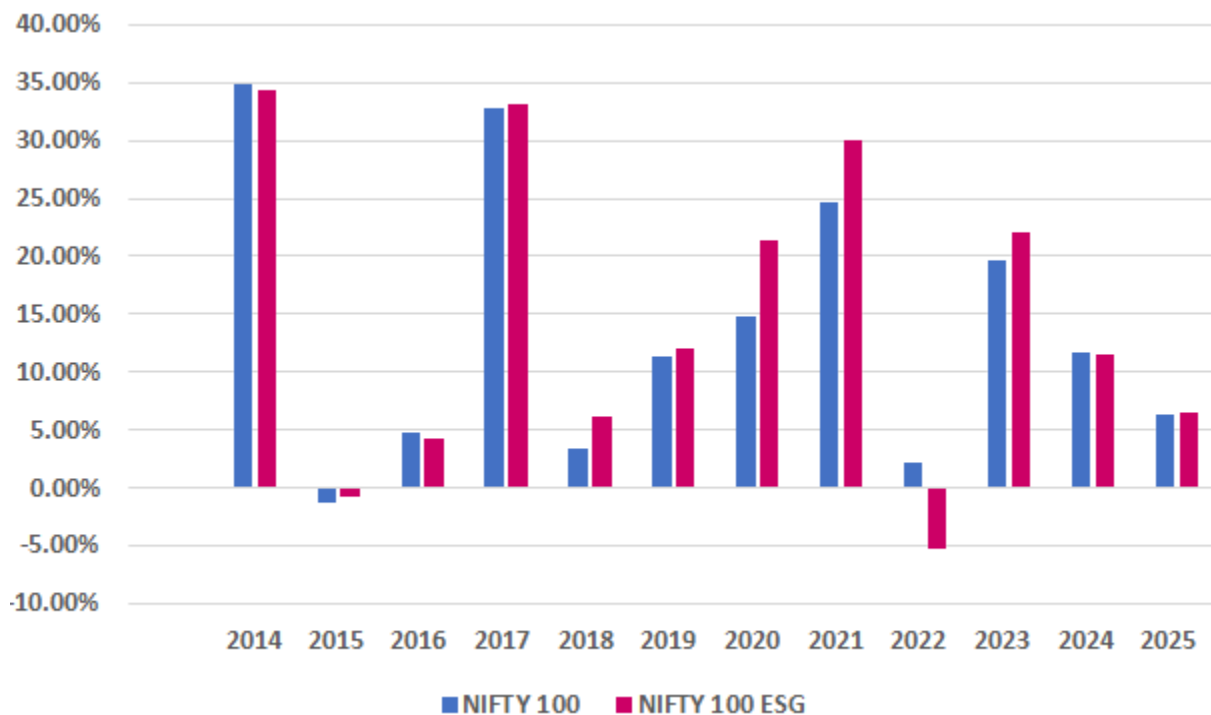
Figure 5: Comparative 5 Year Return of ESG Fund Vs their Non ESG Benchmark Fund



Source: MSCI, Nifty Indices

A similar pattern is visible in India. The Nifty100 ESG Index returned 21.42% over five years, compared to 21.41% by its benchmark the Nifty 100 Index. Again, the returns are at par. There is another aspect to these figures, especially when considering the ESG fund applies stricter filters that limit sector exposure. Investors can benefit from portfolio risk and return. ESG integration by businesses can lead to lower risk. Given the relationship between risk and return, for an investor maintaining a similar return whilst lowering risk is an attractive outcome. These comparisons indicate that ESG investing performs on par with traditional options, while also aligning with investor values and mitigating long- term environmental or reputational risks.

Figure 6: Comparative Performance of NIFTY 100 & NIFTY 100 ESG Fund



Source: NSE Indices

4.2. Does ESG Add Value for Investors?

The philosophy behind ESG investing is that the sustainable businesses can generate sustainable growth. The core idea is that ESG-compliant companies are better positioned for long-term, stable growth, which in turn benefits investors. Because these companies are mindful of their impact on all stakeholders—not just profits—they are seen as more resilient and trustworthy. Sustainable companies add value to its investors in the following ways-

- Deliver compounding returns to shareholders
- Have a lower cost of capital
- Command premium valuation
- Have a lower volatility and reduced drawdown risk
- Maintain structural growth

Figure 7: Global Experience of ESG Companies



Source: Oxford report ‘From stockholder to stakeholder’ based on more than 200 academic studies (Mar 2015), Bloomberg

*Percentage of studies showing

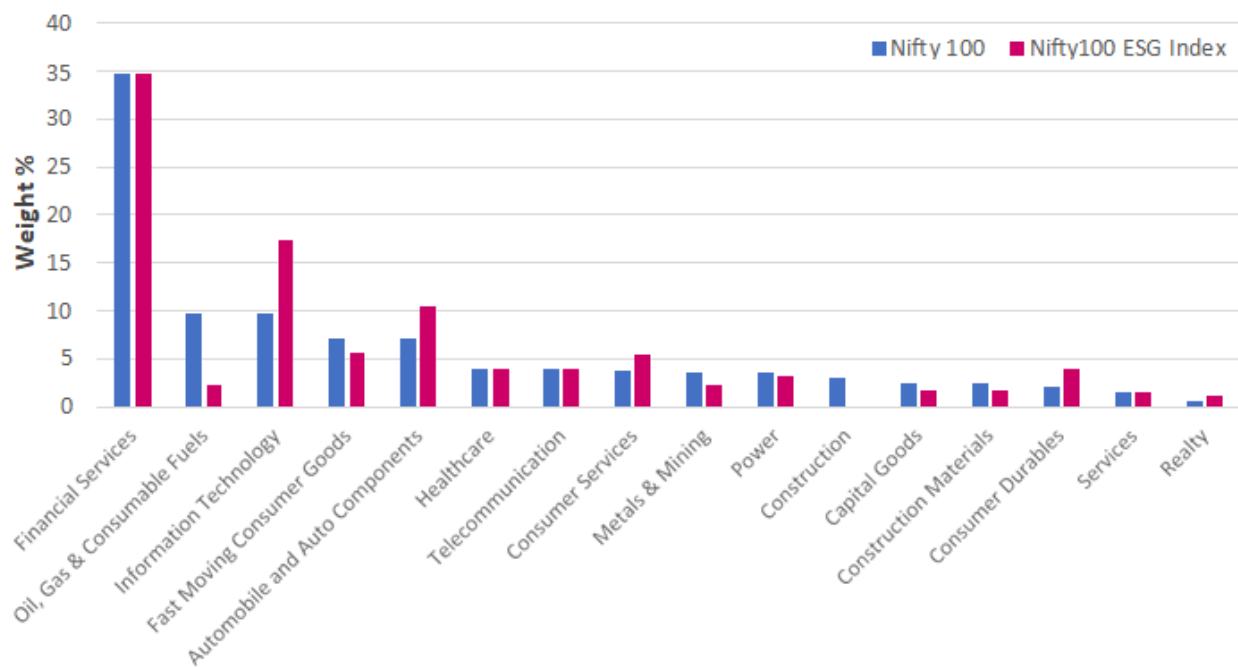
The data reviewed across both U.S. and Indian markets suggests that ESG funds have, in general, delivered returns that are comparable to traditional investments. While ESG funds may not consistently outperform conventional benchmarks, they have demonstrated competitive performance, suggesting that investors are not sacrificing returns when aligning their portfolios with ethical or sustainable values. Therefore, ESG investing does appear to add value—not necessarily through higher gains, but by offering a way to invest responsibly without compromising on financial objectives. ESG-aligned companies are built for long-term, sustainable growth by focusing on all stakeholders, not just shareholders. This approach often results in consistent returns, lower risk, and stronger market valuations—making them attractive to investors seeking both value and stability.

4.3. ESG Investing Themes: What Do ESG Funds Actually Invest In?

The Securities and Exchange Board of India, in its March 2023 Board meeting, announced a set of regulatory requirements on ESG disclosures, ratings, and investing. Among other measures, it mandated that ESG schemes must invest at least 65% of AUM in listed entities, where assurance on BRSR Core is undertaken.

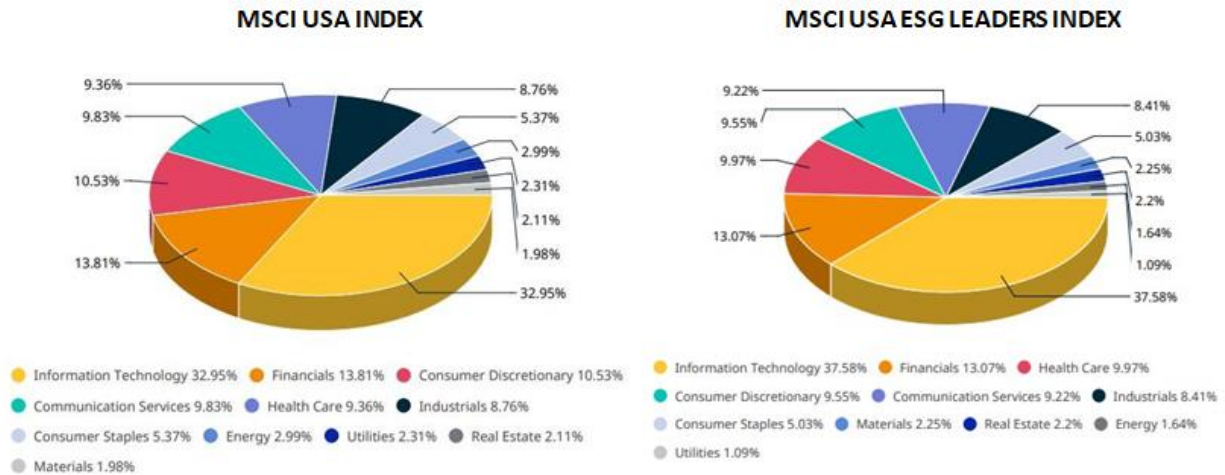
ESG funds don't simply exclude controversial industries—they actively invest in sectors that align with sustainability and responsible practices. These often include renewable energy, electric mobility, clean technology, green finance, and consumer brands with ethical supply chains. While they are typically underweight in areas like oil, coal, and tobacco, ESG funds tend to favour sectors such as IT, financials, and healthcare that demonstrate stronger ESG compliance and long-term resilience. “Cleaner” industries are seen as more future-ready, adaptable, and reputationally safer. From the chart below, it may be observed that both Nifty 100 and Nifty ESG index have maximum and almost equal exposure in financial services. While Nifty 100 ESG index has much higher exposure in IT companies, Nifty 100 has a higher investment in oil and gas sectors. Moreover, ESG investments in construction sector is broadly missing.

Figure 8: Top Sector Allocations in ESG vs Traditional Funds in India



Source: NiftyIndices, as on 30th June 2025

Figure 9: Top Sector Allocations in ESG vs Traditional Funds in US



Source: MSCI, as on 30th June 2025

5. Criticisms and Limitations of ESG Investing

Despite a historic surge in popularity, many believe that ESG investing will not tackle our generation’s urgent environmental and social challenges. While returns remain competitive, ESG investing also faces valid criticisms — from greenwashing to inconsistent scoring — which must be examined to understand its true effectiveness.

5.1. Greenwashing and Lack of Standardization

Greenwashing is where an organisation makes vague, misleading or even false claims about their product or operations and their subsequent environmental impact. Greenwashing can take various forms, but most often occurs when an organisation or individual attempts to market or advertise their products or services as ‘green’. In a 2022 survey of almost 1,500 CEOs and C-Suite leaders, well over half (58%) admitted their companies were guilty of greenwashing, and two-thirds questioned whether their efforts were genuine in the first place. Being sustainable is important to modern consumers – according to a McKinsey survey, over 60% of respondents would pay more for a product with sustainable packaging. However, being truly ‘sustainable’ is far from easy. A staggering 98% of sustainability initiatives fail to meet their objectives, according to research by Bain & Company, while research by Software AG found that 82% of the 2,000 decision makers it surveyed would rather accept regulatory fines than launch an initiative in the first place. Greenwashing has become so common and widespread because many businesses would rather risk paying the price than undertake complex sustainability programmes that lead to organisational change. Yet with so much emphasis placed on businesses and employers that care

about the environment, they're willing to take shortcuts to realise the commercial benefits of sustainability.

ESG data can be inconsistent and challenging to compare across companies and industries. Another problem is of lack of standardisation. ESG scores are often based on self-reported data, not independently verified. Different rating agencies (MSCI, Sustainalytics, etc.) use different criteria. So, the same company may have very different ESG ratings. This causes confusion and mistrust among investors.

5.2. Other Limitations

High ESG scores may reflect good disclosures rather than real-world impact. A company may “look good on paper” but still harm the environment or workers. ESG frameworks sometimes measure inputs and policies, not outcomes. Typical of a thematic fund, ESG funds also suffer from Sector Bias and as a result leads to limited diversification. ESG funds tend to avoid entire industries e.g., oil & gas, tobacco, defense. This can lead to sector over-concentration like in tech or finance. Such filters may reduce diversification and expose investors to sector-specific risks. Moreover, ESG funds don't always outperform. Some critics argue that ESG returns are driven more by market trends than by sustainability filters. Example: Fossil fuel stocks outperformed in certain periods (like 2022) but were excluded from most ESG portfolios. Lastly, there is lack of ESG awareness or accessibility in some regions. In emerging markets like India, ESG investing is still relatively nascent. Limited ESG disclosure regulations and small ESG fund universe can limit impact and performance.

6. Conclusion

ESG investing demonstrates that financial performance and ethical responsibility can coexist. Based on fund data from the U.S. and India, it is evident that ESG funds generally deliver returns on par with traditional investments, debunking the belief that ethical investing comes at a financial cost. While ESG frameworks still face issues like risks of greenwashing, inconsistent ratings and sector exclusions, their growing adoption and the increased focus on sustainability suggest that ESG investing is not just a passing trend, but a fundamental evolution in how capital is deployed. Despite these challenges, ESG investing continues to evolve—with rising regulatory support, investor awareness, and demand for more transparent and impactful metrics. For investors who wish to make a difference without compromising on returns, ESG investing offers a promising path forward. This ongoing refinement highlights the importance of ESG's role in shaping a more responsible and resilient financial future.

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