Analyzing ESG Investment Trends in India: A Focus on HDFC's ESG Practices and Framework

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Abstract

SRI- Socially Responsible Investment refers to the allocation of funds in certain practices that have a high social impact which includes assessment of the business on the Environmental, Social and Governance (ESG) schemes.ESG (Environmental, Social, and Governance) investments have garnered significant interest from the investors and customers globally. Such investments adopt a triple bottom-line approach, integrating financial returns with environmental and social considerations. This study examines the development and evolution of ESG practices in India, analyzes the legal and regulatory framework governing ESG investments of various corporate entities and focusing on HDFC Bank in Particular, and evaluates the sustainability performance of various corporate entities. This research paper investigates the dynamics and performance of sustainable investment funds, focusing on HDFC Environmental, Social, and Governance (ESG) schemes. As environmental, social, and governance considerations gain prominence in investment decision-making, understanding the efficacy and outcomes of such investment strategies becomes imperative, this study aims to provide insights into the effectiveness of HDFC's ESG schemes in delivering sustainable impact. The research contributes to the broader understanding of sustainable investing in the contemporary financial landscape.

Keywords: Sustainable investment, ESG funds, HDFC, Environmental, Social, Governance criteria.

Introduction

Sustainable investing is the investment practice of making the decisions based on environmental, social, and governance factors, at the side of traditional financial metrics. It strives to generate long term financial returns while chip in to constructive environmental and social outcomes. Sustainable investing has its source in religious and ethical investing practices that come from centuries. Modern sustainable investing emerged during 1960s and 1970s, roused by growing social and environmental awareness. The demand for sustainable investment options are strived by the growing awareness of climate changes, societal issues and corporate governance misconduct.

The Indian economy has moved from unorganized to organized, from cash to digital and from import based to domestic manufacturing due to paradigm shift in business.

Environment, Social and Governance (ESG)- investing has slowly started gaining popularity across the globe as several investment funds now started adopting these practices in recent years. While ESG investing is a relatively new concept for Indian investors. Approximately 3000 ESG plans are available globally for investments. There has been many sustainable challenges observed from couple of years such as risk for risk of flood, the risk of sea levels come on privacy risks, data security concerns, demographic transitions, legislative changes etcetera. These in turn bring out new risk factors to investors.

Indeed, Corporate Social Responsibility (CSR) has been a significant focus in India, It has become mandatory particularly after the introduction of companies Act 2013. Sec 135 under this law compelled companies to allocate a portion of its resources towards projects that have a constructive impact on the social and environmental aspects of the companies. CSR initiatives in India have addressed various issues ranging from education and healthcare to environmental conservation and community development.

On the other hand, Environmental, Social, and Governance (ESG) criteria have gained prominence globally, including in India, over the past few years. ESG goes beyond traditional CSR by considering not only social and environmental factors but also governance practices within an organisation. It provides a framework for evaluating an organisation's sustainability performance and risk management practices, thereby enabling conscious investors to make informed decisions.

While CSR focuses more on philanthropy and corporate impart, ESG encompasses a broader set of considerations that reflects a company's overall sustainability and ethical practices. Both CSR and ESG initiatives align with India's Sustainable Development Goals (SDGs) by promoting responsible business practices and contributing to the country's social, economic, and environmental development.

The integration of ESG considerations into investment decisions not only fosters sustainable business practices but also enhances transparency, accountability, and long-term value creation for corporations. In this way, both CSR and ESG play crucial roles in advancing India's journey towards achieving its SDGs and fostering sustainable development.

In recent times, there has been a notable shift in the direction of investments, with a significant focus on sustainability and ESG (Environmental, Social, and Governance) criteria. This trend is observed both globally and domestically, spanning various economies worldwide. Investors are increasingly recognizing the limitations of traditional financial metrics and are placing greater importance on ESG considerations, moving beyond conventional financial statements of businesses (Bhavani and Sharma, 2019).

It is becoming evident that relying solely on traditional financial metrics is inadequate to meet the evolving demands of investors and customers, who seek investment options that go beyond monetary measures. Traditional investments have often prioritized narrow self-interest and neglected their adverse environmental and social impacts (D'Souza, 2020), prompting the need for re-evaluation.

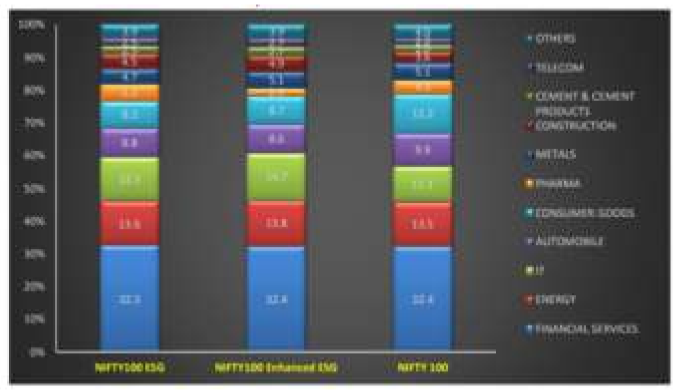
Non-financial factors like environmental, social, and governance criterias are now central to investors' decision-making processes (World Bank, 2018). This shift reflects a growing recognition of the importance of sustainability and responsible investment practices in the modern economic landscape.

Transparent reporting and disclosure of Environmental, Social, and Governance (ESG) information are fundamental aspects of sustainable investing. While some countries have established legal requirements for ESG reporting and disclosure, in many others, it remains voluntary. However, regardless of legal mandates, such reporting is crucial for investors and customers to comprehend the long-term business strategies and investment approaches of corporate entities, enabling them to evaluate sustainability factors.

Access to this information is vital for investors to effectively manage investment risks and gain insights into companies' strategies and purposes (PWC, 2020). Over time, numerous scoring and rating systems have emerged to assess the ESG performance of companies, providing investors with various perspectives across different countries and regions.

Sustainable investment, also known as Socially Responsible Investment (SRI), has gained prominence globally, driven by various factors such as corporate frauds, financial crises, environmental concerns, and investor awareness. In India, ESG funds have witnessed significant growth, with an asset size exceeding Rs. 12,300 crores in the year 2021-22. Regulatory bodies like the Indian National Stock Exchange (NSE) have introduced frameworks like NSE Prime, which encourages companies to exceed regulatory requirements in terms of corporate governance standards. Integrating ESG factors into asset pricing and risk modelling poses challenges as traditional models like the CAPM Model (Capital Asset Pricing Model) and AP Theory (Arbitrage Pricing Theory) may not fully account for ESG risks. Additionally, quantifying ESG indicators and incorporating them into fixed-income securities remains a challenge. Companies with strong ESG credentials have demonstrated better performance during crises like pandemic and the global financial crisis during 2007-2009, leading to improved recognition of the importance of ESG integration in asset pricing model. The UNPRI has reported significant growth in ESG assets globally with a rise in the number of ESG ETF's(Exchange Traded Funds) and increased inflows into ESG mutual fund schemes. While ESG investing in India is still in its early stages compared to global trends, the NIFTYESG100 index has outperformed the NIFTY100 index. Pension funds are also incorporating ESG factors as they recognize the potential for long-term risk-adjusted returns and the importance of sustainable investment strategies.

Sector-wise allocation of NIFTY100 ESG Indices compared with NIFTY 100 is shown below:



Source: Niftyesg indices white paper.

The NIFTY100 ESG indices aim to maintain equivalent sector weights as the parent NIFTY 100 index, ensuring comparable sector distributions. Consequently, the sector weightings in The NIFTY100 ESG indices maintain alignment with the NIFTY100 index. In particular, the aggregate weight of the top 5 sectors in the NIFTY100 ESG indices is 76.7%, mirroring the NIFTY 100 index, where the consolidated weight of the same top 5 sectors stands at 79%. Together NIFTY100 ESG indices and the NIFTY 100 index comprises of 15 sectors, with the weights of 12 sectors individually lessthan 10%.

Over the past decade, ESG investing has witnessed a significant surge in popularity. Investors now acknowledge that assessing a company's true value goes beyond financial returns alone. ESG factors offer a holistic evaluation, enabling investors to gauge the long-term risks and opportunities inherent in a company's operations. As per findings from the Global Sustainable Investment Alliance, global assets in sustainable investment soared to $35.3 trillion in 2020, reflecting a 15% increase from 2018.

Navigating Sustainable Investment Trends in the Indian Market:

'The evolution of ESG investments in India is gaining momentum, albeit in its nascent phase, but with significant progress underway. In light of India's developmental imperatives, integrating ESG criteria into investment strategies is gaining prominence as a means to tackle enduring societal issues and mounting environmental and climate-related challenges, as highlighted by the Government of India (2021). This aligns with the nation's pledge to achieve the Sustainable Development Goals (SDGs). Research underscores that fulfilling India's SDG targets necessitates annual investments of at least USD 0.6 trillion (Impact Investors Council, 2020).

The growing emphasis on addressing climate change and increasing investments in renewable energy highlight India's prioritization of and the necessity for ESG investments. India's international pledges, including a 30% reduction in carbon emissions by 2050 and sourcing 40% of energy from non-fossil fuel sources by 2030, underscore the critical role of incorporating ESG considerations into investment strategies.

Recently, the Government of India (GOI) has acknowledged the importance of integrating ESG factors into corporate activities and has actively advocated for ESG principles through regulatory reforms. A notable advancement in this area is highlighted in the latest Economic Survey, which underscores the importance of aligning financing mechanisms with sustainable development goals (Government of India, 2021).

It is crucial to highlight the sustainability efforts led by Indian corporate entities, such as their active participation in global initiatives like RE100, which advocate for environmentally friendly practices. This aligns with the strategic business outlook in India, where industrial electricity consumption comprises over 40% of the total usage (Sarangi and Taghizadeh-Hesary, 2021). Major Indian corporations like Infosys, Mahindra & Mahindra, Dalmia Cement, and Tata Motors have joined RE100, committing to source their energy from renewable sources voluntarily (Mudaliar and Telang, 2020). For instance, Dalmia Cement aims to transition entirely to renewable energy by 2030. The swift adoption of renewable energy reflects Indian businesses' recognition of the pressing need for sustainable practices.

Furthermore, many Indian companies are demonstrating excellence through corporate renewable Power Purchase Agreements (PPAs), placing India second globally in this aspect. Several Indian corporations have also been recognized in the Dow Jones Sustainability Index, including Infosys, Mahindra & Mahindra, Tata Motors, Godrej Consumer Products, Tata Steel, Hindalco Industries, Glenmark, Havells India, M&M Financial Services, Tech Mahindra, and Wipro, reflecting their commitment to sustainability and responsible business practices. These companies are part of an emerging market sustainability index, showcasing their proactive efforts.

Additionally, numerous Indian firms have voluntarily embarked on initiatives to enhance sustainability. For example, various cement companies are harnessing energy from waste, thereby reducing their dependence on conventional fuels. A review of these sustainability endeavors by Indian corporations underscores significant progress in reducing carbon footprints, integrating renewable energy sources, and embracing energy-efficient practices in their operations

Average score of Indian Companies based on Various ESG factors:

Source-NSE-2020

The Advantages of ESG Investing:

Risk Mitigation:

Integrating ESG factors into investment strategies aids in mitigating risks linked to environmental catastrophes, labor disputes, regulatory infringements, and reputational harm. By proactively identifying and resolving potential issues, investors can shield their portfolios from significant setbacks.

Enhanced Long-term Performance:

Most of the studies have demonstrated a positive correlation between robust ESG performance and financial returns. The Companies that prioritize sustainability and ethical practices are positioned better to succeed in the long term, attracting investors and establishing resilient business models.

Stakeholder Collaboration:

ESG investing promotes meaningful collaboration between companies and their stakeholders, including employees, customers, suppliers, and communities. By aligning their operations with stakeholder expectations, companies can bolster their reputation, cultivate brand loyalty, and appeal to socially conscious investors.

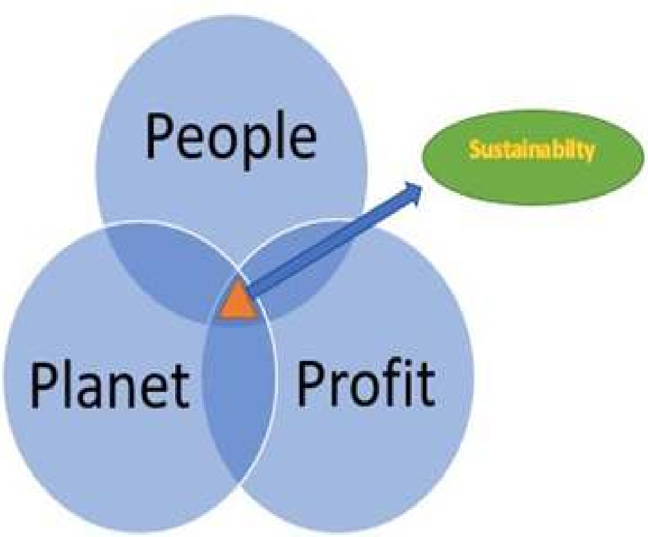
Addressing Global Challenges:

ESG investing plays a pivotal role in tackling critical global challenges such as climate change, social inequity, and corporate malpractice. By channeling investments into sustainable enterprises, investors can actively contribute to positive transformation and support the transition to a more equitable and environmentally sustainable future.

Objective of the Study:

The objective of this paper is to provide a comprehensive overview of sustainable investment practices and the frameworks commonly adopted, both in general and specifically by HDFC Bank, concerning environmental, social, and governance (ESG) factors.

Fig: Author Compilation



Methodology:

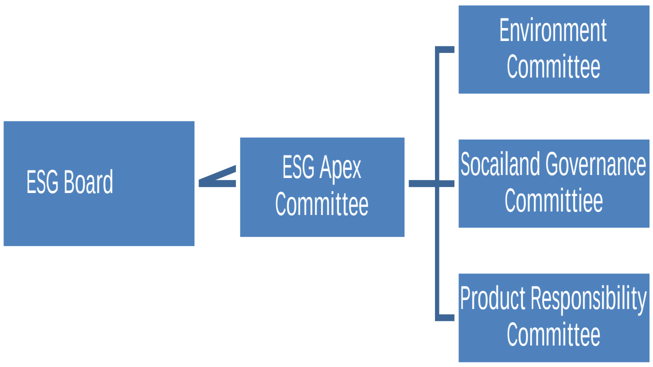
This study basically concentrates on exploring the sustainable investment practices and its adoption, hence review of published papers, journals, websites and annual reports is followed.

ESG Approach and Strategy at HDFC Bank

The integration of Environmental, Social, and Governance (ESG) principles within the banking sector requires a comprehensive approach that goes beyond internal operations to encompass the entire ecosystem. The Bank has demonstrated a commitment to sustainability by incorporating it as a core value parallel to customer focus, operational excellence, product leadership, and people since FY-15. In FY-19, the Bank established a board-governed environmental policy to effectively manage environmental risks, impacts, and opportunities.

In FY20, to further enhance its focus on ESG, the Bank formed an ESG Apex Council consisting of senior executives from various functions. This council is responsible for overseeing the Bank's Environmental, social and governance strategy, initiatives, and roadmap to achieve predetermined goals. The Apex council will report to the CSR and ESG Committee of the Board of Directors, ensuring alignment with overarching goals.

Fig: Author Compilation



(Source: Annual Report HDFC)

The ESG Apex Council has three working groups:

Environment: It Sets the targets and identifies the opportunities for improving areas of gas emissions,water ,energy and waste.

Social and Governance: It mainly focuses on the policies related workplace which includes Human rights and Code of conduct, stakeholders, diversity and corporate governance policies;

Product/Service Responsibility: It mainly focuses on assessing the environment & Social risks, including climate risks in the banks current portfolio and identifies latest business opportunities in environmental and social space.

In financial year 2021, the Bank committed to achieving carbon neutrality by financial year 2032. Extensive efforts have been made to develop and implement a framework aimed at progressing towards this objective while simultaneously expanding operations. The Bank's dedication to reducing energy consumption across its operational sites is evident through investments in various technological solutions and operational measures. These include the adoption of renewable energy sources, green tariffs, and initiatives to enhance energy efficiency through projects and equipment upgrades, all aimed at minimizing the Bank's carbon footprint.

In financial year 2023, the Bank introduced an enhanced and more comprehensive ESG Risk Management Policy is an integral component of its credit assessment process for wholesale corporate borrowers. This policy supersedes the previous Social and environment monitoring system framework and is applicable to the borrowers who exceeds the credit exposure of INR 0.5 billion. (includes Bank's direct funded and non-funded credit exposure). Under this policy, the Credit Appetite Memorandum evaluates ESG and climate change risks associated with borrowers' operations, along with their mitigation measures and controls.

The Bank's ESG initiatives are transparently communicated through Integrated Annual Reports, which are readily available on the Bank's website. These reports adhere to various frameworks, including the IIRC (International Integrated Reporting Council) guidelines, and incorporate disclosures in accordance with the GRI standards 2021(Global Reporting Initiative-2021), TCFD (Task Force on Climate related Financial Disclosures) (Task Force on Climate-related Financial Disclosures), BRSR (Business Responsibility and Sustainability Report) (Business Responsibility and Sustainability Report), and UNSDGs(United Nations Sustainable Development Goals). Additionally, the key ESG performance metrics undergo external assurance to ensure credibility and reliability.

Green Finance Criteria: Eligible Green categories at HDFC Bank (Passes through SEMS Frame Work)

Fig: Social and Environment Monitoring System Framework (SEMS).

- GHG Emissions & Climate change: At HDFC Bank, we have developed an integrated strategy to effectively manage our scope 1 and scope 2 emissions, as detailed on pages 69 and 70 of our report. Building upon our previous achievements, we have set new targets with fiscal year 2022 as the base year. Our commitment to transparency and ambition is evident in the expansion of our base year GHG inventory to include additional emission sources.
- We have not only ensured the completeness of our Scope 2 emissions by including previously identified source categories but have also incorporated collocated data centres as a new source category for our Scope 2 emissions. Moreover, we have introduced a new source

category for our Scope 3 emissions, encompassing emissions arising from electricity consumption at our other facilities. This demonstrates our ongoing efforts to enhance transparency and address a broader spectrum of emission sources in our sustainability initiatives.

Measures to reduce GHG emissions at HDFC Bank:

Reducing Paper Waste Emissions-

HDFC bank's paper waste reduction initiatives are strongly supported by our digital strategy, which serves as the foundation. Through the implementation of digital products and services, as well as the automation of various internal and customer-related processes and channels, we have successfully minimized paper waste generation. The introduction of 'Green Event Guidelines' by the bank's retail marketing team has notably contributed to saving approximately 2.14 million square feet of paper during the reporting year.

Furthermore, the transition to electronic payments for electricity bills has eliminated the need for issuing around 50,000 Demand Drafts annually, thereby reducing paper usage. In instances where paper usage remains unavoidable, we have prioritized the use of recycled paper. Despite an 18.3% increase in customer base, associated emissions saw a marginal increase of less than 2% year-on-year in fiscal year 2022. These initiatives underscore our commitment to sustainable practices and environmental stewardship.

Tree Plantation:

The Bank is also implementing an ambitious tree plantation programme, under which the bank planted over 1700000+ trees till now. This programme has not only positively impacted the Banks GHG emissions but also helped to enhance the social capital and relationship capital.

Energy efficient space cooling measures:

At Kanjurmarg facility, the bank has deployed 55 Air Handling Units (AHUs), with plans to transition all blowers to EC Fans by FY23, anticipating savings of 25-40%. Its initial trial involved converting one AHU, resulting in a saving of approximately 4,082 kWh of electrical energy and preventing 4 metric tons of carbon emissions.

Across their locations, they are installing inverter ACs, contributing to a significant electricity saving of over 5 million kWh during FY-22. Additionally, the installation of a VRF HVAC Unit at our back offices led to an extra 54,450 kWh of electricity savings during the year.

To optimize energy consumption, the bank utilize digital systems and data analytics to comprehend energy usage patterns. This enables the bank to maintain optimal temperatures in branches, enhance the power factor, and automate major energy-consuming assets. These efforts align with banks commitment to sustainability and efficiency across its operations.

Conclusion:

ESG investments have garnered global interest from investors and customers because of their triple-bottom-line approach, which integrates financial returns with environmental and social factors.ESG investing marks a transformative change in the finance sector, acknowledging the inseparable link between economic prosperity and social accountability. Through the evaluation of environmental, social, and governance factors, investors gain insights to make well-informed decisions that yield both financial gains and positive societal impacts. Embracing ESG principles is not merely a wise investment tactic; it's a catalyst for driving beneficial transformations, nurturing a future characterized by sustainability and fairness for future generations.

This research paper has examined the progression and evolution of ESG practices within India, scrutinized the legal and regulatory framework governing ESG investments across corporate entities, with a particular focus on HDFC Bank. By analysing HDFC Bank's approach to ESG factors, we've gained insights into how financial institutions navigate sustainability challenges and integrate responsible investment practices into their operations.

Through this study, it becomes evident that ESG considerations play an increasingly crucial role in investment decision-making and corporate governance. HDFC Bank's commitment to ESG principles serves as a noteworthy example of how financial institutions can align their business strategies with sustainability goals while delivering value to stakeholders.

Moving forward, it is essential for companies, including financial institutions like HDFC Bank, to continue prioritizing ESG factors in their operations and investment strategies. By doing so, they can contribute to building a more sustainable and resilient economy while meeting the evolving expectations of investors and society at large.

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