

Sustainable Investment in India

ISSUE BRIEF



Introduction

To support the growth of sustainable capital flows, IFC's advisory services seek to influence, support and enable capital market stakeholders to better integrate ESG factors into capital allocation and portfolio management processes, using IFC's own investment practices as a model. IFC is playing its part to support the growth of the market by funding the development of enhanced stock market indices, financial instruments, and through targeted market research.

Compiling data on the state of development of the sustainable investment industry is important for global investors and investment managers to understand the scale and location of opportunities in the market for sustainable investment products. While a number of organizations provide this information in developed economies such data is scarcely available in emerging markets.

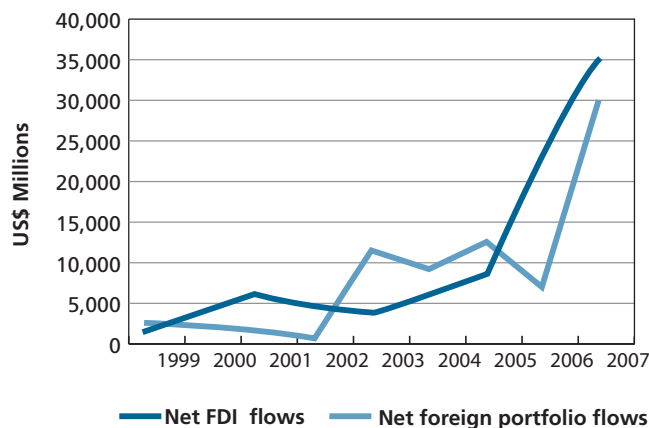
IFC thus decided to launch a series of Sustainable Investment Country Reports initially covering the largest emerging capital markets attracting global portfolio investors – Brazil, India and China. Further regional reports will be added to the series covering Sub-Saharan Africa and the Middle East.

This summary version of the report Sustainable Investment in India 2009, which may be downloaded in full from IFC's website, provides a snapshot of the Indian market. TERI-Europe finds a long road ahead for the development of sustainable investment in India. Although green shoots are visible, such as the IFC-sponsored S&P ESG India Index, further work to encourage domestic investors to take environmental and social factors into account in their investment strategies is still needed. In our own investments and through our interactions with clients and other stakeholders, IFC will continue to play a role in promoting Sustainable Investment in India.

EXECUTIVE SUMMARY

TERI-Europe estimates that the total stock of investment in Indian equities where the investment strategy includes a strong focus on environmental, social and governance (ESG) considerations is approximately US\$1 billion at the current time. This is almost entirely composed of investment by foreign institutional investors (FIIs).

Figure 1. FDI and foreign portfolio investment in India: flows (source: RBI)



India has limited domestic sustainable investment market or infrastructure in the listed equity space. The country's first and so far only retail SRI mutual fund was launched by ABM AMRO in March 2007 and raised the equivalent of approximately US\$12 million. The fund - which is now managed by Fortis following the 2008 break-up of ABN AMRO - has performed respectably compared to its BSE200 benchmark, but its size today is only US\$2.6 million due to redemptions and the sharp fall in the stock market. The fund's ESG methodology is relatively basic. The IFC-backed S&P ESG India Index, launched in January 2008, represents an important step forward but at this early stage has not yet had a discernable impact on the market. There is little interest in sustainable investment in India's rapidly growing mutual fund and life insurance market at the current time. For complex reasons that are explained in the report, Indian pension funds are not significant in the agenda addressed by this report.

The enabling environment for sustainable investment in Indian listed equities is currently weak. Despite some notable exceptions from companies such as HSBC, CLSA, Trucost, KLD and Innovest, ESG research coverage is still relatively limited. Numerous organisations, such as TERI, the Confederation of Indian Industry (CII), the UN Global Compact and IFC itself, are active in promoting corporate responsibility and sustainability reporting. ESG transparency and disclosure by Indian companies in the form of corporate sustainability reports and responses to the Carbon Disclosure Project are slowly improving, but from a very low starting point.

However, there is relatively strong and growing interest in ESG risks and opportunities amongst India's FIIs, who include Citigroup, Deutsche Bank, HSBC as well as large pension funds such as CalPERS, APB and PGGM and asset managers such as F&C and Colonial First State. Many of these stakeholders are signatories to the UN Principles for Responsible Investment (UNPRI), which has also indicated its interest in working in India. An additional positive feature is that the National Stock Exchange of India (NSE) has committed to take some leadership in raising ESG awareness among Indian companies and domestic investors and to brokering a dialogue on these issues between the business community and FIIs. NSE and TERI-Europe are cooperating with UNPRI and IFC on plans to take this forward later in 2009 through a "Sustainable Investment in India" capital markets event.

Leveraging this FII/UNPRI interest and NSE's offer to play a local convening role represents the best strategy for developing India's sustainable investment market in the short- to medium-term, and will provide a much stronger platform for the longer-term challenge of promoting sustainable investment to domestic investors. For the short to medium term, we therefore recommend a strategy that is based on:

- **Helping FIIs to define and** prioritise the key issues of common concern in relation to ESG risks and opportunities in India.
- **Further measurement of the gap** between FIIs' needs/expectations and the current ability of the Indian market to meet these parameters.
- **Identification of measures that FIIs** could/should take themselves to address these gaps, in particular the opportunity to make greater use of (or further develop) existing ESG research, information and analytical resources.

- **Raising awareness amongst domestic financial institutions** through e.g. roundtable meetings hosted by NSE and opportunities to network with FIIs.
- **Establishment of effective mechanisms for FIIs** to engage on an on-going basis with the Indian business and investment community at a strategic level.
- **Enabling Indian corporations to get** a better understanding of how and why they can address the ESG issues framed by FIIs, including more effective linkages back to existing implementation resources offered by organisations such as TERI, CII, GRI, etc.
- **To reinforce the upside to Indian corporations**, the strategy should also explicitly provide opportunities for them to increase their profile with FIIs and analysts.

A key part of such a strategy is to convene interested FIIs and achieve some degree of critical mass, agreement on key issues, and organisation. UNPRI is an obvious candidate for this mobilisation role and the Emerging Market Disclosure Project (EMDP) should also play into the mix. However, it will be important to open the process to FIIs that are not currently UNPRI signatories, such as Citigroup and CLSA Asia-Pacific. For this reason, one option that could be considered is a convening process that is co-owned by UNPRI and IFC.

The second key part of this strategy is to facilitate interaction between FIIs and Indian corporations that is business focused, adds value and will achieve real change. The way that interaction between these two groups is packaged and facilitated will be crucial to its credibility and outcomes: in particular, the right Indian entities must be involved and at the current time the clearest candidate in this respect is NSE.

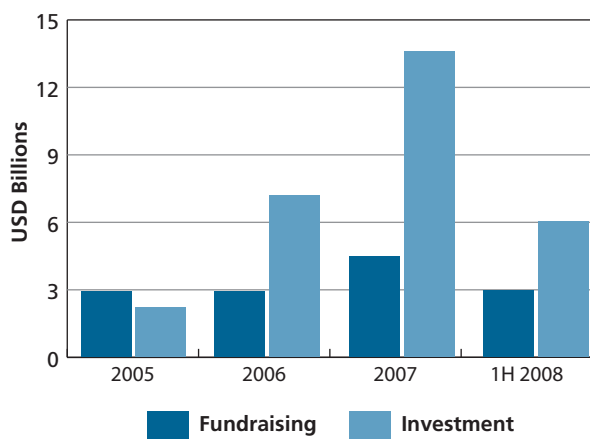
Whilst the main focus of this strategy is on FIIs, domestic investors should also be given opportunities and reasons to participate. Whilst uptake may be modest, at least in the short- to medium-term, the process will help to raise awareness and may encourage some entrepreneurial ideas to emerge from the mutual fund and life insurance sector. Longer-term initiatives aimed at domestic stakeholders could include:

- **Public policy engagement with government** agencies such as the Securities and Exchange Board of India (SEBI), the Pension Fund Regulatory and Development Authority (PFDR) and the Insurance Regulatory and Development Authority (IRDA), with the ultimate goal of incorporating ESG factors into their guidelines.

- **Raise awareness and encouraging thinking** about integration of ESG issues in the mutual fund and life insurance industries. One way to do this is by facilitating dialogue with FIIs who are investing in India and have a more advanced ESG agenda. Another possibility could be to commission market research (perhaps in cooperation with AMFI) on retail and HNW investor attitudes to sustainable investment.
- **Direct high-level engagement with key** Indian business leaders and the main families that control large parts of the Indian private sector. Identifying the key individuals and the best tactics for getting their interest would require additional research that is beyond the scope of this report.

In contrast to the situation in the listed equity market, there is a growing interest by the private equity industry in India to exploit opportunities in the sustainability space. The growth of PE funds in general and venture capital in particular is encouraging from a sustainability perspective since the ownership structure of this asset class has the potential to ensure that ESG issues can be successfully integrated into management systems provided of course that there is a willingness to do so.

Figure 2. India's PE fundraising and investments totals (2005 - 1H08) (source: EMPEA)



Source: EMPEA (fundraising for India-dedicated private equity funds), Venture intelligence (private equity investment in Indian companies).

Note: EMPEA includes infrastructure-focused funds and excludes real estate-focused funds in its fundraising totals.

The examples of Actis, IL&FS, IDFC private equity, and YES Bank private equity as well as the New Ventures India programme are especially encouraging, as all of these aim to be commercially successful while generating environmental and social returns from their investments. The need of the hour is to replicate these examples and assist the sector in developing these models further and faster. Potential measures to facilitate this include:

- **Training GPs on integrating ESG** issues into mainstream investment analysis through the development of appropriate management systems. IFC's Performance Standards for private equity funds and the Actis model both provide good examples.
- **Making tools and training available** to the sector on calculation of social returns and integrating this into financial analysis.
- **Training to help LPs interface** with GPs on ESG issues, in collaboration with UNPRI and its private equity work stream.
- **Strengthening capacity and good practice guidelines** for disclosure and reporting on ESG issues in response to the increased demand for transparency.
- **Working with the Green Investor Network** to promote investments in clean technology, renewables and social enterprises.

Sustainable Investment in India 2009, full report:
http://www.ifc.org/ifcext/sustainability.nsf/Content/Publications_SustFinance#SIIndia

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