Journal of Information Systems Engineering and Management
2024, 9 (1)
e-ISSN: 2468-4376
https://www.jisem-journal.com/

Research Article

Sustainable Investment, Better Financial Returns, and the Role of ESG Indices

[1]Dr. P. Sairani, [2]Prof. Mohd Khaja Qutubuddiin
[1]*Professor & Head- Finance, ICBM-School of Business Excellence, Hyderabad/ORCID: 0000-002-9447-7883 ,sairani@icbm.ac.in*
[2]*Professor, ICBM-School of Business Excellence, qutubuddin@icbm.ac.in Hyderabad*

ARTICLE INFO

Received: 10 Oct 2023

Accepted: 24 Dec 2023

ABSTRACT

Sustainable investment, once considered an ethical niche, has emerged as a mainstream strategy combining financial returns with long-term value creation. This paper explores the link between sustainable investment and financial performance, focusing on the role of Environmental, Social, and Governance (ESG) indices. Using insights from contemporary literature and empirical studies, we analyse the mechanisms through which ESG integration contributes to enhanced risk-adjusted returns and portfolio resilience. The paper also addresses limitations such as ESG rating inconsistencies and greenwashing concerns, concluding with recommendations for standardization, transparency, and policy reform.

Keywords: Sustainable Investment, ESG Indices, Financial Performance, Responsible Investing Risk Mitigation

Introduction

Sustainable investing, often aligned with ESG criteria, has experienced rapid growth globally. According to Bloomberg, over $2.1 trillion was invested in green technologies alone in 2024, highlighting investors' increasing preference for sustainability-linked assets. ESG investing seeks to align financial objectives with ethical considerations, climate awareness, and long-term risk mitigation.

This research investigates whether sustainable investment truly results in better financial performance and how ESG indices guide investors. The evidence presented challenges the conventional belief that financial returns must be sacrificed for sustainability, instead presenting ESG as a lever for both profitability and resilience.

Theoretical Framework and Investment Rationale

ESG as a Risk Mitigation Tool

Companies that perform well in ESG metrics often demonstrate enhanced corporate governance, reduced regulatory exposure, and stronger stakeholder relationships. These factors reduce idiosyncratic and systemic risks, making ESG-aligned firms more resilient during crises.

Value Creation through Sustainability

Firms prioritizing ESG are better positioned for long-term success due to increased operational efficiency, innovation in resource management, and brand reputation. ESG governance promotes transparency, ethical leadership, and accountability—factors highly valued by institutional investors.

ESG Indices: Function and Relevance

ESG indices serve as benchmarks for sustainable investment portfolios. Key examples include:

- MSCI ESG Leaders Index

Copyright © 2024 by Author/s and Licensed by JISEM. This is an open access article distributed under the Creative Commons Attribution License which permitsunrestricted use, distribution, and reproduction in any medium, provided the original work is properly cited.

- FTSE4Good Index
- Dow Jones Sustainability Index (DJSI)
- S&P 500 ESG Index

These indices apply proprietary ESG scoring methodologies to rank companies. They are used for both benchmarking and portfolio construction, allowing investors to align capital with sustainability goals.

Literature Review

Over the past decade, the relationship between sustainable investment practices and financial performance has gained significant scholarly and institutional attention. Numerous empirical studies suggest that ESG-aligned investments not only meet ethical and environmental goals but also provide competitive—and in many cases superior—financial returns compared to conventional strategies.

Chen and Zhou (2024) provide a comprehensive analysis of ESG performance and firm valuation across OECD countries, demonstrating a robust positive correlation between high ESG scores and increased firm market value. Their research confirms that sustainability initiatives can drive shareholder value, particularly in mature and regulated economies. Similarly, Curran and Moran (2007) examined the market reaction to the inclusion of companies in the FTSE4Good Index and found that firms generally experienced a positive, albeit sometimes modest, market response. This suggests that inclusion in ESG indices can serve as a signal of firm quality and future growth potential.

During periods of economic uncertainty, ESG investments often show greater stability. Iannone, Duttilo, and Gattone analysed the resilience of ESG portfolios in European markets during turbulent financial conditions. Their study confirmed that companies with higher ESG scores had lower drawdowns and quicker recoveries, reinforcing the notion that sustainability factors enhance risk-adjusted returns. Similarly, Mishra, Raj, and Chakrabarty (2023) used scenario-based stress testing for green portfolios in India, concluding that ESG-integrated portfolios performed more robustly during adverse market scenarios. This regional perspective further validates the universality of ESG effectiveness across both developed and emerging markets.

Reputation also plays a vital role in ESG investment outcomes. Nicolas et al. (2023) employed social media data to analyse how ESG-related reputational risks affect stock performance. Their event study found that companies involved in ESG controversies faced statistically significant drops in share prices, emphasizing the material impact of social perception and stakeholder sentiment on financial outcomes. In a related study, Zhang et al. (2023) tackled the problem of uncertainty in ESG scoring by developing probabilistic models that factor in discrepancies among rating agencies. Their findings suggest that integrating uncertainty into ESG investment decision-making leads to more reliable and defensible outcomes.

Industry reports corroborate academic findings with real-world data. The Morgan Stanley Institute for Sustainable Investing (2024) reported that sustainable mutual funds outperformed their conventional counterparts in 2023, with a median return of 12.6% compared to 8.6%. This outperformance was attributed to strong performance in clean energy, sustainable manufacturing, and firms with robust social governance structures. FTSE Russell (2023) observed a similar trend, noting that global sustainable indices outperformed broad-market indices in 2023, rebounding from relative underperformance during the inflation-driven downturn of 2022.

Investor behaviour further affirms the growing confidence in ESG assets. Reuters Graphics (2023) reported significant net inflows into sustainable funds worldwide, despite political backlash and scepticism in certain jurisdictions. Bloomberg NEF (2024) highlighted that more than $2.1 trillion was invested in green technologies such as renewable energy, electric vehicles, and sustainable agriculture in 2024 alone. This surge reflects a growing consensus that green investments are not only ethically aligned but also economically prudent amid climate change risks.

Nevertheless, the ESG investment landscape is not without challenges. Reuters (2024) discussed the importance of flexibility in ESG investment strategies, especially in adapting to changing macroeconomic environments. The Australian (2023) reported notable fund outflows in late 2023, driven by ESG underperformance in certain sectors and

Copyright © 2024 by Author/s and Licensed by JISEM. This is an open access article distributed under the Creative Commons Attribution License which permitsunrestricted use, distribution, and reproduction in any medium, provided the original work is properly cited.

increasing scrutiny of greenwashing practices. Retail investor sentiment, while generally positive, remains cautious; the Washington Post (2024) provided an accessible guide for individual investors, noting that ESG funds generally outperformed since 2019, with the exception of 2022, a year dominated by fossil fuel outperformance.

Concerns over ESG transparency and performance gaps are echoed by the Financial Times (2024), which documented how some institutional investors began withdrawing capital from ESG funds due to perceived inconsistency and underperformance. Finally, the OECD (2020) offered a policy-focused overview of ESG investing, outlining key challenges such as fragmented disclosure standards, lack of comparability in ESG ratings, and uneven regulatory enforcement. The OECD's findings underscore the need for harmonized frameworks to sustain investor trust and long-term viability of ESG investment models.

Together, these studies and reports present a strong body of evidence supporting the financial validity of sustainable investing. They also highlight emerging complexities around ESG scoring, reputational dynamics, and investor expectations, emphasizing the evolving nature of ESG finance in the global economy.

Objective:

- To understand about sustainable investment
- To examine sustainable investment relevant with ESG investment.
- To study how ESG indices contribute for sustainable investment

ESG Performance: Empirical Insights

Studies consistently show that ESG investments are competitive—if not superior—to traditional strategies:

- The **MSCI World ESG Leaders Index** outperformed the MSCI World Index over a five-year span (2017–2022).
- ESG portfolios exhibited **lower drawdowns** during the COVID-19 crisis (Morgan Stanley, 2024).
- Pension funds like **Norway's GPFG** and **Japan's GPIF** have adopted ESG mandates, citing fiduciary duty and return enhancement.

Challenges and Limitations

Despite growing evidence of ESG's value proposition, several obstacles persist:

- **Inconsistent Ratings**: ESG scores vary across providers due to differing methodologies.
- **Greenwashing**: Companies may exaggerate ESG compliance to attract capital.
- **Short-Term Underperformance**: ESG funds may lag during commodity or extractive sector bull runs.

These challenges necessitate better data transparency, cross-provider harmonization, and stronger regulatory enforcement.

Recommendations:

- Standardize global ESG reporting frameworks.
- Strengthen regulatory oversight to deter greenwashing.
- Incentivize institutional investors to adopt ESG benchmarks.
- Promote ESG literacy for retail investors and financial advisors.

Copyright © 2024 by Author/s and Licensed by JISEM. This is an open access article distributed under the Creative Commons Attribution License which permitsunrestricted use, distribution, and reproduction in any medium, provided the original work is properly cited.

Journal of Information Systems Engineering and Management
2024, 9 (1)
e-ISSN: 2468-4376
https://www.jisem-journal.com/

Research Article

Conclusion:

Sustainable investing is a financially viable and ethically responsible strategy. ESG indices facilitate informed capital allocation and promote responsible corporate behaviour. The future of finance is increasingly green, but success depends on improving ESG data reliability and combating greenwashing.

References:

[1] Chen, J., & Zhou, Y. (2024). Sustainable investing: ESG effectiveness and market value in OECD regions. Journal of Sustainable Finance & Investment, 12(3), 245–263.
[2] Curran, M. M., & Moran, D. (2007). Impact of the FTSE4Good Index on firm price: An event study. Journal of Environmental Management, 82(4), 529–553. https://doi.org/10.1016/j.jenvman.2006.01.013
[3] Mishra, S., Raj, R., & Chakrabarty, S. P. (2023). Green portfolio optimization: A scenario analysis and stress testing based novel approach for sustainable investing in the paradigm Indian markets. arXiv preprint arXiv:2305.16712. https://doi.org/10.48550/arXiv.2305.16712
[4] Nicolas, M. L. D., Desroziers, A., Caccioli, F., & Aste, T. (2023). ESG reputation risk matters: An event study based on social media data. arXiv preprint arXiv:2307.11571. https://doi.org/10.48550/arXiv.2307.11571
[5] Zhang, J., Tan, K. S., Wirjanto, T. S., & Porth, L. (2023). Navigating uncertainty in ESG investing. arXiv preprint arXiv:2310.02163. https://doi.org/10.48550/arXiv.2310.02163
[6] Morgan Stanley Institute for Sustainable Investing. (2024). Sustainable funds outperform peers in 2023. Morgan Stanley. https://www.morganstanley.com/ideas/sustainable-funds-performance-2023-full-year
[7] FTSE Russell. (2023). Global sustainable investment indices outperform in 2023. FTSE Russell. https://www.ftserussell.com/
[8] Reuters Graphics. (2023). Sustainable funds grab new money worldwide. Reuters. https://graphics.reuters.com/
[9] BloombergNEF. (2024). Why now could be the right time to go green with your investments. Investopedia. https://www.investopedia.com/going-green-with-your-investments-11744567
[10] Reuters. (2024, March 5). Flexibility is key to minding the ESG investment returns gap. Reuters. https://www.reuters.com/
[11] The Australian. (2023, December 6). The ESG backlash gets real as outflows hit hard. The Australian. https://www.theaustralian.com.au/
[12] Washington Post. (2024, April 11). How to decide whether sustainable investing is right for you. Washington Post. https://www.washingtonpost.com/
[13] Financial Times. (2024, May 2). Investors pull cash from ESG funds as performance lags. Financial Times. https://www.ft.com/
[14] Organisation for Economic Co-operation and Development. (2020). ESG investing: Practices, progress and challenges. OECD Publishing. https://www.oecd.org/

Copyright © 2024 by Author/s and Licensed by JISEM. This is an open access article distributed under the Creative Commons Attribution License which permitsunrestricted use, distribution, and reproduction in any medium, provided the original work is properly cited.