# Investment Strategy - Redefined with the emergence of Ethical funds

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**Abstract**

Various dynamic patterns have been identified in context of the investment strategies followed by retail investors. The current study attempts to bring the attention of the investors towards the importance of the application of the concept of ESG (environmental, social and governance) norms while deciding about investment opportunities available in the stock markets. The data for the study includes the returns of the stocks in the Tata Ethical Fund and Nifty Midcap Index for a period of three years from January, 2016 to January 2019. Various statistical tests like the t-test, KS test, F-test and Levene's test have been employed in the study. The study highlights the benefit that the investors achieve by constructing portfolio out of stocks in the ethical funds as compared to the stocks of Nifty Midcap Index, thereby concluding that the investment in stocks contained in ethical funds provides significantly higher return than investments in Nifty Midcap Index.

**Keywords:** Ethical Funds, Investment Strategy, Retail Investors.

**JEL Classification:**E22, G11, Q01

## Introduction

The investment strategy by retail investors in stock market exhibits dynamic pattern over certain period of time and gradually gets skewed towards the sector or trend likely to witness growth in future. In the recent past, the investment strategy seems to have synchronized with goal of sustainable development and preferencefor investment in stocks of companies qualifying parameters of environmental, social and governance norms has been observed. Various dedicated funds have been developed on the basis of this concept. The investors shall therefore prefer to pick stocks from the portfolios of such fund and remain invested in them for long period of time to earn respectable return. This study attempts to highlight the benefit of constructing portfolio out of stocks in the ethical funds instead of making investment in stocks of Nifty Midcap Index as though it has potential to generate high return but at the time it is subject to high risk as well.

## Review of Literature

Kotsantonis, Pinney, & Serafeim (2016) conducted study to provide evidences in support of the financial performance of sustainable investing and eradicating various misconceptions relating to the expanding set of principles and methods. With regard to myth that the ESG programs often reduce the returns on capital as well as the long-run shareholder value, they concluded that companies that arecommitted to ESG are acquiring competitive advantages in the product, labor& capital markets. The portfolios that have incorporated these important ESG norms have provided superior average returns to their investors in comparison to the conventional portfolios and a lower associated risk. Other myths such as an already integrated ESG mechanism in place, inability of the companies to influence the kind of investors and scarcity and unreliability of ESG data were also rejected. Regarding the popular myth that ESG adds valueentirely by reducing risks, it was concluded that the operating efficiency of high ESG companies has increased and they entered into new markets because of the lower risk and a lower cost of capital. The study also focused on the mythof creation of conflict with the fiduciary duty of the investors because of the consideration of ESG factors and it was concluded that many of the ESG factors positive correlations with the corporate financial performance and value.Beal, et al. (2017) concluded that thecorporate leaders in today’s world are rethinking the role and importance of business in society. The investors, in general, are increasingly

focusing on the companies' social as well as environmental practices because of the fact that the performance in those areas affects the returns in the long term. The standards which are being developed for ESG topics are financially important to the industry, and the data on company performance in these areas is becoming easily and readily available. The reliability of this information stems from increased transparency which ultimately draws more scrutiny from investors and other stakeholders.Risalvato (2017)in his study observed that after the financial crisis of 2008,ethical or sustainable indices have generally performed better than traditional indices, which are derived through a selection of stocks that are subject to strict requirements.Hsu, Liu, Shen, Viswanathan, & Zhao (2018) observed that sorting of the stocks based on cost of equity of capital generated positive and significant returns for both ESG & non-ESG firms. They also focused on investing in an ESG in Need index containing only high-ESG companies and inclined towardsthe firms with high cost of capital which generates higher social value as well as better returns as compared to investing in traditional market capitalization-weighted ESG indexes.

## Data and Methodology

The returns generated by the stocks in the Tata Ethical Fund over a period of three years i.e. January,2016 to January, 2019 have been calculated and compared against the return generated by the Nifty MidcapIndex. The study tests thenull hypothesis that there is no significant difference between return of stocks and return of NiftyMidcapIndex.

**i.e.** $H_0$: **Mean** $_{\text{Return on stocks}}$ = **Mean** $_{\text{Return on NIFTY Midcap}}$ **(Null Hypothesis)**

$H_a$: **Mean** $_{\text{Return on stocks}}$ ≠ **Mean** $_{\text{Return on NIFTY Midcap}}$ **(Alternate Hypothesis)**

The statistical test, namely t-test, has been employed for the study using SPSS after ensuring compliance of necessary conditions required for the same. It has been ensured that the samples are independent of each other because the stocks of Tata Ethical funds are not included in the NiftyMidcapIndex. Thus, the conditions with regard to independence of the two samples under the study has been met. The other conditions such as normality of the data and homogeneity of variance have been examined using Kolmogorov Smirnov test and Levene's test respectively. Finally, t –test has been conducted on the sample and meaningful interpretations were made.

## Data Analysis and Interpretation

The data used for the study has been collected from the website of the National Stock Exchange and is summarized in Table 1.

It can be observed from Table 1 that most of the stocks in the Tata Ethical fundhave generated significantly higher returns in the last three years as against the return generated by the NiftyMidcapIndex during the same period. Only in one case, the return of stock happens to be less than the return generated by the index under study and in another case, the return on stock is marginally higher than return on Nifty Midcap Index. Thus, it becomes necessary to examine if there has been statistically significant difference between the returns of stocks in Tata Ethical Fund and the return of NiftyMidcap Index.

In order execute, t – test, on the data, the condition of normality of the data was examined using Kolmogorov Smirnov test with the help of SPSS, and the output of the same is given in Table 2:

It can be observed from the output of the KS test that p-value is greater than 0.05 (level of significance used for the study); therefore, it implies that the given data complies with the condition of normality.

After ensuring the normality of data, the given samples were subject to t-test using SPSS and the output obtained from the same is shown below in table 3:

The group statistics of the output highlight the mean return of the stocks and the index alongwith their standard deviation. The mean return of the stocks in the ethical funds has been observed as 79.71 % as against 29.74% of the NiftyMidcap Index and the standard deviation of the stock return is57.09%.Primafacie, the mean return of the stocks in Tata Ethical Funds appeared to be significantly higher than the return of the NiftyMidcapIndex.
The t-test output (as shown in table 4) generated using SPSS contains Levene’s statistic which is used for examining if the independentsamples under study have equal variances or not. The p- value of the Levene’s test in the above case is 0.000 which is lower than 0.05. This indicates that the null hypothesis i.e. there is no significant difference in the variances of the two samples, stands reject. In other words, there is significant difference in the variances of the two samples and this is, to some

extent, visible in the group statistics Table 3. Based on the above analysis, we focus on the top row of the above output for further analysis. The p-value in the top row is 0.018 which is less than 0.05. Therefore, we reject the null hypothesis that there is no significant difference between the return offered by stocks in Tata Ethical Fund and the broader market index under study (NiftyMidcap Index). In other words, it amounts to statistical validation of the fact that the return generated by stocks in Tata Ethical Funds significantly differs from return generated by Nifty Midcap Index during the period January, 2016 to January,2019.

## Conclusion

In line with the global trend, the investment strategies by funds managers and retail investors are gradually getting aligned with the theme of sustainable of investing. World over, various experts and researchers in the area of investment management have noticed the paradigm change in the investment strategy of portfolio managers and emergence of sustainable investing. Myths concerning with investments in stocks complying ESG criteria have been examined by researchers and outcome of their analysis has been disseminated in the public forum. Keeping in view the researches carried out on this subject and its nascent stage in India, this study was conducted with the objective of making comparative analysis of the return offered by Nifty Midcap Index and the stocks included in the Tata Ethical Fund. The study aims to educate the retail investors with this new concept and to apprise them with the benefit of being invested in the stocks constituting ethical funds. The study concludes that investment in stocks contained in ethical funds provides significantly higher return than investments in Nifty Midcap Index, the stocks of which happens to be preferred choice of many traders and retail investors. It is therefore advisable for retail investors to invest in stock complying ESG criteria or simply to choose stock from ethical funds for long term investment.

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**Table 1: Return of stocks Tata Ethical Fund and Return on Nifty Midcap Index**

| S.No. | Ethical Stocks | Return on Stocks | Return on Nifty Midcap | Excess /Deficit Return |
|---|---|---|---|---|
| 1 | Hindustan Unilever Ltd. | 124.8455 | 29.74889 | 95.09661 |
| 2 | Tech Mahindra Ltd. | 40.76923 | 29.74889 | 11.02034 |
| 3 | Asian Paints (India) Ltd. | 56.81818 | 29.74889 | 27.06929 |
| 4 | Bata India Ltd.} | 113.9048 | 29.74889 | 84.15591 |
| 5 | Britannia Industries Ltd. | 110.0472 | 29.74889 | 80.29831 |
| 6 | Alkem Laboratories Ltd. | 30.65844 | 29.74889 | 0.90955 |
| 7 | Oil & Natural Gas Corporation Ltd. | -8.02469 | 29.74889 | -37.77358 |
| 8 | GAIL (India) Ltd. | 70.14218 | 29.74889 | 40.39329 |
| 9 | Larsen & Toubro Infotech Ltd. | 178.2958 | 29.74889 | 148.54691 |

**Table 2: Normality test for the sample under study**

| One-Sample Kolmogorov-Smirnov Test | | | |
|---|---|---|---|
| | | **Return on Index** | **Return on stocks** |
| **N** | | **9** | **9** |
| Normal Parameters[a,b] | Mean | 29.7489 | 79.7174 |
| | Std. Deviation | .00000 | 57.09794 |
| Most Extreme Differences | Absolute | .500 | .147 |
| | Positive | .500 | .122 |
| | Negative | -.500 | -.147 |
| Kolmogorov-Smirnov Z | | 1.500 | 0.440 |
| Asymp. Sig. (2-tailed) | | .022 | 0.99 |

a. Test distribution is Normal.

b. Calculated from data.

**Table 3: SPSS output for Group Statistic of the samples under study**

**Group Statistics**

| | Securities | N | Mean | Std. Deviation | Std. Error Mean |
|---|---|---|---|---|---|
| Return | Ethical Stocks | 9 | 79.7174 | 57.09794 | 19.03265 |
| | Nifty Midcap Index | 9 | 29.7489 | .00000 | .00000 |

**Table 4: SPSS output for t-test**

**(Independent Samples Test)**

| Return | Levene's Test for Equality of Variances | | t-test for Equality of Means | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | F | Sig. | t | df | Sig. (2-tailed) | Mean Difference | Std. Error Difference | 95% Confidence Interval of the Difference | |
| | | | | | | | | Lower | Upper |
| Equal variances assumed | 22.63 | .000 | 2.63 | 16 | .018 | 49.9685 | 19.03265 | 9.621 | 90.316 |
| Equal variances not assumed | | | 2.63 | 8 | .030 | 49.9685 | 19.03265 | 6.079 | 93.858 |