

IFC Sustainable Investment Country Reports:

Sustainable Investment in India 2009

Final Report

May 2009



Sustainable Investment in India 2009

FINAL REPORT

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IFC, a member of the World Bank Group, creates opportunity for people to escape poverty and improve their lives. We foster sustainable economic growth in developing countries by supporting private sector development, mobilizing private capital, and providing advisory and risk mitigation services to businesses and governments. Our new investments totalled US\$16.2 billion in fiscal 2008, a 34 percent increase over the previous year. For more information, visit www.ifc.org.

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- To catalyze capital market flows into sustainable investment, IFC works to (a) promote the business case for sustainable investment by drawing lessons from IFC's own portfolio, (b) establish frameworks to identify and assess new sustainable investment opportunities, and (c) develop new financial products (e.g. Sustainability indices); and
- To support fund managers investing in sustainable companies, IFC works (a) with private equity funds in IFC's portfolio to assist them to establish E&S analytical processes, and (b) with capital market actors to improve the enabling environment for the market to recognize and value sustainability in corporate valuation.

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GLOSSARY OF ABBREVIATIONS

ACCGS	Asian Centre for Corporate Governance and Sustainability
ACGA	Asian Corporate Governance Association
ADB	Asian Development Bank
ADR	American Depository Receipt
AMFI	Association of Mutual Funds in India
ASRIA	Association for Sustainable & Responsible Investment in Asia
AUM	Assets under management
BSE	Bombay Stock Exchange
CDP	Carbon Disclosure Project
CII	Confederation of Indian Industry
DB	Defined Benefit
DC	Defined Contribution
DJSI	Dow Jones Sustainability Index
EMDP	Emerging Markets Disclosure Project
EMPEA	Emerging Market Private Equity Association
EPF	Employees Provident Fund
ESG	Environment, social and governance
FDI	Foreign Direct Investment
FII	Foreign Institutional Investor
GDP	Gross Domestic Product
GP	General partner (manager of a private equity fund)
GRI	Global Reporting Initiative
HNWI	High Net Worth Individual
IAIP	Indian Association of Investment Professionals
ICGN	International Corporate Governance Network
IFC	International Finance Corporation
IMC	Indian Merchants Chamber
IMF	International Monetary Fund
IPO	Initial Public Offering
IRDA	Insurance Regulatory and Development Authority
IVCA	Indian Venture Capital Association
LIC	Life Insurance Corporation of India
LP	Limited partner (investor in a private equity fund)
MDG	Millennium Development Goals
NAPCC	National Action Plan on Climate Change
NAV	Net asset value
NPS	New Pension System
NSE	National Stock Exchange
P/E	Price/earnings ratio
PE	Private equity
PFRDA	Pension Fund Regulatory and Development Authority
PIS	Portfolio Investment Scheme
RBI	Reserve Bank of India
ROE	Return on equity
SEBI	Securities and Exchange Board of India
SEC	United States Securities and Exchange Commission
SME	Small and medium sized enterprises
SRI	Socially Responsible Investment
ULIP	United Linked Insurance Plan
UNEPFI	United Nations Environment Program Finance Initiative
UNPRI	United Nations Principles for Responsible Investment
VC	Venture Capital
WRI	World Resources Institute

EXECUTIVE SUMMARY

This report has been prepared for IFC by TERI-Europe to (a) determine the current state of development of sustainable investment in India and (b) develop recommendations on future interventions by IFC and/or other actors to stimulate the market.

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).

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 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 HNWI 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.

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.

1. INTRODUCTION

Objectives

This report has been prepared by TERI-Europe for the International Finance Corporation (IFC) in accordance with Terms of Reference agreed in July 2008. The report has the following objectives:

- To determine the current state of development of sustainable investment in India by measuring the market on a number of indicators; and
- To establish the feasibility of interventions to stimulate the market further and make recommendations for the appropriate development path for India's sustainable investment market.

The report was commissioned by the Sustainable Investing Program of the Sustainability Business Innovator in IFC's Environment & Social Development Department. It forms part of a wider IFC project that includes similar assessments of the sustainable investment markets of Brazil, China and South Africa. In addition to the current report, TERI-Europe is also responsible for the Brazilian study.

The current report builds on and updates TERI-Europe's May 2007 report *SI²: Sustainable Investment in India*, which was sponsored by the UK Foreign & Commonwealth Office. It has been prepared based on comprehensive desk research together with extensive field interviews conducted by Dan Siddy and Ritu Kumar in Mumbai and New Delhi over the period November 2008 – January 2009.

Scope

The term "sustainable investment" can mean different things. In the interests of clarity, the scope of "sustainable investment" as covered in this report is domestic and foreign investment in India's publicly quoted companies using strategies that take environmental and social (sometimes combined with governance) issues into consideration. This includes negative screening, positive screening, best-in-class, shareholder activism and similar "socially responsible investment" styles, together with "integrated" approaches such as engagement and non-financial risk analysis.

Private equity and venture capital funds investing in India are a secondary focus of this study. Specifically, the report covers (a) the use of environmental/social due diligence policies and procedures by "mainstream" private equity and venture capital funds (b) private equity and venture capital funds that are based on sustainability themes such as clean technology and climate change.

The report does not cover other segments of the sustainable finance and investment market such as the Equator Principles, ESG-related banking products or microfinance. As context, however, it is essential to note that microfinance is a strong feature of the Indian capital market and, whilst no Indian banks have adopted the Equator Principles, many of them have alternative social and environmental risk management systems and several are active in promoting sustainability-related financial services and banking products in areas such as carbon credits, access to finance and alternative energy.

A snapshot in time

This report must be seen in the context of the global financial crises that have unfolded during 2008 – and will continue to evolve for the foreseeable future - following the emergence of problems in the US sub-prime mortgage market in 2007.

The authors have done their best to present an accurate and balanced ‘snapshot’ of India’s sustainable investment market in this fast-changing and turbulent environment and to frame conclusions and recommendations that will hold their currency for the next 6-12 months. We have sought to use the most up-to-date data available, but acknowledge that some of the information and corresponding analysis contained in this report may have an unavoidably short shelf life in these exceptional circumstances.

Exchange rates used

Unless otherwise stated, the exchange rate used in this report is Rs 48.71 to the US\$ (the rate prevailing as of February 10, 2009).

Structure of the report

As important context for the rest of the report, Chapter 2 provides an overview of the main findings from TERI-Europe’s May 2007 report. Chapter 3 then delivers a brief overview of India’s development profile, economy and stock markets, along with a summary of the key industries and companies that are traded on the stock market. More detailed information on these issues is provided in Appendix A. Chapter 4 adds to the context for sustainable investment in India through a short discussion on ESG value drivers in India, including the National Action Plan on Climate Change.

Chapter 5 sets out detailed information on current sustainable investment activity in India, beginning with the S&P ESG India Index and then dealing in turn with foreign institutional investors and different segments of the domestic investment community, including the Fortis Sustainable Development Fund. Chapter 5 also includes information on India’s private equity market and related ESG trends.

The enabling environment for sustainable investment in India is analysed in Chapter 6, which focuses on ESG transparency and disclosure; the availability of research, indices and rating services; and key organisations that are likely to be relevant to any future work to develop sustainable investment in India. This includes information on an upcoming initiative by the National Stock Exchange of India (NSE), UNPRI and other partners that is likely to be one of the key developments in 2009 in this respect.

Finally, Chapter 7 provides a forward-looking discussion on the current status of sustainable investment in India and the prospects for future market development. Chapter 7 concludes with a number of recommendations that focus on strategies for making further progress in both the listed equity and private equity sectors.

2. BACKGROUND

Previous analysis by TERI-Europe

TERI-Europe's May 2007 report evaluated the strategic importance of sustainable investment in India (focusing solely on portfolio investment in publicly quoted companies) and provided a critical analysis of strengths and weaknesses at that time. The report's conclusions can be summarised as follows:

- *Good ESG investment practice will continue to rise up the agenda of an increasingly large cross-section of investors, especially foreign institutional investors, who will continue to seek long-term opportunities in an increasing universe of investable emerging markets. This is especially relevant to carbon reduction opportunities and climate change adaptation costs.*
- *ESG and sustainable development issues in India generally will become more pronounced and will have a higher profile in public, media, NGO and government circles. ESG problems related to Indian, Chinese and other emerging market companies will also become more frequent, more acute, more visible and more likely to be associated with shareholder value destruction. Already, the climate impacts of India and China's growth have become a major concern to governments and NGOs.*
- *Investors will become increasingly discriminating about investment in India and other emerging markets, especially if (or when) those markets cycle into more bearish conditions. ESG issues will become an increasingly important feature in such investment decisions. They will also become more prominent in ownership decisions affecting Indian and other emerging market companies, including shareholder engagement and voting practices.*
- *There will be corresponding pressure for greater transparency, disclosure and analysis of ESG issues associated with emerging market companies, which is likely to widen informational inefficiencies. Many Indian companies are likely to struggle with these new demands, as they are unused to ESG reporting. In addition, although the S&P ESG India Index is an important development, the information & research infrastructure for sustainable investment is still very limited and immature in India compared to Brazil, South Africa and even China.*
- *ESG issues in India and sustainable investment trends globally are also creating important upside opportunities that can be capitalised upon. Many investors are now allocating very large amounts of capital to new sustainable finance markets ranging from carbon finance, clean technology and sustainable energy to microfinance, social enterprise and venture philanthropy.*

Overall, the May 2007 report concluded that India was relatively unprepared for foreign sustainable investment and that this should be seen as a strategic risk to the country's global competitiveness and sustainable development.

3. COUNTRY OVERVIEW

Development Profile

Appendix A provides information on key development indicators in India and the country's progress towards the Millennium Development Goals (MDGs).

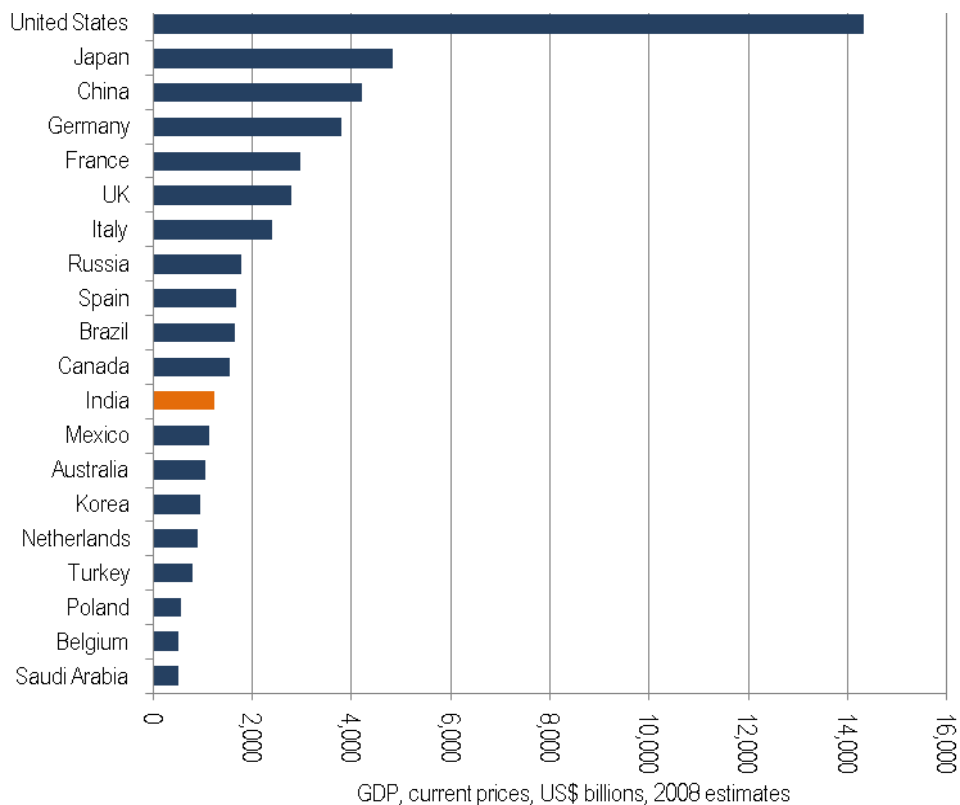
Economy

Based on the IMF's 2008 estimates of worldwide GDP, India is today the world's 12th largest economy (Figure 1).

India's diverse economy encompasses traditional village farming, modern agriculture, handicrafts, a wide range of modern industries, and a multitude of services. Services are the major source of economic growth, accounting for more than half of India's output with less than one third of its labor force.

About three-fifths of the work force is in agriculture, leading the United Progressive Alliance (UPA) government to articulate an economic reform program that includes developing basic infrastructure to improve the lives of the rural poor and boost economic performance.

Figure 1: The world's 20 largest economies (source: IMF)

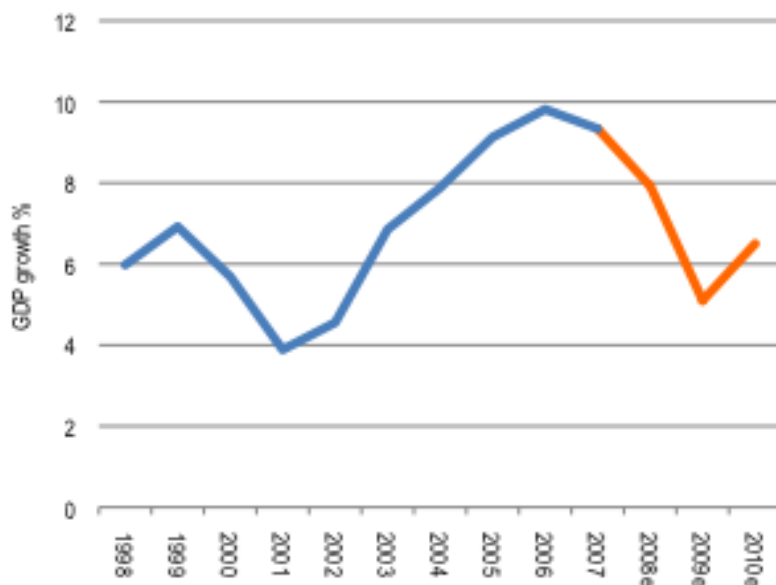


The government has reduced controls on foreign trade and investment. Higher limits on foreign direct investment were permitted in a few key sectors, such as telecommunications. However, tariff spikes in sensitive categories, including agriculture, and incremental progress on economic reforms still hinder foreign access to India's vast and growing market. Privatization of government-owned industries remains stalled and continues to generate political debate; populist pressure from within the UPA government and from its Left Front allies continues to restrain needed initiatives.

India's trade deficit widened to US\$79.1 billion in 2007 in balance-of-payments terms, from US\$62.1 billion in 2006. Exports performed strongly in 2007, rising by 23 per cent to US\$151.3 billion, but imports jumped by 25 per cent to US\$230.5 billion, largely owing to higher international oil prices and strong demand for industrial inputs and consumer goods. China overtook the US as India's largest trade partner in 2007/08.

The economy has posted an average growth rate of more than 7% in the decade since 1997, reducing poverty by about 10 percentage points. India achieved 8.5% GDP growth in 2006, 9.0% in 2007, and 7.3% in 2008, significantly expanding production of manufactures. India is capitalizing on its large numbers of well-educated people skilled in the English language to become a major exporter of software services and software workers. Economic expansion has helped New Delhi continue to make progress in reducing its federal fiscal deficit. However, strong growth combined with easy consumer credit and a real estate boom fueled inflation concerns in 2006-08, leading to a series of central bank interest rate hikes that have slowed credit growth and eased inflation concerns. The huge and growing population is the fundamental social, economic, and environmental problem.

Figure 2: India GDP growth trends (source: IMF)



Private capital flows

Net debt and equity inflows to developing countries increased by US\$269 billion in 2007 to reach a record US\$1.03 trillion, according to the World Bank’s *Global Development Finance 2008* report. This marks five consecutive years of strong gains in net private flows, which averaged over 44 per cent a year (however, much of the increase in dollar terms reflects the depreciation of the US\$ against most other currencies). The rapid expansion in private flows reflects strong gains in both equity and debt components. Net (foreign direct and portfolio) equity inflows reached an estimated US\$616 billion in 2007 (Figure 3), equal to a record 4.5 per cent of GDP, up from 4.1 per cent in 2006. Figure 3 also illustrates how portfolio equity inflows have become increasingly important since the turn of the millennium.

Figures 4 and 5 provide information on private capital flows into India. Net foreign portfolio investment has increased significantly since 2004 and by the end of 2007 was approximately US\$ 30 billion, almost on a par with net FDI flows. India received approximately 20 per cent of all net portfolio flows to emerging markets that year.

Figure 3: Net equity flows to developing countries (source: World Bank *Global Development Finance 2008*)

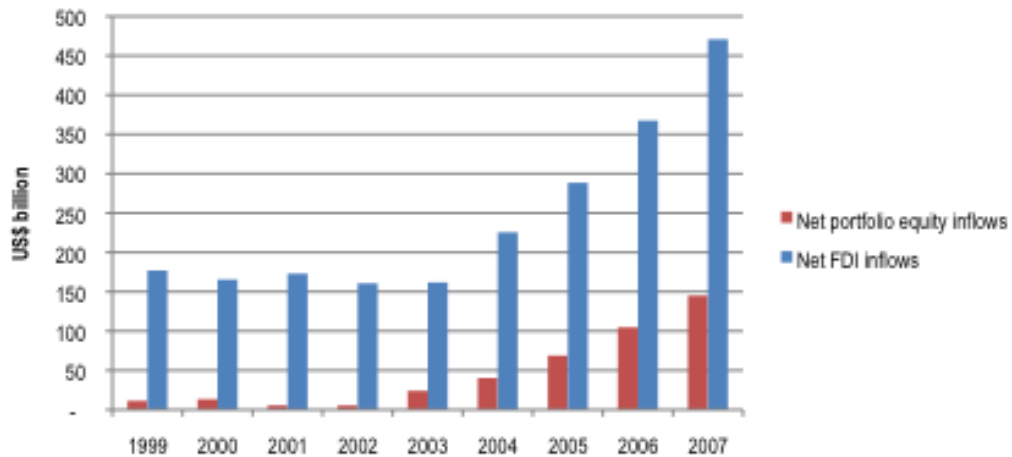


Figure 4: FDI and foreign portfolio investment in India: flows (source: RBI)

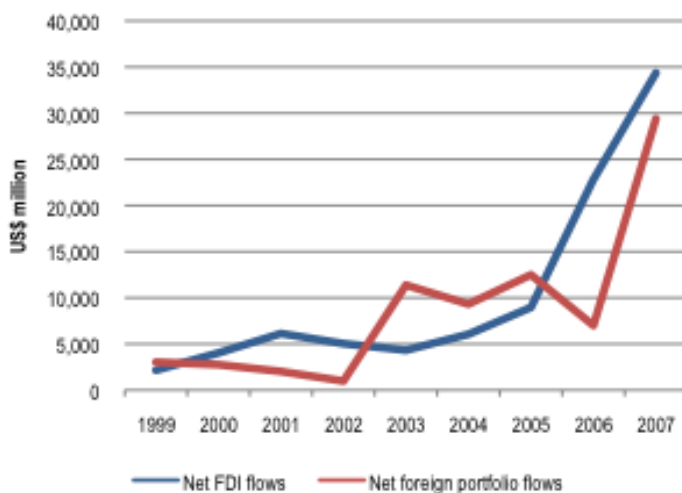


Figure 5: India's share of net portfolio equity flows to developing countries (sources: RBI; World Bank *Global Development Finance 2008*)



The stock markets

Market size

India has two main stock exchanges, the Bombay Stock Exchange (BSE) and the National Stock Exchange of India (NSE). The BSE is the 14th largest market in the world by market capitalization, while NSE follows closely behind in 16th place (Figure 6).

In common with almost all other markets, India's market capitalisation has experienced a sharp decrease in the last 12 months as a result of the global economic crisis and the worldwide fall in equity prices (Figure 7). As of the end of November 2008, the market value of BSE and NSE listed companies came to US\$600 billion.

Table 1 shows the country weighting for India in the three main emerging market indices published by FTSE, MSCI and Standard & Poor's. The table includes data for Brazil for comparison.

Table 1: Country weighting in key emerging market indices

Index	BRAZIL	INDIA	Reporting date
FTSE All-World Emerging Index	14.59%	9.97%	Jan 14, 2009
MSCI Emerging Market Index	13.36%	6.65%	Jan 14, 2009
S&P/IFCI Composite Index	12.78%	7.13%	Nov 30, 2008

Figure 6: Domestic market capitalisation of the world's 20 largest exchanges (USD millions) (source: World Federation of Exchanges)

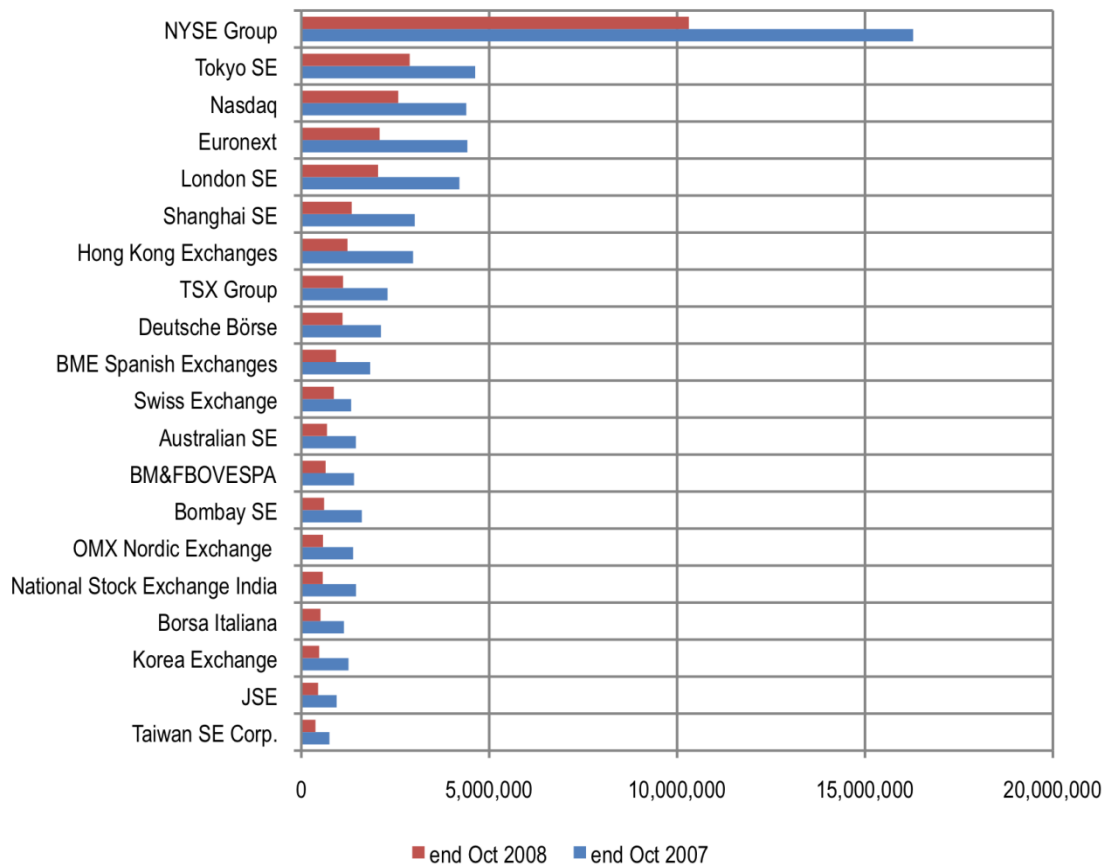
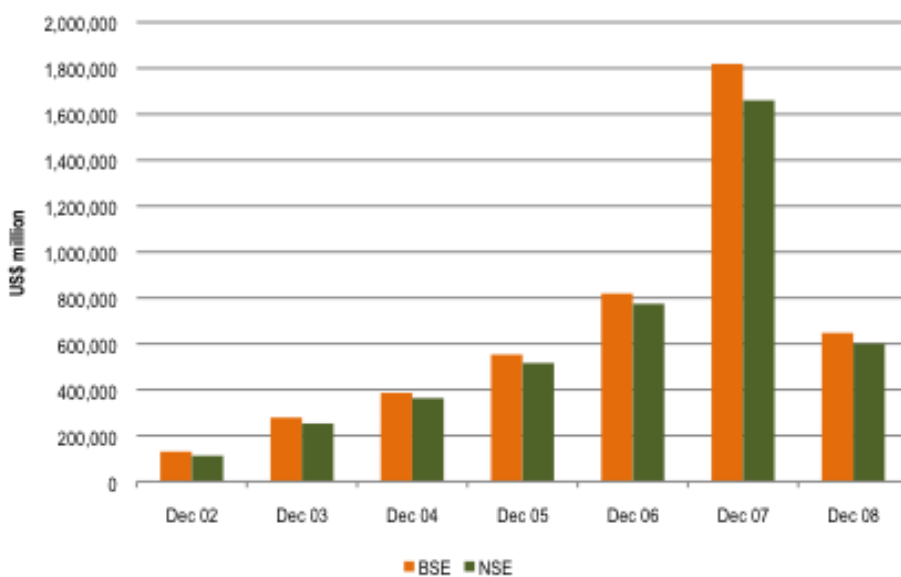


Figure 7: Domestic market capitalisation of BSE and NSE (source: World Federation of Exchanges)



Key companies and industries

Table 2 lists all the companies in the Sensex, the market's main benchmark index.

The five industrial sectors with the highest market value are petrochemicals (23 per cent); manufacturing (23 per cent); infrastructure (17 per cent); telecommunications (9 per cent); and banking (9 per cent) (Figure 8).

Figure 8: Industry breakdown of 'Top 50' NSE-listed companies by market cap (source: NSE)

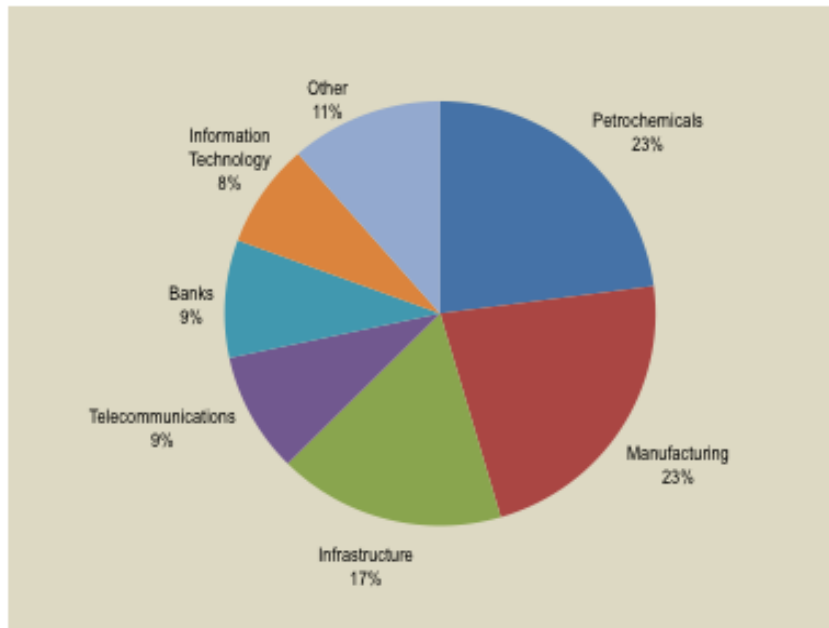


Table 2: Sensex companies

Company	Industry	S&P ESG India Index	Market cap US\$ million
ACC Ltd.	Housing Related	●	2,118
Bharat Heavy Electricals Ltd.	Capital Goods		14,194
Bharti Airtel Ltd.	Telecom	●	25,348
DLF Ltd.	Housing Related		5,462
Grasim Industries Ltd.	Diversified		2,539
HDFC	Finance	●	8,911
HDFC Bank Ltd.	Finance		8,132
Hindalco Industries Ltd.	Metal, Metal Products & Mining	●	1,576
Hindustan Unilever Ltd.	FMCG	●	11,569
ICICI Bank Ltd.	Finance	●	9,629
Infosys Technologies Ltd.	Information Technology	●	14,794
ITC Ltd.	FMCG	●	13,798
Jaiprakash Associates Ltd.	Housing Related	●	1,775
Larsen & Toubro Limited	Capital Goods		8,198
Mahindra & Mahindra Ltd.	Transport Equipments	●	1,554
Maruti Suzuki India Ltd.	Transport Equipments		3,640
NTPC Ltd.	Power	●	30,470
ONGC Ltd.	Oil & Gas		30,511
Ranbaxy Laboratories Ltd.	Healthcare		1,836
Reliance Communications Limited	Telecom		7,307
Reliance Industries Ltd.	Oil & Gas	●	43,678
Reliance Infrastructure Ltd.	Power	●	2,572
State Bank of India	Finance		15,113
Sterlite Industries (India) Ltd.	Metal, Metal Products & Mining		3,912
Sun Pharmaceutical Industries Ltd.	Healthcare		4,701
Tata Consultancy Services Limited	Information Technology	●	10,230
Tata Motors Ltd.	Transport Equipments		1,436
Tata Power Company Ltd.	Power	●	3,615
Tata Steel Ltd.	Metal, Metal Products & Mining	●	2,782
Wipro Ltd.	Information Technology	●	6,679

Capital raising

The amount of capital raised on stock exchanges by Indian companies through the issuance of new and secondary equity offerings has increased significantly over the last three to four years (Figures 9 and 10). Although the number of IPOs has increased since 2005 and reached a record high in 2007, the longer-term trend is dominated by secondary public offerings.

Table 3 provides details of Indian IPO and secondary public offerings in 2007 and 2008. New deals since June 2008 have all but dried up as a consequence of wider economic conditions.

Figure 9: Capital raised by share issues on BSE and NSE (US\$ millions) (source: World Federation of Exchanges)

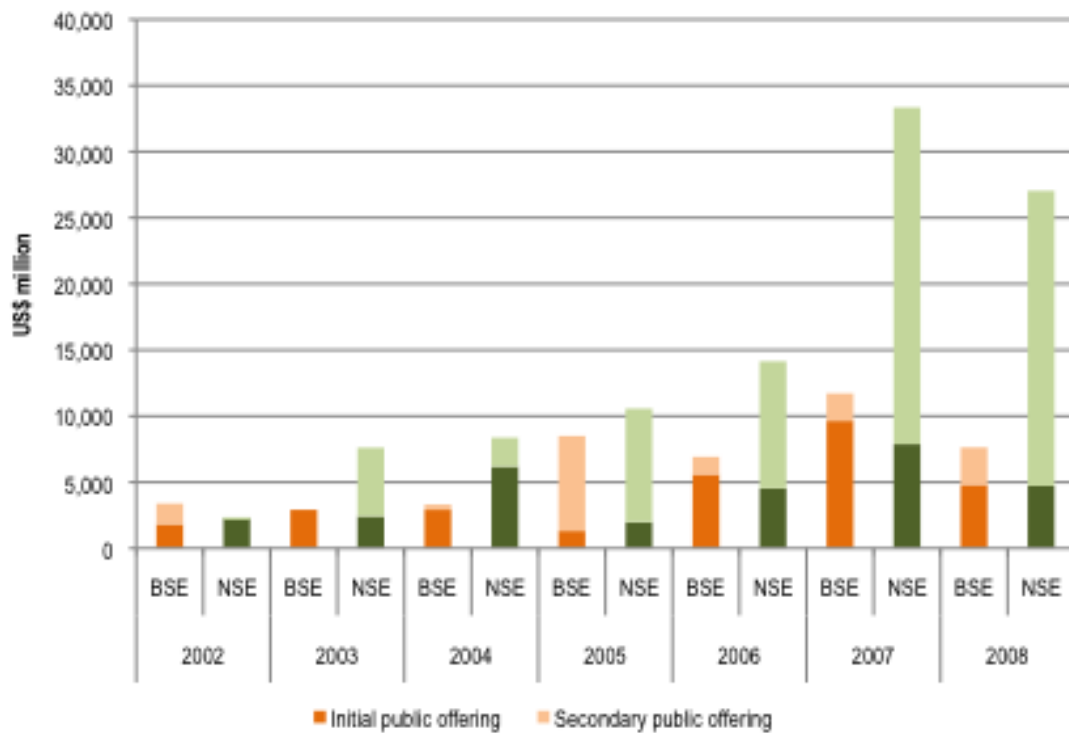


Figure 10: New listings on BSE and NSE (source: World Federation of Exchanges)

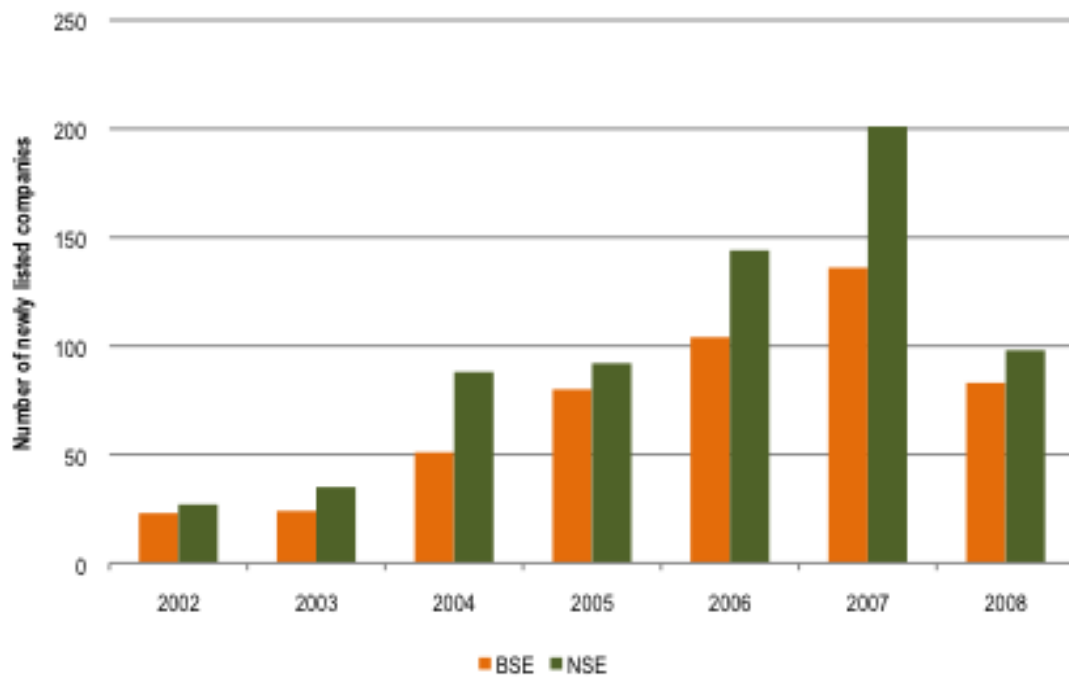


Table 3: Top 30 IPOs, 2007-2008 (source: NSE)

Company	Industry	Date	Rs crore	US\$ million
Reliance Power Limited	Infrastructure	11-Feb-08	11563.20	2,373.89
DLF Limited	Infrastructure	05-Jul-07	9187.50	1,886.16
Power Grid Corporation of India Limited	Infrastructure	05-Oct-07	2984.45	612.70
Mundra Port and Special Economic Zone Limited	Services	27-Nov-07	1771.00	363.58
Housing Development and Infrastructure Limited	Infrastructure	24-Jul-07	1707.75	350.60
Rural Electrification Corporation Limited	Finance	12-Mar-08	1639.26	336.53
IRB Infrastructure Developers Limited	Infrastructure	25-Feb-08	944.57	193.92
Puravankara Projects Limited	Infrastructure	30-Aug-07	856.28	175.79
Central Bank of India	Banks	21-Aug-07	816.00	167.52
Brigade Enterprises Limited	Infrastructure	31-Dec-07	745.62	153.07
IVR Prime Urban Developers Limited	Infrastructure	16-Aug-07	721.65	148.15
Edelweiss Capital Limited	Finance	12-Dec-07	691.86	142.04
Omaxe Limited	Infrastructure	09-Aug-07	605.94	124.40
Fortis Healthcare Limited	Miscellaneous	09-May-07	496.76	101.98
Future Capital Holdings Limited	Finance	01-Feb-08	491.34	100.87
OnMobile Global Limited	Petrochemicals	19-Feb-08	479.62	98.46
BGR Energy Systems Limited	Manufacturing	03-Jan-08	438.53	90.03
Maytas Infra Limited	Infrastructure	25-Oct-07	327.45	67.22
Jyothy Laboratories Limited	Pharmaceuticals	19-Dec-07	305.69	62.76
Kolte - Patil Developers Limited	Infrastructure	13-Dec-07	275.54	56.57
Motilal Oswal Financial Services Limited	Finance	11-Sep-07	246.07	50.52
Advanta India Limited	FMCG	19-Apr-07	216.32	44.41
Empee Distilleries Limited	FMCG	26-Nov-07	192.20	39.46
Consolidated Construction Consortium Limited	Infrastructure	15-Oct-07	188.70	38.74
Binani Cement Limited	Manufacturing	28-May-07	153.75	31.56
Take Solutions Limited	Information Technology	27-Aug-07	153.30	31.47
Shriram EPC Limited	Infrastructure	20-Feb-08	150.00	30.79
Koutons Retail India Limited	Manufacturing	12-Oct-07	146.26	30.03
Religare Enterprises Limited	Finance	21-Nov-07	140.16	28.77
GSS America Infrastructure Projects Limited	Information Technology	07-Mar-08	139.90	28.72

Note: FMCG = Fast Moving Consumer Goods

Performance and market participants

Figure 11 compares the performance of India’s benchmark index, the Sensex, with that of the MSCI Emerging Market Index (MSCI EM) over the last three years. The Sensex steadily gained in value over the 2006-2007 period and reached a record high in December 2007. Table 4 provides a breakdown of the different categories of market participant.

Figure 11: Sensex performance compared to MSCI Emerging Market Index, 3 years



Table 4: Shareholding pattern of NSE listed companies (end March 2008) (source: NSE)

Promoters	Indian Promoters	49.10%
	Foreign Promoters	7.03%
Institutional	Financial institutions/central & state government/insurance companies	5.36%
	Foreign institutional investors	10.62%
	Mutual funds	3.26%
	VC funds	0.14%
Non-Promoters	Other	0.29%
	Corporate bodies	5.81%
	Non-Institutional Individuals	13.07%
	Other	3.37%
Shares held by custodians and against which Depository Receipts have been issued		1.96%

4. KEY ESG ISSUES

Environmental and social issues

Corporations and their investors in India face a wide and often complex range of social and environmental issues that present potentially significant risks and opportunities to shareholder value and corporate reputation. At the current time there does not appear to be any single source that synthesises this information into an investor-friendly, comprehensive analysis of key sustainability-related business drivers in the industries that make up India's stock market. A detailed assessment is beyond the current scope of this report. On-going IFC-sponsored research by the World Resources Institute (WRI) may go some way to filling this gap in due course.

Principal issues

The main environmental and social issues that influence business and investor risk in India include:

- Poverty and inequality
- Access to finance at the 'base of the pyramid'
- Food security
- Labour standards
- Land rights
- Urban air pollution
- Urban congestion
- Greenhouse gas emissions
- Water scarcity and sanitation
- Rural electrification
- Energy security
- Climate change adaptation

National Action Plan on Climate Change

On 30 June 2008 the Indian Government, under the leadership of the Prime Minister, announced the National Action Plan on Climate Change (NAPCC). The plan identifies eight core "national missions" running through 2017 and directs ministries to submit detailed implementation plans to the Prime Minister's Council on Climate Change by December 2008.

Emphasizing the overriding priority of maintaining high economic growth rates to raise living standards, the plan "identifies measures that promote our development objectives while also yielding co-benefits for addressing climate change effectively." It says these national measures would be more successful with assistance from developed countries, and pledges that India's per capita greenhouse gas emissions "will at no point exceed that of developed countries even as we pursue our development objectives."

National Solar Mission: The NAPCC aims to promote the development and use of solar energy for power generation and other uses with the ultimate objective of making solar competitive with fossil-based energy options. The plan includes:

- Specific goals for increasing use of solar thermal technologies in urban areas, industry, and commercial establishments;
- A goal of increasing production of photovoltaics to 1000 MW/year; and

- A goal of deploying at least 1000 MW of solar thermal power generation. Other objectives include the establishment of a solar research centre, increased international collaboration on technology development, strengthening of domestic manufacturing capacity, and increased government funding and international support.

National Mission for Enhanced Energy Efficiency: Current initiatives are expected to yield savings of 10,000 MW by 2012. Building on the Energy Conservation Act 2001, the plan recommends:

- Mandating specific energy consumption decreases in large energy-consuming industries, with a system for companies to trade energy-savings certificates;
- Energy incentives, including reduced taxes on energy-efficient appliances; and
- Financing for public-private partnerships to reduce energy consumption through demand-side management programs in the municipal, buildings and agricultural sectors.

National Mission on Sustainable Habitat: To promote energy efficiency as a core component of urban planning, the plan calls for:

- Extending the existing Energy Conservation Building Code;
- A greater emphasis on urban waste management and recycling, including power production from waste;
- Strengthening the enforcement of automotive fuel economy standards and using pricing measures to encourage the purchase of efficient vehicles; and
- Incentives for the use of public transportation.

National Water Mission: With water scarcity projected to worsen as a result of climate change, the plan sets a goal of a 20% improvement in water use efficiency through pricing and other measures.

National Mission for Sustaining the Himalayan Ecosystem: The plan aims to conserve biodiversity, forest cover, and other ecological values in the Himalayan region, where glaciers that are a major source of India's water supply are projected to recede as a result of global warming.

National Mission for a "Green India": Goals include the forestation of 6 million hectares of degraded forest lands and expanding forest cover from 23% to 33% of India's territory.

National Mission for Sustainable Agriculture: The plan aims to support climate adaptation in agriculture through the development of climate-resilient crops, expansion of weather insurance mechanisms, and agricultural practices.

National Mission on Strategic Knowledge for Climate Change: To gain a better understanding of climate science, impacts and challenges, the plan envisions a new Climate Science Research Fund, improved climate modelling, and increased international collaboration. It also encourages private sector initiatives to develop adaptation and mitigation technologies through venture capital funds.

Other Programs

The NAPCC also describes other ongoing initiatives, including:

- Power Generation: The government is mandating the retirement of inefficient coal-fired power plants and supporting the research and development of IGCC and supercritical technologies.

- **Renewable Energy:** Under the Electricity Act 2003 and the National Tariff Policy 2006, the central and the state electricity regulatory commissions must purchase a certain percentage of grid-based power from renewable sources.
- **Energy Efficiency:** Under the Energy Conservation Act 2001, large energy-consuming industries are required to undertake energy audits and an energy-labelling program for appliances has been introduced.

Implementation

Ministries with lead responsibility for each of the missions are directed to develop objectives, implementation strategies, timelines, and monitoring and evaluation criteria, to be submitted to the Prime Minister's Council on Climate Change. The Council will also be responsible for periodically reviewing and reporting on each mission's progress. To be able to quantify progress, appropriate indicators and methodologies will be developed to assess both avoided emissions and adaptation benefits.

State level initiatives

Following the NAPCC, State governments in India have taken the cue and announced their own policy frameworks. Gujarat state for example, launched a Solar Power Policy on January 6, with an operating period up to March 31, 2014, for projects between 5 and 500MW and exemptions from paying the electricity duty on solar power sent to the grid or used on site. This was followed by an investor summit meeting—the Vibrant Gujarat Global Investors' Summit— which has drawn commitments for more than Rs 1.02 lakh crore (\$20.8 billion) in renewable energy projects. Amongst the firms that have signalled commitment are Tata Power, Suzlon, Refex Energy, Astonfield Renewable Resources.

Corporate response

While climate change is becoming increasingly central to the policy preoccupations of the government, the corporate sector in order to participate in the eight missions under India's National Action Plan on Climate Change (NAPCC) will have to move beyond treating climate change as a corporate social responsibility issue and treat it as a key environmental condition shaping corporate strategy. This message was summarised in the corporate statement at the World CEO Forum in February 2009, organised by TERI Business Council for Sustainable development (BCSD India), a partner of the WBCSD (World Business Council for Sustainable Development) and a member of its regional network. The statement describes key actions that Indian companies need to implement to support the eight missions of the NAPCC and is a reflection that the private sector sees the growth of sustainability in general and the clean energy sector in particular, as a business opportunity rather than a risk in times of economic slowdown.

Listed equity investor response

The response of listed equity investors to climate change in general and the NAPCC in particular has so far been muted. To some extent this is justifiable since the policy details and incentives of the eight missions outlined above have yet to be articulated.

A notable exception however is HSBC, which has produced a comprehensive report on India's climate investment opportunities (Wide Spectrum of Choices—November 2008). The report highlights the fact that compared with the industrialized world, India has a 'wider spectrum of choices' as it confronts the global threat of climate change, with a large potential for technological leapfrogging. Within the framework of a range of existing policies to promote the low carbon power and energy efficiency, the HSBC research identifies an initial set of investable themes focusing on the mitigation potential from curbing carbon emissions. These include wind, solar, hydro, bio-power, bio fuels, buildings efficiency, industrial efficiency, power efficiency, cleaner coal, fuel switching and nuclear. The report estimates that INR7.65tr (USD150bn) in investments will be made in these themes FY2008-17, yielding annual emission cuts 18% below 'business as usual'.

Governance issues

In January 2009, the founder of Satyam Computer Systems, a world class Indian information technology company that attracted vast amounts of foreign investment, confessed that the \$1 billion in cash that the company had reported in its accounts did not exist. He also confessed that he had been cooking the books for seven years in order to keep control of the company. The Satyam fraud has shocked investors, the government and regulators and has led to questioning the accounting practices of statutory auditors.

This may be India's largest corporate scam and some may interpret it as a reflection of poor governance practices in India. However, it is also a reflection of the absolute growth in the size of India Inc., and not necessarily a change in the modus operandi of Indian or international companies. Accounting scandals, such as the \$50 billion Madoff fraud, are not new phenomena in the global corporate world. Nor are they necessarily a reflection of weak corporate governance standards. In fact, the reality is that India has strong corporate governance standards, which have continuously been tightened to address India's economic growth. These are contained in the Listing Agreements that all publicly listed companies execute with the stock exchange where their shares are traded. The Indian Companies Act also sets out principles for corporate governance which include a duty on the board of directors to adopt the accounting standards stipulated by the Indian Chartered Accountants Institute, a duty to maintain proper books of accounts and prepare financial statements etc.

The Satyam fraud, like the Madoff 'Ponzi Scheme', is evidence that despite sound governance norms unscrupulous businessmen will find ways to circumvent the law. What differentiates India Inc. from other, particularly Western, corporate environments is that the personality of the promoter overshadows everything else—and this is well known to lending banks, investors, auditors and the authorities. Indian companies have been likened to extended families, a maze of holdings and cross holdings, whereas foreign investors and shareholders like things nuclear and defined; the concept of fungibility of capital and resources is unfamiliar territory for them. Indian shareholders will rarely oppose the promoter or the patriarch.

The lesson for corporate governance from the Satyam scandal is that along with better vigilance, better transparency and accountability are crucial to keep investors interested and confident.

5. SUSTAINABLE INVESTMENT ACTIVITY

S&P ESG India Index

Background

The S&P ESG India was launched in January 2008. The Index was developed by Standard & Poor's, CRISIL and KLD and was sponsored by IFC. The Index consists of 50 stocks selected from the top 500 companies by total market capitalisation that are listed on the NSE. This universe of stocks is then subjected to a research process, which yields a score based on a company's ESG disclosure practices in the public domain and on third-party information on corporate ESG performance.

Constituents and performance

Since inception, the S&P ESG India Index's performance has closely matched its benchmark, the S&P CNX Nifty (Figure 12). The current composition of the index is show in Table 5. In terms of sector breakdown, the index is relatively well diversified (Figure 13).

Impact to date

ABN AMRO Asset Management (now Fortis) launched a retail SRI fund in India in March 2007 (9 months before the launch of the Index) that draws heavily on the Index's data and methodology (see below). Other than this fund, there does not appear to be any investment products or strategies based explicitly on the S&P ESG India Index. There is insufficient information to judge what impact the index has had on investors in terms of general awareness raising or informal use of the index by analysts and portfolio managers. A small number of companies (e.g. ITC, GTL, ACC and KPIT Cummins) issued press releases in 2008 drawing attention to their inclusion in the Index. CRISIL reports that average ESG scores for the 500 companies researched have improved since the launch of the Index. At this early stage, there is little additional information on the impact that the Index has had on companies (in terms of improving ESG transparency and disclosure) or whether companies regard inclusion in the Index as a positive feature for branding and investor relations purposes.

Figure 12: S&P ESG India Index - performance

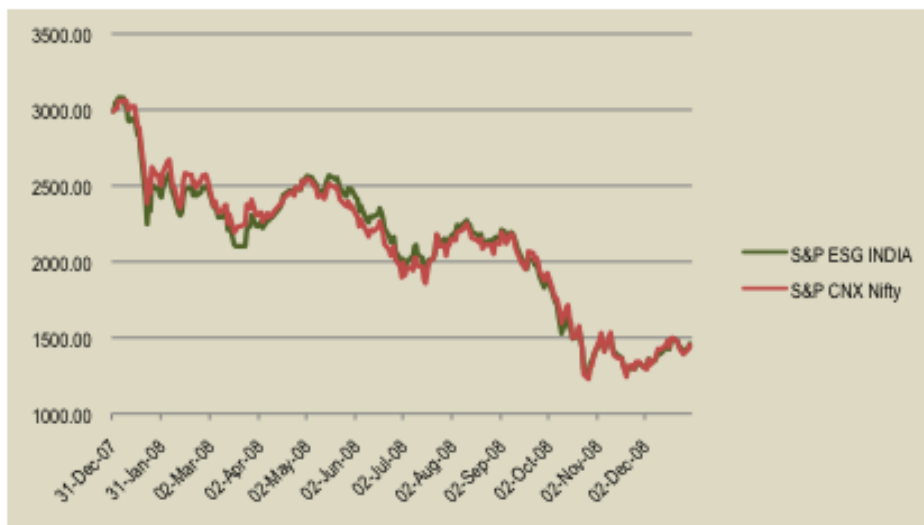
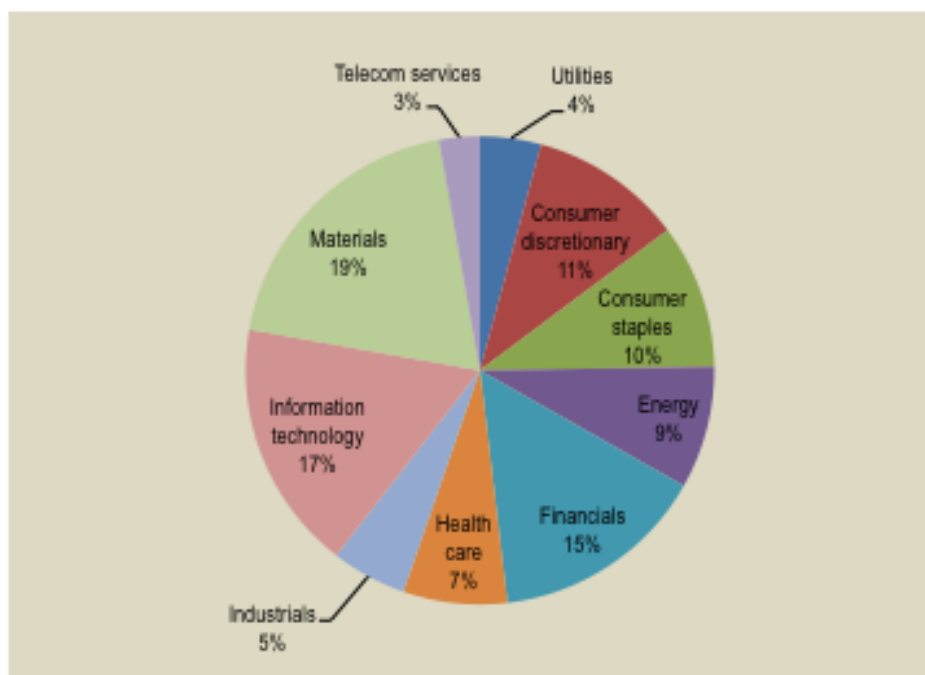


Table 5: S&P ESG India Index – constituents as of March 2009

1	ABB Ltd.	26	I T C Ltd.
2	ACC Ltd.	27	ICICI Bank Ltd.
3	Aditya Birla Nuvo Ltd.	28	IndusInd Bank Ltd.
4	Alok Industries Ltd.	29	Infosys Technologies Ltd.
5	Ambuja Cements Ltd.	30	Jaiprakash Associates Ltd.
6	Andhra Bank	31	Jindal Steel & Power Ltd.
7	Axis Bank Ltd.	32	JSW Steel Ltd.
8	Bharat Petroleum Corporation Ltd.	33	Jubilant Organosys Ltd.
9	Bharti Airtel Ltd.	34	KPIT Cummins Infosystem Ltd.
10	Bongaigaon Refinery & Petrochemicals Ltd.	35	Mahindra & Mahindra Ltd.
11	Chambal Fertilizers & Chemicals Ltd.	36	Moser Baer India Ltd.
12	Crompton Greaves Ltd.	37	NTPC Ltd.
13	Divi's Laboratories Ltd.	38	Panacea Biotech Ltd.
14	Dr. Reddy's Laboratories Ltd.	39	Polaris Software Lab Ltd.
15	Financial Technologies (India) Ltd.	40	Reliance Industries Ltd.
16	Godrej Industries Ltd.	41	Reliance Infrastructure Ltd.
17	GTL Infrastructure Ltd.	42	Sesa Goa Ltd.
18	GTL Ltd.	43	SRF Ltd.
19	Gujarat Alkalies & Chemicals Ltd.	44	Tata Consultancy Services Ltd.
20	Gujarat NRE Coke Ltd.	45	Tata Power Co. Ltd.
21	HCL Infosystems Ltd.	46	Tata Steel Ltd.
22	Hero Honda Motors Ltd.	47	Tata Tea Ltd.
23	Hindalco Industries Ltd.	48	Titan Industries Ltd.
24	Hindustan Unilever Ltd.	49	United Phosphorous Ltd.
25	Housing Development Finance Corporation Ltd.	50	Wipro Ltd.

Figure 13: S&P ESG Index Index - sector breakdown



Foreign Institutional Investors

General overview

Foreign Institutional Investors (FIIs) are allowed to invest in the primary and secondary capital markets in India through the portfolio investment scheme (PIS) administered by the Reserve Bank of India (RBI). Under this scheme, FIIs can acquire shares/debentures of Indian companies through the stock exchanges in India.

The ceiling for overall investment by FIIs is 24 per cent of the paid up capital of the Indian company (20 per cent in the case of public sector banks, including the State Bank of India). The ceiling of 24 per cent for FII investment can be raised subject to (i) approval by the company's board and the passing of a special shareholder resolution to that effect (ii) certain sector caps imposed by RBI and the Government of India. The RBI monitors the ceilings on FII investments in Indian companies on a daily basis and publishes a list of companies allowed to attract investments from FIIs with their respective ceilings.

Figure 4 illustrates the dramatic increase in net portfolio equity flows to India over the period 2002-2007, and especially over the bull rally that climaxed in January 2008 when the Sensex reached a lifetime high of 21,206.77 points. FIIs invested US\$17 billion in Indian stocks in 2007.

However, the onset of the current global economic crisis saw FIIs pulling out a record \$13 billion (Rs 67,470) in 2008, the largest outflows since India opened its doors to FIIs 15 years ago.

In 2009 so far, FIIs have sold another US\$2.1 billion worth of Indian stocks. The Children's Investment Fund Management (TCI) (a UK-based hedge fund) accounts for about 10 per cent of this sum, making it the single-largest seller of Indian stocks among FIIs. The hedge fund registered its biggest annual loss in 2008 and is liquidating its investments in India at a steep discount to the prices at which it bought the stocks last year.

FII ownership in Indian stocks has now fallen to 15.5 per cent, a level last seen in December 2003 in the early days of the bull market. Citi analysts estimate the value of FII ownership in Indian stocks to be about US\$94 billion (Rs 484 crore).

Deutsche Bank AG has shown the most confidence in Indian firms during the difficult conditions of 2008. The bank remained the top holder of Indian stocks among FIIs in 2008. Though the value of its investment fell sharply due to the massive decline in stock prices, it actually invested in more firms in 2008 than 2007. Deutsche Bank and its affiliates hold Rs 16,344.77 crore (US\$3.4 billion) in Indian equities. HSBC and Citigroup own the second and third largest portfolios (Table 6). Deutsche Bank is the only FII that has increased its number of firms in its portfolio - from 84 in 2007 to 88 in 2008.

Table 6: Top 3 FIIs in India by AUM at the end of 2008 (source: www.livemint.com)

FII	PRI signatory	Equity Holdings		No. of companies in portfolio	
		Rs crore	US\$ million	2008	2007
Deutsche Bank	●	16,345	3,356	88	84
HSBC	●	10,400	2,135	92	126
Citigroup		8,337	1,712	112	180
TOTAL		35,082	7,203		

Table 7: ADRs issued by BRIC companies (data as of March 16, 2009)

Economy	No. of companies issuing ADRs	Ownership value USD million	% of BRIC total
Brazil	101	72,242	39%
Russia	115	64,709	35%
India	143	13,557	7%
China	158	35,741	19%
TOTAL		186,249	

Source: www.adr.com

These 'top 3' FIIs have total equity holdings of approximately US\$7.2 billion, or about 8 per cent of the US\$94 billion total stock of FII investment estimated by Citi.

Other leading FIIs include Morgan Stanley, Merrill Lynch Capital Markets, CLSA Asia-Pacific, Goldman Sachs Investments Mauritius, JPMorgan Chase, UBS Securities Asia and Fortis Investment Management.

International investors can also invest in Indian companies through American Depository Receipts (ADRs) that are traded on the NYSE or other US markets. 143 Indian companies issue ADRs, with a total ownership value of US\$13.6 billion (Table 7). The 25 largest such ADRs are listed in Table 8 and have a total value of US\$11 billion: the leading issuers of ADRs include Infosys, ICICI and HDFC. Seven companies in this list are in the current S&P ESG India Index portfolio. Table 9 identifies some of the main US and non-US investors that hold the ADRs of Indian companies. Investors include:

- Western asset management firms such as Barclays Global Investors, JP Morgan, Fidelity, BlackRock, HSBC, ING and DFA (the latter is one of CalPERS' emerging market managers);
- Indian investors including L P Jaiswal, LIC and Tata;
- China International Fund Management, a joint venture between J.P. Morgan Fleming Asset Management (UK) Limited and Shanghai International Trust and Investment Co., Ltd (SITICO) which manages assets on behalf of Chinese clients.

Table 8: Top 25 Indian ADRs

Company	Ownership value USD million	S&P ESG India Index
INFOSYS TECHNOLOGIES LTD [INFY]	2,546.64	●
ICICI BANK LTD [IBN]	2,415.74	●
HDFC BANK LTD [HDB]	1,809.11	
RELIANCE INDUSTRIES LTD [RLNIY]	864.34	●
INDIAN HOTELS CO LTD [IDHUY]	802.15	
SATYAM COMPUTER SERVICES LTD [SAY]	622.87	
STERLITE INDUSTRIES INDIA LTD [SLT]	392.41	
STATE BANK OF INDIA LTD [SBKFF]	279.88	
TATA COMMUNICATIONS LTD [TCL]	257.26	
LARSEN & TOUBRO LTD [LTOUF]	214.79	
WIPRO LTD [WIT]	181.44	●
DR REDDYS LABORATORIES LTD [RDY]	164.44	●
GAIL INDIA LTD [GAILF]	106.88	
PATNI COMPUTER SYSTEMS LIMITED [PTI]	93.87	
WNS HOLDINGS LTD [WNS]	89.7	
SUBEX LTD [SBXZY]	67.07	
HIMACHAL FUTURISTIC COMMUNICATIONS [HIFCY]	54.69	
MAHANAGAR TELEPHONE NIGAM [MTE]	48.44	
RELIANCE COMMUNICATION LTD [RLCMZ]	34.13	
AXIS BANK LTD [AXB]	33.62	●
AMBUJA CEMENTS LTD [GUJTF]	22.03	●
GITANJALI GEMS LTD [GITG]	20.48	
RANBAXY LABORATORIES LTD [RBXZF]	16.86	
AMBUJA CEMENTS LTD [AMBUY]	14.97	●
CIPLA LTD [CIPLG]	13.67	
TOTAL (top 25)	11,167.48	

Source: *adr.com* (data as of March 16, 2009)

Table 9: Key investors in Indian ADRs (source: adr.com)

TOP 10 HOLDERS OF INDIAN ADRs		Value (US\$ m)	% of portfolio	Filing date	PRI
Barclays Global Investors, N.A.	US	1,424.22	0.29	Jan-31-2009	
Modi (Yogendra Kumar)	UK	1,332.83	100.00	Oct-07-2008	
L P Jaiswal & Sons Pvt. Ltd.	India	301.86	97.13	Mar-31-2008	
J.P. Morgan Investment Management Inc.	US	271.76	0.34	Dec-31-2008	●
Fidelity Management & Research	US	239.87	0.06	Jan-31-2009	
Jennison Associates LLC	US	219.61	0.57	Jan-31-2009	
LIC Mutual Fund Asset Management Company	India	201.15	1.02	Mar-31-2008	
Tata Sons, Ltd.	India	200.5	25.43	Mar-31-2008	
China International Fund Management Co., Ltd.	China	185.78	2.93	Jun-30-2008	
OppenheimerFunds, Inc.	US	182.85	0.28	Dec-31-2008	
TOTAL		4,560.43			
TOP 10 US MUTUAL FUND HOLDERS OF INDIAN ADRs		Value (US\$ m)	% of portfolio	Filing date	PRI
iShares MSCI Emerging Markets Index Fund	US	1,131.24	6.38	Jan-31-2009	
Oppenheimer Developing Markets Fund	US	109.53	2.41	Nov-30-2008	
Dodge & Cox International Stock Fund	US	82.78	0.34	Dec-31-2008	
Artisan International Fund	US	58.76	0.76	Dec-31-2008	
Harbor Capital Appreciation Fund	US	56.43	1.00	Dec-31-2008	
Fidelity Diversified International Fund	US	46.48	0.19	Jan-31-2009	
iShares MSCI All Country Asia Ex Japan Ind Fund	US	46.09	9.92	Dec-31-2008	
Janus Contrarian Fund	US	42.11	1.14	Oct-31-2008	
Vanguard Emerging Markets Stock Index Fund	US	40.84	0.33	Oct-31-2008	
DFA Emerging Markets Value Fund Inc.	US	40.83	1.05	Oct-31-2008	
TOTAL		1,655.09			
TOP 10 NON-US MUTUAL FUND HOLDERS OF INDIAN ADRs		Value (US\$ m)	% of portfolio	Filing date	PRI
China International Asia Pacific Advantage Stock F	China	185.78	7.62	Jun-30-2008	
JPMorgan Funds - JF India Fund	Hong Kong	150.84	6.49	Jun-30-2008	●
Raiffeisen Euroasien Aktien	Austria	141.31	13.44	Jul-31-2008	
HSBC Global Investment Fund Indian Equity Fund	Singapore	132.47	3.64	Sep-30-2008	●
DIT Fonds EEE	Germany	93.25	5.20	May-31-2008	
iShares MSCI Emerging Markets	UK	88.00	6.65	Feb-29-2008	
JPMorgan Investment Fd JF Asia ex-Japan Fund	Singapore	83.89	8.01	Jun-30-2008	●
Blackrock India Stock Fund	Japan	79.71	7.16	Dec-10-2007	●
JPMorgan Funds - Emerging Markets Equity Fund	UK	69.21	1.06	Jun-30-2008	●
ING J.P. Morgan Emerging Markets Equity	UK	69.04	10.60	Dec-31-2008	●
TOTAL		1,093.5			

Sustainable investment

There are insufficient data to make a reliable estimate of the proportion of FII assets in India that are managed under 'sustainable' or 'socially responsible' mandates.

Of the 1,500 or so FIIs registered in India, brokers estimate that no more than 100 are active. Deutsche Bank and HSBC are both signatories to the UNPRI; their combined holdings are estimated at US\$5.5 billion, or about 6 per cent of the total stock of FII in India. However, there is little information on the extent to which PRI is being implemented in the specific case of these firms' Indian holdings. It is not currently possible to comment on the ESG approaches used by the other 98 firms.

In the absence of hard data, it may therefore be legitimate to make a conservative educated guess that FIIs who take environmental, social and/or governance (ESG) issues into account in a formal way represent about 1 per cent of the US\$94 billion corpus of FII assets, i.e. about US\$1 billion.

With respect to ADRs, only four of these fund managers listed in Table 9 (JP Morgan, ING, HSBC and BlackRock) are signatories to the UNPRI. Again, using a 1 per cent estimate in the absence of hard data suggests that ESG investment in Indian ADRs could be about US\$130 million.

ESG engagement

Norway's US\$374 billion Government Pension Fund (a UNPRI signatory) provides two examples of shareholder engagement by FIIs in India:

- In November 2007, the Fund announced that it had sold off about US\$13 million in shares of the London-listed metals and mining group Vedanta, due to unresolved concerns about environmental, human rights and labor practices of four of its subsidiaries in India.
- The Fund has an investment of about US\$100 million in Monsanto and has been lobbying the company to address the problem of child labour at Monsanto's hybrid cottonseed operations in India.

FIIs wishing to engage with portfolio companies on issues related to human rights often experience difficulties when dealing with Indian companies, who (along with Chinese firms) are frequently unresponsive. This is particularly the case in relation to companies with operations in countries such as Burma and Sudan.

For example, Amnesty International, Genocide Intervention Network (GIN) and Investors Against Genocide have called for US investors to boycott India's Oil and Natural Gas Corp (ONGC) over its operations in Sudan following similar campaigns against Chinese and Malaysian oil firms. ONGC has invested nearly US\$1bn in Sudanese oilfields and is one of the top three players in the oil sector in that country.

PRI pension fund investment in Infrastructure and Private Equity

It is also important to note that some international investors with a strong focus on ESG issues are preparing to increase their exposure to infrastructure and private equity investments in India. Predominant amongst such investors are the two Dutch pension funds, APG and PGGM, both of which are signatories and active members of the UNPRI. The strategy of both pension funds appears to be to invest directly in these assets classes in India, rather invest as Limited Partners in a third-party private equity or infrastructure funds.

Although this trend is at an early stage (particularly given current market conditions), implementation of such strategies will involve significant ESG management challenges and sustainability-related investment barriers.

Domestic institutional investors

Pension Funds

In sharp contrast to other BRIC markets such as Brazil, in practical terms, pension funds are largely absent from the DII landscape in India and are of little or no immediate relevance to the development of a domestic sustainable investment market. There are two main reasons for this.

Firstly, India does not have a comprehensive old age income security system. India's workforce consists of two groups: organized (or formal sector) and unorganized (informal sector). About 10 per cent of India's workforce are organized workers, and as such, are covered by state provident funds or private pension schemes. The remaining 90 percent of workers fall into the unorganized sector, with only minimal benefits. Secondly, the regulations that apply to provident funds and other retirement schemes have historically been based solely on investment in government-run saving plans and fixed income instruments. The idea that such schemes might invest in equities is relatively new and politically controversial. It is only in the last year or two that the Government has been prepared to introduce a small degree of flexibility in terms of asset allocation, and even this has not yet been fully rolled out.

The overall pensions fund system in India is varied, very complex and in a state of significant change. To simplify matters, the key points relevant to this report are as follows:

Public sector pensions

Existing government-run and government-mandated retirement schemes are essentially defined-benefit (DB) provident funds. These schemes have combined assets of about US\$35 billion but are required to invest solely in government bonds and government-run fixed income plans. These DB provident fund schemes have large deficits. Consequently, the Government is currently introducing the New Pension System (NPS), a defined contributions (DC) scheme for civil servants recruited after January 2004. The old DB pension schemes will continue to operate for civil servants recruited before the cut-off date.

The Government has created a Pension Fund Regulatory and Development Authority (PFRDA) to implement the NPS. The new system is currently being rolled out. It is expected that 2.6 million people will be enrolled in the plan within two years, paying 20% of their wages into a fund that will then have assets of about US\$4 billion. The PFRDA has appointed three asset management firms to manage the NPS corpus: State Bank of India (SBI), UTI Asset Management Company (UTI-AMC), and Life Insurance Corporation (LIC). The NPS offers investors only two investment options. Subscribers have the option of having their pension contributions invested fully in Government bonds and securities. Alternatively, subscribers can choose to have their contributions invested in accordance with the investment guidelines for non-Government Provident Funds issued by Government of India in January 2005. These guidelines specify that investment in equities cannot exceed 5 per cent of total assets and investment into equity-linked mutual funds cannot exceed a further 10 per cent.

Furthermore, it appears that initially at least, equity investments up to this 15 per cent cap will be passive-only, tracking the Nifty 50 index. The possibility of incorporating actively managed equity portfolios at a future date has not been ruled out. However, one of the key features of the NPS is that management fees are very low (an investment management fee of three to five basis points and transaction costs of up to 10 basis points) and are unlikely to support the costs of active management.

ESG factors are absent from the investment guidelines set by the PFRDA and for a range of reasons – including the strong emphasis on fixed income, very low management fees, relatively small fund size, poor equity market conditions, political resistance and institutional inertia – we believe it would be unrealistic to expect to get sustainable investment onto the NPS agenda in next few years. In the longer term, the S&P ESG India Index could have a good fit with the NPS given that the scheme's low management fees mean that a passive sustainable investment style would be more practical.

Statutory pension schemes for private sector workers

The Employees' Provident Fund (EPF) scheme is a state-sponsored compulsory contributory pension and insurance scheme introduced in 1952. Membership in the EPF fund is mandatory for entities employing 20 or more people and is compulsory for all employees with earnings of Rs 6,500 or less per month. Participation is optional for employees earning above this amount, but most multinational corporations provide the provident fund benefit to all employees. The EPF is a defined contribution (DC) scheme. Employers contribute 12 percent of eligible earnings up to Rs 6,500 a month. Employees must make a matching contribution of 12 percent of eligible salary.

Again, the key point to note is that all assets are invested in interest-bearing government-run special deposit plans (a 2008 proposal to allow the scheme to invest up to 5 per cent of its funds in the stock market was rejected by the EPFO board following opposition from trade unions). EPF assets are therefore irrelevant to this report's analysis of sustainable investment in Indian equities.

Voluntary pension plans

Private pension funds and retirement investment products are still relatively new to India, although many firms have entered this growing and competitive market. These products fall into two main categories: products offered by insurance firms (unit linked investment plans and annuities); and mutual funds. These pension fund products are discussed below and are typically hybrid schemes with a strong orientation towards debt. In addition, from April 2009, the NPS scheme for civil servants will be opened up to all Indian citizens.

Mutual Funds

According to the Association of Mutual Funds in India (AMFI), there are almost a thousand mutual fund products on the market at the current time with combined value of about US\$105 billion (Table 10). In terms of assets under management, equity-based mutual funds make up about 18 per cent of the market. Table 11 lists the top 35 mutual fund managers by assets under management. Table 11 also identifies those firms that are signatories to the UNPRI or have an international parent group that is a UNPRI signatory. There are 7 such firms, all of which are the Indian arms of international asset managers. These 7 signatories represent about 10 per cent of total assets under management by the top 35 firms. Due to lack of information, it is not possible to comment on the extent to which the Indian arms of these 7 UNPRI signatories are implementing the Principles. Only one asset manager – Fortis – currently offers a retail SRI mutual fund product.

Table 10: Indian mutual funds as of February 2009

Type	Total no. of schemes (open, closed and interval funds)	Assets under management Rs cr	Assets under management USD million	Percentage
Income	503	259,517.00	53,277.97	51.02%
Equity	292	89,874.00	18,450.83	17.67%
Balanced	35	10,293.00	2,113.12	2.02%
Liquid/Money Market	58	127,591.00	26,194.01	25.08%
Gilt	34	6,135.00	1,259.49	1.21%
ELSS - EQUITY	46	11,130.00	2,284.95	2.19%
Gold ETF	5	781.00	160.34	0.15%
Other ETFs	11	808.00	165.88	0.16%
Fund of Funds Investing Overseas	10	2,541.00	521.66	0.50%
Total	994	508,670.00	104,428.25	100.00%

Source: AMFI (data as of end February 2009)

Table 11: Top 35 Indian mutual fund managers by AUM

Rank	Asset manager	Total assets under management		Signatory to UNPRI
		Rs cr	USD m	
1	Reliance Mutual Fund	81,627.08	16,757.77	
2	HDFC Mutual Fund	56,864.39	11,674.07	
3	ICICI Prudential Mutual Fund	53,538.20	10,991.21	
4	UTI Mutual Fund	49,224.94	10,105.71	
5	Birla Sun Life Mutual Fund	48,571.02	9,971.47	
6	SBI Mutual Fund	27,626.81	5,671.69	
7	LIC Mutual Fund	24,268.43	4,982.23	
8	Franklin Templeton Mutual Fund	19,571.97	4,018.06	
9	Tata Mutual Fund	19,299.74	3,962.17	
10	Kotak Mahindra Mutual Fund	17,432.24	3,578.78	
11	DSP BlackRock Mutual Fund	14,116.86	2,898.14	●
12	IDFC Mutual Fund	13,616.17	2,795.35	
13	Sundaram BNP Paribas Mutual Fund	9,702.10	1,991.81	
14	Deutsche Mutual Fund	9,606.87	1,972.26	●
15	HSBC Mutual Fund	9,550.71	1,960.73	●
16	PRINCIPAL Mutual Fund	6,960.04	1,428.87	
17	Fidelity Mutual Fund	6,267.83	1,286.76	
18	Fortis Mutual Fund	5,603.18	1,150.31	●
19	JM Financial Mutual Fund	5,425.59	1,113.86	
20	Religare Mutual Fund	5,423.70	1,113.47	
21	Canara Robeco Mutual Fund	4,926.80	1,011.46	●
22	ING Mutual Fund	2,838.00	582.63	●
23	JPMorgan Mutual Fund	2,422.26	497.28	●
24	Benchmark Mutual Fund	1,475.68	302.95	
25	AIG Global Investment Group Mutual Fund	1468.56	301.49	
26	Morgan Stanley Mutual Fund	1,423.75	292.29	
27	DBS Chola Mutual Fund	977.87	200.75	
28	Baroda Pioneer Mutual Fund	864.79	177.54	
29	Taurus Mutual Fund	220.69	45.31	
30	Bharti AXA Mutual Fund	186.77	38.34	
31	Escorts Mutual Fund	186.10	38.21	
32	Mirae Asset Mutual Fund	167.56	34.40	
33	Sahara Mutual Fund	141.70	29.09	
34	Quantum Mutual Fund	58.32	11.97	
35	Edelweiss Mutual Fund	30.67	6.30	
Total		501,687.36	102,994.74	

Source: AMFI, UNPRI (data as of end February 2009)

Fortis Sustainable Development Fund

The Sustainable Development Fund was launched in March 2007 by ABN AMRO India and was taken over by Fortis in late 2008 following the sale of ABN AMRO’s global business to Royal Bank of Scotland, Santander and Fortis.

The fund’s investment objective is to generate long-term capital growth from an actively managed portfolio of equity and equity-related securities issued by ‘socially responsible’ companies. The fund is a closed-end product benchmarked to the BSE 200.

The fund’s ESG analysis is provided by CRISIL and draws heavily on the methodology of the S&P ESG India Index. As with the index, the ESG analysis is based on measurement of companies’ transparency and disclosure on ESG issues and other information in the public domain. The investment process is summarised in Figure 14 below.

The fund’s current portfolio is summarised in Table 12. The sector breakdown is shown in Figure 15. It is noteworthy that companies in the S&P ESG India Index form less than 40 per cent of the fund’s current portfolio. Half of the fund’s top 10 holdings are not in the ESG index.

The fund raised approximately Rs 60 crore on its launch in March 2007 (equivalent to US\$12.32 million at today’s exchange rate); as of February 2009, this figure had fallen to just under Rs 13 crore (US\$2.63 million) due to redemptions as well as falling stock prices. Performance since inception closely matches the BSE 200, delivering an absolute return of -34 per cent. Over 6 months and 1 year, however, the fund has outperformed its benchmark (Table 13).

Figure 14: Fortis Sustainable Development Fund - methodology

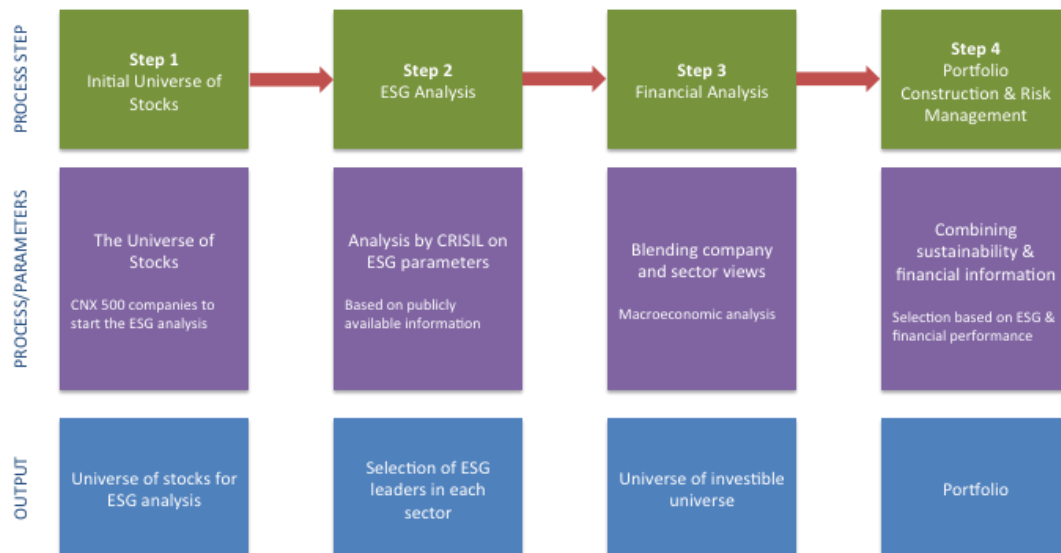


Table 12: Fortis Sustainable Development Fund - sector allocation as of February 27, 2009

Sector	%	S&P ESG India Index
Oil & Gas	19.34	
Reliance Industries	7.42	●
Oil and Natural Gas Corporation	4.86	
Indian Oil Corporation	3.08	
Hindustan Petroleum Corporation	2.63	
Bharat Petroleum Corporation	1.35	●
Banking & Financial Services	14.24	
HDFC Bank	3.13	●
ICICI Bank	3.07	●
Housing Development Finance Corporation	2.99	●
Indian Bank	2.64	
State Bank of India	2.41	
Engineering & Capital Goods	6.89	
Larsen and Toubro	3.60	
Bharat Heavy Electricals	3.29	
Automotive	6.48	
Hero Honda Motors	2.62	●
Ashok Leyland	1.96	
Exide Industries	1.90	
Tobacco	6.44	
ITC	6.44	●
Telecommunication	4.82	
Bharti Airtel	3.00	●
Reliance Communications	1.82	
Miscellaneous	4.78	
GAIL India	4.78	
Consumer Non-durables	4.34	
Hindustan Unilever	4.34	●
Utilities	4.31	
NTPC	2.60	●
Tata Power Company	1.71	●
Chemicals	3.11	
Asian Paints	1.84	
Chambal Fertilisers and Chemicals	1.27	●
Pharmaceuticals	3.05	
Lupin	3.05	
Net Receivable / Payable	22.21	
TOTAL	100.00	36.81%

Figure 15: Fortis Sustainable Development Fund - asset allocation as of February 27, 2009

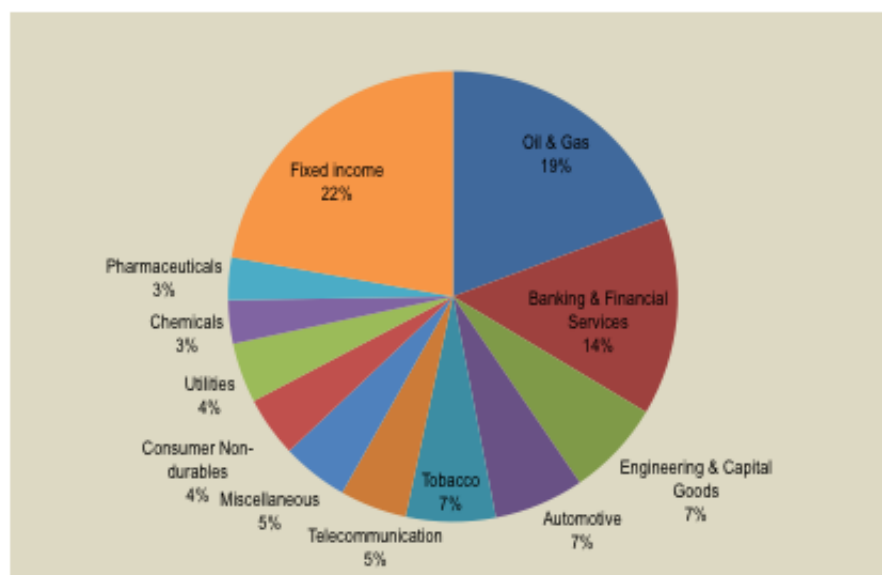


Table 13: Fortis Sustainable Development Fund - performance

	6 month	1 year	2 year	3 year
Fortis Sustainable Development Fund	-28.67%	-38.07%	-34.40%	n/a
Category Average	-37.87%	-45.27%		-11.48%
Category Best	-25.45%	-31.27%		-1.87%
Category Worst	-72.81%	-76.90%		-36.80%
SENSEX	-37.46%	-42.98%	-32.60%	-6.76%
BSE200	-40.49%	-46.57%	-33.60%	-8.92%
NIFTY	-37.46%	-42.98%	-27.90%	-6.76%

Source: India Capital Markets

Life Insurance

22 life insurance firms are registered in India (Table 14). Of these, the state-owned Life Insurance Corporation of India (LIC) has a 74 per cent market share. The majority of the private life insurance firms (with a combined market share of 26 per cent) are joint ventures between Indian firms and international insurance groups.

According to India's Insurance Regulatory and Development Authority (IRDA), these 22 firms had total investment assets of Rs 762,041 crore (US\$156.4 billion at today's exchange rate) as of April 2008 (Table 15). This is made up of assets from non-ULIP products (Rs 628,333 crore) and assets from ULIP products (Rs 133,382 crore).

IRDA sets explicit norms on how life insurance companies can invest their assets from non-ULIP products:

- investment in Government Securities must be at least 50 per cent;
- investment in Infrastructure and the Social Sector must be at least 15 per cent;
- Investment in equities, debentures and loans must not exceed 20 per cent.

Table 14: Life insurance companies in India

Company	International JV partner is UNPRI signatory
Bajaj Allianz Life Insurance Company Limited	
Birla Sun Life Insurance Co. Ltd	
HDFC Standard Life Insurance Co. Ltd	●
ICICI Prudential Life Insurance Co. Ltd.	
ING Vysya Life Insurance Company Ltd.	●
Life Insurance Corporation of India	
Max New York Life Insurance Co. Ltd	
Met Life India Insurance Company Ltd.	
Kotak Mahindra Old Mutual Life Insurance Limited	
SBI Life Insurance Co. Ltd	
Tata AIG Life Insurance Company Limited	
Reliance Life Insurance Company Limited.	
Aviva Life Insurance Co. India Pvt. Ltd.	●
Sahara India Life Insurance Co, Ltd.	
Shriram Life Insurance Co, Ltd.	
Bharti AXA Life Insurance Company Ltd.	●
Future Generali Life Insurance Company Ltd.	
IDBI Fortis Life Insurance Company Ltd.	●
Canara HSBC Oriental Bank of Commerce Life Insurance Co. Ltd	●
AEGON Religare Life Insurance Company Limited.	●
DLF Pramerica Life Insurance Co. Ltd.	
Star Union Dai-ichi Life Insurance Comp. Ltd.	

Table 15: Life assurance companies - investment assets

Insurer	2006-07		2007-08		% change
	Rs crore	US\$ m	Rs crore	US\$ m	
Public Sector	559,201	114,802	674,475	138,467	20.61
Private Sector	44,979	9,234	87,566	17,977	94.68
Total	604,180	124,036	762,041	156,444	

Source: IRDA Annual Report 2007-08

Note: conversion to US\$ uses exchange rate as of February 10, 2009

As of April 2008, total investment in equities, debentures and loans using premiums from non-ULIP products was Rs 178,957 crore, or about US\$36.7 billion at today's exchange rate. IRDA data do not enable us to provide a breakdown of this figure. This Rs 178,957 crore investment in equities, debentures and loans is just over 28 per cent of the Rs 628,633 crore portfolio that is subject to the above IRDA norms. We are not able to explain the discrepancy between the 28 per cent actual exposure compared to the 20 per cent regulatory cap.

The investments of Unit Linked Insurance Plans (ULIPs) are guided by the stated objectives of the plans, rather than by the above norms. ULIPs are essentially investment products with a linked life insurance component and have become increasingly popular over the last two years. The investment component may be equity, debt or a hybrid. As of April 2008, total ULIP assets were Rs 133,382 crore or about US\$27.4 billion at today's exchange rate, representing a five-fold increase since April 2006. The ULIP market is split more or less equally between LIC and private sector life insurance firms.

We do not have a breakdown of ULIP portfolio allocation. Assuming that ULIP allocation equities is similar to that of mutual funds (Table 10) i.e. 18 per cent, ULIP equity investments are estimated at around US\$5 billion.

In summary, at the end March 2008, India's life insurance industry had assets of around about US\$42 billion) in equities, corporate bonds, debentures and loans. A more detailed breakdown is not possible. There is no evidence to suggest that ESG issues play a role in this part of the investment market at the current time.

Private Equity

Market overview

The Emerging Market Private Equity Association (EMPEA) provides extensive and authoritative information on private equity and venture capital in India, as does the Indian Venture Capital Association (IVCA). According to EMPEA estimates, in 2007 India dedicated funds raised US\$ 4.6 billion (versus China's US\$3.9 billion). This is complemented by a number of PE investors deploying capital in India through pan-Asia funds. Venture Intelligence, a data provider, estimates that PE investments through June 2008 had reached US\$6.3 billion (Figure 16).

The 2008 correction in Indian capital markets brought mixed results for private equity. The BSE Sensex P/E ratio fell from its December 2007 peak monthly average of 26.94 to 20.71 in April 2008. This has been a boon to the pipelines of Indian PE firms as PE has become a more attractive option for companies seeking to raise capital. However it has also made it more difficult to get some deals done because of mismatches between investors' and owners' price expectations.

Fundraising Activity

PE fund raising in India showed a dramatic growth up to September 2008 despite the macroeconomic challenges (Figure 17). The number of new funds increased to 136, with a corresponding increase in fund size. This was a result of continued interest from developed markets as well as local veterans. Fund managers with successful funds in the market include Jacob Ballas Capital India, Chrys Capital each raising a fourth fund. Actis, ICICI Ventures, IDFC Private Equity, IL&FS and Baring India are currently in the market with their third funds. There are also a number of captive and sponsored funds appearing in the market including Tata, Reliance, Aditya Birla and Mittal. Tata Capital launched its first PE vehicle in 2008, with a target of US\$200 - US\$300 million, aimed at investments in mid sized health care and technology companies. Azim Premji of Wipro provided funding for the US\$1 billion evergreen fund, PremjiInvest, which has invested in 40 companies since 2006.

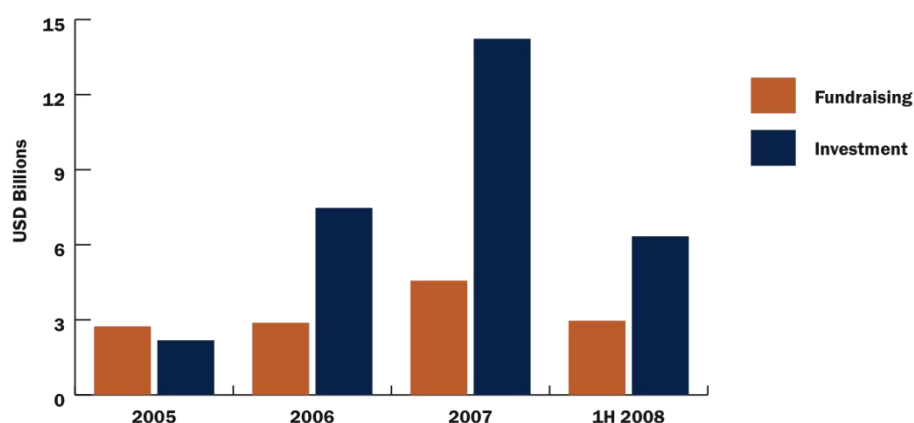
Reflecting the growing sophistication of the Indian market, several new sector focused funds are now emerging including agribusinesses and life sciences (Table 16).

Limited partners include foreign investors and pension funds, banks, corporations and investment managers. Indian pension funds are still prohibited from investing in private equity. Whereas the net effect of the global economic recession is unclear, EMPEA's 2008 survey of Institutional Investor Interest revealed that 77% of LPs surveyed expect to be investing in India within the next three to five years.

Exit Trends

Following the slump in world markets, the attraction of the Indian IPO market has waned. Prospects for secondary sales however are growing, and the growth in size of Indian companies as well as increasing presence of multinationals is yielding strategic buyers for private equity assets. In 2007 Actis sold its stake in Punjab Tractors to Indian conglomerate Mahindra and Mahindra. SAIF Partners sold its stake in IL&FS Investsmart Ltd., to HSBC in May 2008.

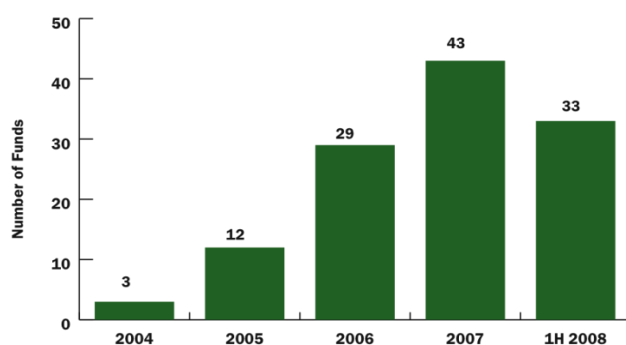
Figure 16: India's PE fundraising and investments totals (2005 - 1H08) (source: EMPEA)



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.

Figure 17: Number of India-focused funds launched by year (2004-2008) (source: EMPEA)



Source: EMPEA.

Table 16: Sector-focused India funds (2008)

Fund Manager	Most recent fund (vintage year, size)	Sector
3LOGi Capital, Evolve Capital	Evolve India Life Science Fund (2007, US\$150m)	Life Sciences
A K Purwar and Ajay Piramal	Health Care Fund (US\$200m)	Healthcare
Cinema Capital Venture Fund	Cinema Capital Venture Fund (2008, US\$178m)	Entertainment
India Rizing	India Rizing Fund (2008, US\$100m)	Defence
Rabobank Private Equity	India Agribusiness Fund (2008, US\$100m)	Agriculture/Agribusiness
Tuscan Ventures	Tuscan Ventures (2007, US\$50m)	Logistics
YES BANK Limited	Food and Agribusiness Fund (2008, US\$100m)	Agriculture/Agribusiness

Source: EMPEA

Table 17: Examples of PE firms investing in India

PE Firms Investing in India	Most Recent Fund (Vintage Year, Fund Size)	Sector Focus
India-dedicated Funds		
3i Group	India Infrastructure Fund (2007, US\$1.2b)	Infrastructure
Actis	India Real Estate Fund (2007, US\$300m)	Real Estate
Aureos Capital	South Asia Fund (2006, US\$123m)	Generalist
Baer Capital Partners	Beacon India Private Equity Fund (2007, US\$220m)	Generalist
Baring Private Equity India	Baring India Private Equity Fund III (2008, US\$550m)	Energy
Blue River Capital	Blue River Capital I (2006, US\$135m)	Generalist
ChyrsCapital	ChyrsCapital Fund V (2007, US\$1.25b)	Generalist
GVFL Limited	GVFL SME Technology Venture Fund (2008, US\$59.8m)	Technology
Helion Venture Partners	Helion Venture Partners II (2008, US\$210m)	Generalist
ICICI Venture Funds	ICICI Venture Capital Fund III (US\$1.5b)	Generalist
IDFC Asset Management Co Ltd.	IDFC Private Equity Fund III (2008, US\$700m)	Infrastructure
IL&FS Investment Managers Ltd.	Tara India Fund III (2007, US\$400m)	Generalist
Jacob Ballas Capital India	New York Life Investment Management India Fund III (2008, US\$278m)	Generalist
Kotak Private Equity Group (KPEG)	Kotak India Growth Fund II (2008, US\$440m)	Generalist
Lighthouse Funds	India 2020 Opportunity Fund (2008, US\$125m)	Generalist
Mayfield Fund	Mayfield India (US\$150m)	Generalist
Millennium Spire Asset Management	Millennium Spire Fund II (US\$200m)	Real Estate
Motilal Oswal Venture Capital Advisors Pvt Ltd.	India Business Excellence Fund (2008, US\$125m)	Generalist
New Silk Route Private Equity	New Silk Route Private Equity Asia Fund (2008, US\$1.5b)	Generalist
Nexus India Capital	Nexus India Capital II (2008, US\$220m)	Generalist
Quantum Equity Advisors	Q India Fund (US\$500m)	Infrastructure
Samara Capital Partners	Samara Capital Partners Fund I (2007, US\$250m)	Generalist
Sequoia Capital	Sequoia Capital India III (2007, US\$300m)	Technology
Tata Realty & Infrastructure Ltd.	Tata Realty & Infrastructure Ltd. (US\$750m)	Infrastructure
TVS Capital, Shriram Group	TVS Shriram Growth Fund (US\$115m)	Consumer
VenturEast	VenturEast Proactive Fund (raising, US\$150m)	Technology
YES BANK	YES BANK Infrastructure Fund (raising, US\$700m)	Infrastructure
Zephyr Peacock	Zephyr Peacock India Fund I (2006, US\$100m)	Generalist
BTS Investment Advisors Ltd.	BTS India Private Equity Fund (Raising, US\$50m)	Generalist
Asian, Pan-EM and Global Funds		
HBG Holdings	HBG Holdings Limited (2007, US\$200m)	Generalist
Citi Venture Capital International (CVCI)	Growth Partnership LP Fund II (2007, US\$4.5b)	Generalist
Global Capital Management (100% subsidiary of Global Investment House)	Global Buyout Fund (2007, US\$750m)	Generalist
Warburg Pincus	Warburg Pincus PE X (2007, US\$15b)	Generalist
Siguler Guff	BRIC Opportunities Fund II (2007, US\$1b)	Generalist
Navis Capital Partners Ltd.	Navis Asia V (2007, US\$1b)	Generalist

Source: EMPEA

Table 18: Examples of recent PE-backed exits

Firm Name	Company	Sector	Investment Year	Capital Invested (US\$M)	Exit Type	Exit Date
3i India Infrastructure	Adani Power	Energy	2007	US\$227M	IPO on LSE	May-08
ChrysCapital	Shriram Group	Transport	2005	US\$22M	Partial Exit through Secondary Sale (US\$3.5M)	Feb-08
Granite Hill Capital Ventures	Gokul Refoils and Solvent	Industrials	2007	US\$1.2M	Partial Exit (US\$35)	Apr-08
IL&FS Investment Managers, i-Labs, TDA Capital Partners, Indian Value Funds, IFC	DQ Entertainment	Online Education	n/a	n/a	Share sale on AIM	Jan-08
Lehman Brothers	KSK Energy Ventures	Energy	2001	n/a	IPO	Jun-08
New Vernon Capital	Updater Services	Services	2006	US\$10M	Secondary Sale (US\$26M)	Feb-08
SAIF Partners	IL&FS Investsmart Ltd.	Financial Services	2004	US\$8.4M	Trade Sale	May-08
UTI Ventures	Excelsoft Technologies	Technology	2001	US\$0.6M	Secondary Sale (US\$31M)	Apr-08

Source: EMPEA

Status of sustainable investment

The growing private equity market in India and the trends outlined above can be a positive force from a sustainability perspective. The ownership structure of private equity and the injection of high quality management in portfolio companies have the potential to ensure that the managers of private equity funds can make sustainability an integral element of their investment strategy. In cases where the general partners' stake in investee companies is large and visible, the potential to integrate sustainability factors into investment analysis and decision-making is particularly significant.

Since investment managers have a close relationship with the company management, it is relatively straightforward to engage on issues relating to environmental, social and governance factors. Very often, private equity investment managers sit on company boards, giving them direct access and influence to shape an ESG agenda. Private equity firms generally hold their investments for 3-5 years, a period long enough to bring about change and add value for example, through: carbon reduction programmes, energy efficiency, improved environmental standards, environmental management systems, and health and safety management systems.

The entry of groups like Tata and Birla into the private equity investor sphere, as mentioned in the previous section, is also encouraging from a sustainability perspective since these groups have repeatedly demonstrated a commitment to good ESG practices in their corporate activities.

An analysis of existing sustainable investment practices in the Indian private equity/venture capital market can be broken down into three main (but overlapping) topics:

- Integration of ESG issues (primarily risks) into the investment policies of 'mainstream' private equity funds (i.e. funds that are not specifically focused on sustainability-related investment themes);
- Private equity and venture capital funds focused on provision of infrastructure, including clean energy and renewables; and
- Venture capital funds and related technical assistance programs focusing on social enterprises and sustainable entrepreneurs towards the 'base of the pyramid'.

Sustainability in mainstream private equity

At the 'mainstream' end of the spectrum, few GPs and private equity funds in India have formal ESG policies and procedures dealing with sustainability-related risks and/or responsible investment values.

There are a few exceptions particularly amongst funds whose LPs include multilateral/bilateral development finance institutions (DFIs). Such DFIs include IFC, the Asian Development Bank (ADB), the US Overseas Private Investment Corporation (OPIC) and CDC. The policies of IFC and many other such DFIs stipulate that private equity funds in which they invest must follow certain social and environmental procedures, including negative screening on issues such as child labour and compliance with applicable national and World Bank standards and guidelines. DFIs such as IFC provide guidance on their environmental and social requirements and occasionally run training programs for their GPs.

The UK-based firm Actis, which has been investing in India since 2004, has a well-defined and comprehensive management system for incorporating environmental, social and governance issues into the investment process. This integration occurs at all stages of investment decision making, from origination through to investment appraisal and management of portfolio companies. Most other mainstream PE firms have no systematic procedures for identifying environmental or social impacts or for subsequently engaging with the investee companies to improve environmental and social standards.

Infrastructure and clean energy funds

PE firms are capitalising on the immense need for increased and better infrastructure in India, estimated at US \$500 billion over the next five years, by targeting logistics, shipping, engineering and construction companies. According to EMPEA estimates, PE firms injected US\$4.5 billion into infrastructure related sectors in 2007, more than double the amount invested in 2006. Examples of 2008 PE investments in the infrastructure space include Sabre Abraak Capital's US\$25 million investment in Hyderabad based Engineering and Construction Company, Blackstone's US\$60 million investment in Allcargo Global Logistics and IDFC Private Equity's US\$28 million investment in Seaways Shipping.

IDFC Private Equity also invests in social infrastructure (health care, education) and rural infrastructure. In the last couple of years, IDFC has consciously built a 'green infrastructure' portfolio, with an estimated investment of US\$ 200million in green projects including PV and water management. They also have minority shareholding in a carbon advisory service company, Emergent Ventures and a proposed majority shareholding in an aggregated portfolio of clean energy assets (including small hydro, renewables and wind). The motivation behind investing in the green space is mainly driven by commercial returns, which are perceived to remain robust even in the current climate of economic uncertainty and slow down. IDFC follow the environmental and social policies and standards prescribed by their LPs, notably ADB, CDC and IFC.

Another major player in the infrastructure space in India is Infrastructure Leasing and Financial Services (IL&FS). IL&FS invests in power generation, construction, roads, water and urban infrastructure facilities. It is unique in that it has developed an approach that internalises

environmental and social considerations into project design and development and has a dedicated group of professionals to manage environmental and social issues across its portfolio.

YES Bank's private equity arm has raised US\$125 million for its South Asia Clean Energy Fund (SACEF) and intends to raise a further US\$75 million by June 2009. Although there has been a delay in fund closing due to the global recession, YES Bank remains confident that it will meet its fund raising target and plans to invest \$7-10 million each in 20-25 companies in the areas of renewable energy, energy efficiency and sanitation solutions. The bank is also planning a \$500 million infrastructure fund, a \$40 million food and agriculture fund and \$250 million life sciences fund. The main challenges YES Bank faces in the managing its investments in this space relate to measurement and monitoring of social returns and how these could be integrated with overall financial returns.

Sustainable VC for SMEs

India is a partner of the New Ventures program, an initiative of the World Resources Institute (WRI) that aims to promote sustainable growth in emerging markets by supporting and accelerating the transfer of capital to businesses that deliver social and environmental benefits at the base of the economic pyramid. New Ventures focuses on small and medium sized enterprises in fast-growth, environmental and base-of-the-pyramid (BoP) sectors such as ecotourism, renewable energy, clean technologies and water management.

Each New Ventures country program releases an annual Call for Business Plans from businesses in target sectors seeking investment from US\$100,000 to US\$5 million. New Ventures screens businesses for financial outlook, innovation, market potential, and social and environmental benefits. New Ventures selects profitable SMEs that safeguard the environment and engage local communities while creating new markets and strong investment opportunities. Once selected into the New Ventures Portfolio, SMEs receive intensive business consulting services that improve their business plans, help increase sales, and better prepare them to move into new markets. Investors have an opportunity to interact with the New Ventures companies at an annual New Ventures Investor Forum.

New Venture India (NVI) is run in partnership with the CII-Sorabhji Godrej Green Business Centre in Hyderabad. It is also supported by USAID under the Global Development Alliance mechanism and British High Commission under the Strategic Programme Fund, the Asia Pacific Partnership and the Citi Foundation.

In November 2007, NVI launched the Green Investor Network, which serves as a platform for investors to interact with sustainable enterprises. It is a membership-based network of mainstream and blended capital investors whose aim is to facilitate investment into high growth sustainable enterprises in sectors such as clean technologies, green building materials, recycling and reuse, advanced water technologies, renewable energy, eco-tourism, and decentralised energy. Members of the Green Investor Network include the Acumen Fund, Nexus India Capital, Rianta Capital, Sequoia Capital, Siemens Venture Capital and Agnus Capital Partners.

Discussions with some members of the Green Investor Network (e.g. Nexus) reveal that the prime motivation behind their investments is commercial and not social. Their investment thesis is that sustainability is closely aligned with growing consumer demand with benefits for the investor, the entrepreneur and society. Investors like Nexus are not seeking to enhance its image by being "socially responsible" - instead, they see this as a challenge that will reap financial benefits.

6. ENABLING ENVIRONMENT

ESG transparency and disclosure

The level of corporate sustainability reporting by Indian companies is very low, especially when compared to other advanced emerging markets such as Brazil (Table 19). However, it is slowly improving and at least 12 Indian firms produced sustainability reports for FY 2007-08 based on adherence to the latest “G3” guidelines published by the Global Reporting Initiative (GRI).

Indian companies also perform poorly in terms of the Carbon Disclosure Project (CDP): over 70 per cent of Indian companies in the 2008 CDP survey failed to respond, up from 61 per cent in 2007 (Table 20) (it should be noted, however, that the 2008 sample size was rather larger than for 2007).

With reference to India’s benchmark SENSEX Index, only 7 of the 30 companies in the index – less than 25 per cent – published sustainability reports in 2008 (Table 21). The proportion of SENSEX companies that answered the questionnaire for CDP’s 2008 survey was also 25 per cent (and many of those refused to give permission for the answers to be made public). Only Infosys, ITC and Mahindra & Mahindra performed well on all counts in 2008.

Table 19: Sustainability reporting by BRIC companies

Year	Brazil	Russia	India	China
2002	26	1	4	1
2003	32	3	4	3
2004	39	4	7	2
2005	60	8	7	3
2006	71	7	10	3
2007	86	14	14	13
2008	103	14	16	17

Source: CorporateRegister.com

Table 20: Indian corporate response to Carbon Disclosure Project

	CDP5 (2007)		CDP6 (2008)	
	No.	%	No.	%
Sample size	112		200	
Answered questionnaire	42	38%	52	26%
Declined to participate	2	2%	6	3%
No response	68	61%	141	71%

Table 21: ESG disclosure by Sensex companies

Company	S&P ESG India Index	Sustainability Report for 2007-08	Responded to CDP6 (2008)
ACC Ltd.	●		
Bharat Heavy Electricals Ltd.			
Bharti Airtel Ltd.	●		
DLF Ltd.			
Grasim Industries Ltd.			
HDFC	●		●
HDFC Bank Ltd.			●
Hindalco Industries Ltd.	●		
Hindustan Unilever Ltd.	●		●
ICICI Bank Ltd.	●		●
Infosys Technologies Ltd.	●	●	●
ITC Ltd.	●	●	●
Jaiprakash Associates Ltd.	●		
Larsen & Toubro Limited		●	
Mahindra & Mahindra Ltd.	●	●	●
Maruti Suzuki India Ltd.			
NTPC Ltd.	●		
ONGC Ltd.			
Ranbaxy Laboratories Ltd.			
Reliance Communications Limited			
Reliance Industries Ltd.	●	●	
Reliance Infrastructure Ltd.	●		
State Bank of India			
Sterlite Industries (India) Ltd.			
Sun Pharmaceutical Industries Ltd.			
Tata Consultancy Services Limited	●	●	
Tata Motors Ltd.		●	
Tata Power Company Ltd.	●		
Tata Steel Ltd.	●		
Wipro Ltd.	●		

Indices, equity research and ratings

Specialised indices in addition to the S&P ESG India Index

Apart from the S&P ESG India Index, there are no other sustainability or similar indices focusing specifically on Indian stocks.

Dow Jones Sustainability Indices

The September 2008 review of the Dow Jones Sustainability Index (DJSI) World led to the inclusion of Indian companies for the first time. Two Indian companies were added to the DJSI – Tata Steel and Tata Consultancy Services.

There are no Indian companies in the DJSI Asia-Pacific Index.

Other indices

A small number of Indian stocks (for example, the wind turbine technology firm Suzlon) feature in global cleantech indices such as HSBC's Climate Change Index family and the Cleantech Index™ (CTIUS).

Independent sustainability research and rating products

In terms of local capacity, this currently consists solely of CRISIL through its work on the S&P ESG India Index and the Fortis Sustainable Development Fund. Both of these products use a relatively basic ESG methodology. CRISIL does not employ expert ESG analysts. Local capacity is therefore considered to be very limited at the current time.

None of the US or European sustainable investment research firms have a permanent presence or full-time research capability in India. However, some of these firms have out-sourced some of the more mechanical data gathering elements of their developed market research to Indian companies.

Firms such as Innovest Strategic Value Advisors and KLD Research & Analytics Inc. (amongst others) provide research on approximately 20 of India's leading companies. In general, however, this kind of research coverage is relatively limited.

At a regional level, the UK research firm Trucost has been carrying out research on Emerging Asia stocks (including Indian stocks) since 2006, initially in association with CLSA through an IFC-sponsored project. Their database is available to investors on a subscription basis. Published outputs to date consist of the report *Carbon Counts Asia 2007*, which demonstrated that the carbon intensity of portfolios can be reduced significantly without sacrificing returns. As part of this work, Trucost developed a carbon-optimised version of the MSCI Asia ex-Japan Index and is now in discussion with IFC about further commercialisation of this investment tool.

Equity research on sustainability issues

Indian sell-side broker/dealers (as distinct from international investment houses and their local offices) do not produce any equity research focusing on environmental and social sustainability issues. We are not aware of any efforts that have been made to engage them on these issues.

With regard to international investment houses, Indian stocks are still under-researched in terms of ESG issues and certainly have not received any coverage of the kind being promoted in Europe and the US under programmes such as the Enhanced Analytics Initiative (EAI). However, two firms are active in this area:

- HSBC's recently established HSBC Climate Change Centre of Excellence has a number of analysts in India providing regional and global research. Recent outputs include a November 2008 report on climate change in India, *Wide Spectrum of Choices: India's climate investment opportunities revealed*. The report identified 11 climate change themes with around US\$150 billion expected in investment between 2008 and 2017. Of 15 beneficiary stocks under HSBC coverage, seven were identified as overweight opportunities: BHEL, L&T, ONGC, PSL, RIL, Shree Renuka and Welspun Gujarat. HSBC's Indian analysts are in discussions with WRI on the possibility of future collaborative research on ESG issues in India.
- CLSA Asia-Pacific Markets is also active in ESG research on Asian stocks and in raising awareness about sustainable investment activities. Research outputs include *CG Watch 2007* (based partly on CLSA's Clean & Green survey) and the September 2008 special report *Panic Button: When Climate Change Get Real*, using Trucost data. CLSA also builds ESG awareness through its annual investment forums and in 2006, former US Vice President Al Gore chose the CLSA Investors' Forum in Hong Kong for the launch of his movie *An Inconvenient Truth* in Asia.

Potential champions, allies and other stakeholders

Investment industry associations

Relevant investment associations in India include the Association of Mutual Funds (AMFI), the Life Insurance Council (not to be confused with the Life Insurance Corporation, LIC) and the India Association of Investment Professionals (IAIP).

Asian Corporate Governance Association

The Asian Corporate Governance Association (ACGA) has only one Indian member, IDFC, although a number of its multinational members have businesses and joint ventures in India.

Asian Centre For Corporate Governance & Sustainability

The Asian Centre For Corporate Governance & Sustainability (ACCGS) (www.asiancentre.org) was established in 2001 and is based in Mumbai. Its Global Advisory Board is chaired by Mervyn E King (chairman and author of South Africa's highly influential King Committee Report on Corporate Governance) and includes other distinguished individuals from the US, the UK and Asia, such as Nasser Munjee, Managing Director & Chief Executive Officer of IDFC. The Centre runs a "Directors Power Breakfast Series", conferences, training programs and award schemes and, in India, works closely with the Indian Merchants Chamber (IMC).

The ACCGS's core focus is corporate governance but in the last two years has begun to explore and raise awareness about 'corporate social responsibility' (CSR) issues, including ESG disclosure through sustainability reports. For example, keynote speakers at its last International Conference included Bjorn Stigson (President of the World Business Council for Sustainable Development, WBCSD) and Ernst Ligteringen (Chief Executive of the GRI).

Confederation of Indian Industry

The Confederation of Indian Industry (CII) plays an important role in promoting sustainable business practices in India, especially through the CII-ITC Centre of Excellence for Sustainable Development (CESD) (www.sustainabledevelopment.in). CESD conducts advocacy and awareness raising, provides training, runs award programmes and undertakes research in fields such as GRI reporting, climate change, environmental technology and management systems.

Indian Merchants Chamber

The Indian Merchants Chamber (IMC) (www.imcnet.org) is a chamber of trade, commerce and industry focusing on the west of the country and to some extent can be considered a rival to CII. As discussed above, the IMC maintains close links with the ACCGS.

IMC has adopted the theme "Turning a new leaf – Education, Innovation and a Green Planet" for its programmes in 2009 and plans to carry out a range of projects focusing on strategic priorities for Indian economy that include water, energy, and climate change. These programmes will reportedly include cooperation with the World Bank and the Asian Development Bank, although further details are unavailable at this stage.

TERI

The Energy and Resource Institute (TERI), based in New Delhi, is one of the largest sustainable development NGOs. TERI's eminent Director-General, Dr R K Pachauri, is also the Chairman of the Intergovernmental Panel on Climate Change (IPCC) and a board member of several leading Indian

companies. TERI has around 700 employees and undertakes advocacy, research, training and other services across a wide range of sustainable development issues and Millennium Development Goals, at both applied and policy level, including the annual Delhi Sustainable Development Summit (DSDS).

TERI-BCSD India

TERI-BCSD India is an independent off-shoot of TERI and acts as a platform for corporate leaders to address issues related to sustainable development and promote leadership in environmental management, social responsibility, and economic performance. TERI-BCSD India is a partner of the WBCSD (World Business Council for Sustainable Development) and a member of its regional network. The network has a total of 69 corporate members across India representing a varied section of Indian industry.

TERI-Europe

TERI-Europe (the author of this report) is a small Anglo-Indian affiliate NGO to TERI. In addition to this current work on India, TERI-Europe published the UK-funded 2007 report on sustainable investment in India, and is also working with IFC on sustainability reporting projects in India.

TERI-Europe is also assisting the National Stock Exchange of India (NSE) to hold an international capital markets event in Mumbai in September 2009 focusing on ESG issues and foreign institutional investors (see page 49).

Centre for Social Markets

The Centre for Social Markets (CSM) is a small Anglo-Indian NGO founded in 2000 and focuses on networking and research initiatives related to climate change, "India as a global player" and corporate responsibility. In 2003, CSM undertook two projects that were explicitly on this topic:

- Research for the Indian report in ASrIA's "SRI in Asian Emerging Markets" series, which was funded by IFC's former Sustainable Financial Markets Facility.
- CSM held a conference in India on "SRI in India: Prospects and Challenges" (also supported by IFC).

ASrIA

The Association for Sustainable and Responsible Investment in Asia (ASrIA) is an important stakeholder in developing a sustainable investment market in India, although to date its footprint in the country has been relatively limited compared to its work in Hong Kong, mainland China and Japan. ASrIA does not have any Indian members.

In addition to the 2003 IFC-funded report on sustainable investment prospects in India mentioned above, ASrIA also produced a second IFC-sponsored research report in 2006, entitled *Taking Stock: Adding Sustainability Variables to Asian Sectoral Analysis*.

More recently, ASrIA has received funding from the Asian Development Bank (ADB) to develop and roll-out sustainable investment training materials for pension funds trustees in emerging Asian countries including India.

ASrIA prepared the 2008 CDP report for Asia ex-Japan.

UN Principles for Responsible Investment

There are currently no Indian signatories to the UNPRI. However, UNPRI is keen to undertake outreach in the country and is carrying out a low key fact finding mission to Delhi and Mumbai in March 2009 with informal advisory support from TERI-Europe and Delsus Limited. Our view at this

time is that PRI may be joined by one or two 'landmark' Indian signatories in 2009; attracting additional Indian signatories will be a medium- to long-term matter.

As mentioned earlier in this report, several UNPRI asset owners and asset managers (such as ABP, PGGM and F&C) have active interests in India. A more relevant and practical priority for UNPRI in relation to India may therefore be to focus on improving the "ESG investment climate" for inward equity investment and share ownership by their members.

In this vein, UNPRI has agreed in principle to cooperate with TERI-Europe and NSE for the planned sustainable capital markets event to be held by NSE in September 2009, particularly in terms of promoting the event to PRI members in developed markets and facilitating UNPRI speakers.

Emerging Markets Disclosure Project

The Emerging Markets Disclosure Project (EMDP) is a coalition of investors and organisations working to improve sustainability disclosure in emerging markets. The project, currently in Phase 3 under the coordination of Calvert Asset Management, the IFC, and the International Working Group of the US Social Investment Forum, focuses on outreach to corporations operating in Brazil, India, Korea, Russia and South Africa. The EMDP "anchor" for India is the San Francisco-based emerging market investment boutique EM Capital Management, which has a country office in India. EMDP outreach and engagement in India is still at a relatively early stage.

UN Global Compact

The UN Global Compact currently has 78 corporate signatories in India, of which 38 registered communications on progress (COPs) for 2008. Further information on members, activities and results is available from the Global Compact Society India (www.globalcompactasiapacific.org/india).

UNEPFI

UNEPFI does not have a strong presence or operational footprint in India. Only two Indian financial institutions – ILFS and YES Bank – are UNEPFI signatories. The UNEPFI Asia-Pacific Task Force focuses mainly on Australia, Japan and Korea, although it has conducted outreach events in India.

Equator Principles

No local Indian banks have publicly adopted the Equator Principles, although it should be noted that multinational EPFIs such as Standard Chartered and HSBC have a strong presence in India and IFC has participated in outreach events in Mumbai.

Stock Exchanges

Independently of our current work for IFC, the authors of this report have been in discussion with the CEO of the National Stock Exchange of India (NSE) about sustainable investment issues for over 12 months. More recently, the Bombay Stock Exchange (BSE) has also indicated an interest in taking a proactive position on the subject.

As a result of these discussions, NSE and TERI-Europe plan to hold a capital markets event on sustainable investment in India. Subject to funding, this event will be held in Mumbai in September 2009 and will focus primarily on FIIs and senior executives from Nifty 50 and S&P ESG India Index companies. As noted above, the UNPRI has agreed in principle to provide non-financial support to the event in the form of co-branding, outreach to PRI members in developed markets, and provision of UNPRI speakers.

7. FOUNDATIONS FOR PROGRESS

Current stock of sustainable investment in listed equity

Table 22 combines the estimates given earlier in this report on the total stocks of equity investment by key market participants. Of the US\$170 billion analysed by TERI-Europe, the amount of ESG-oriented investment is estimated at just over US\$1 billion. It should be noted that this is a rough estimate that relies mainly on the (untested) working assumption that ESG investment by FIIs and ADR investors is around 1 per cent of the total. Domestic ESG-oriented investment consists solely of the US\$3 million size of the Fortis Sustainable Development Fund at the current time, which as noted earlier is based on a relatively simple sustainability methodology.

Table 22 also presents our recommendations on the priority that should be attached to the different categories of market participants in terms of future efforts to strengthen sustainable investment in India. FIIs are the most relevant group to focus on in the short- to medium-term, for the reasons discussed below.

Table 22: Estimated stock of sustainable investment in India

Market participant	Estimated stock of investment in Indian equities (USD million)	Estimated stock of ESG-oriented investment (USD million)	Potential for SI market development in short to medium term
International: FII	94,000	1,000	Medium/High
International: ADR	14,000	130	Medium
Domestic: Mutual funds	19,000	3	Low
Domestic: Life Insurance	42,000	0	Low
Domestic: Pension funds	600	0	Low
Total	169,600	1,133	

In-country awareness, interest and capacity

Indian financial institutions in the listed equity space have made limited efforts to adopt and promote sustainable investment. Although initiatives such as the S&P ESG India Index are an important first step, the financial community of Mumbai and New Delhi still has little or no “infrastructure” for sustainable investment by either domestic or international investors. In addition to S&P/CRISIL, the other key exception to this is NSE: the exchange understands the strategic issues at stake and has committed to take some leadership in advocacy and awareness raising.

This trend is in contrast to actions taken by the corporate sector in India which (notwithstanding the relatively slow uptake of sustainability reporting to GRI standards) has shown a commitment to improve environmental and social performance in various ways. The drivers for these actions have typically been either voluntary initiatives or government incentives and policies, for example, those related to the promotion of renewable energy, energy efficiency and the recent National Action Plan on Climate Change. Apart from the requirements of DFIs, there is little evidence of investor activity to spur better corporate performance on environmental and social issues.

The climate for sustainable investment is also hindered by the limited nature of 'formal' ESG disclosure by Indian companies and the general business culture in relation to transparency and shareowner engagement. A number of Indian organisations are working in different ways to address this gap, such as CII, IMC, TERI and ACCGS. In addition, the landscape includes numerous international entities including WWF, CDP, GRI, UN Global Compact, IFC, ADB and others. Progress on sustainability reporting is still limited and does not mirror the increased awareness and actions of corporate entities as reported in various seminars and forums provided by organisations such as TERI, CII and FICCI.

Domestic investors in mutual funds and equity-linked life insurance products seem to have little or no appetite for sustainability-related products at present. Efforts aimed at mobilising domestic investors would need to have a long-term time frame.

Traction with international investors in India

International firms serving domestic investors

Numerous international investment institutions compete for mutual fund and life insurance business in India, either directly or through joint ventures with local institutions. Around a quarter of these international firms have adopted a proactive stance on sustainable investment at a global level, for example through the UNPRI (see Tables 12 and 15). Many are active in corporate governance advocacy at a country or regional level, especially through their membership of ACGA. In general, even those firms with a global sustainable investment brand are not actively engaging in sustainable investment in the Indian mutual fund and life insurance market. The barriers to doing so are probably greater for firms that have entered India through local joint ventures.

Fortis inherited ABN AMRO India's small retail SRI mutual fund when it acquired the former's asset management business in 2007-8. It is still too early to gauge Fortis' future appetite for sustainable investment in India. At this stage, the firms most likely to have a potential interest in developing new sustainable investment products for the Indian market are Canaro Robeco, HSBC and perhaps Aviva. Given current market conditions, however, significant developments are unlikely in the next year.

FII investing foreign capital

FII that have a corporate position on ESG investment form a healthy proportion of India's FII community. Two of the top three FIIs (Deutsche Bank and HSBC) are UNPRI signatories (see Table 7); other FIIs that are internationally associated with sustainable investment include Goldman Sachs, UBS, CLSA Asia-Pacific and Fortis. India is also on the agenda of PRI asset owners such as CalPERS, APB, PGGM and the Government Pension Fund of Norway, and asset managers such as F&C. In addition, India is a key focus of the EMDP and the UNPRI is keen to undertake outreach in India.

In terms of FIIs, the baseline environment for developing sustainable investment in India is therefore relatively strong. The main challenge is likely to be achieving some improvements in coordination and critical mass, and creating an effective route into the Indian investment and business establishment.

Development strategies for listed equity

In terms of achieving real change and added-value, the most effective strategy for developing India's sustainable investment market is likely to be one that focuses in its initial stages on two main constituencies: FIIs and Indian corporations. The key elements in such a strategy may include:

- 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 (i.e. complementary to the more *ad hoc* company-specific joint engagement mechanism offered by the UNPRI Clearinghouse, not in duplication of this mechanism).
- 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, ACCGS, 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 EMDP should also play into the mix. However, it will be important and useful to open the process to FIIs that may not currently be UNPRI signatories – key examples mentioned earlier in this report include 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. Another alternative could be to involve ACGA in place of or in addition to IFC, although as noted earlier ACGA has so far made little movement in broadening its focus out beyond corporate governance into related areas such as climate change or human rights.

The second key element of this proposed strategy is 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 the National Stock Exchange of India (NSE), which is already planning to take precisely this step with its September 2009 event with TERI-Europe and UNPRI.

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:
 - Engagement with PFRDA (which is implementing the New Pension System) with a view to including ESG factors in the new investment guidelines. As a first step, IFC could organise a brainstorming session with PFRDA and its stakeholders to introduce the concept and raise awareness.
 - Engagement with IRDA and LIC with a view to including ESG factors in regulations and guidelines for life insurance firms and products. IRDA has previously shown some appetite for encouraging private insurance companies to respond to climate change impacts and risks by experimenting with new products (e.g. weather derivatives) and could be a potential partner in launching ESG initiatives with LIC and the insurance industry.

- Engagement with the Securities and Exchange Board of India (SEBI) with a view to improving regulations and/or guidelines on transparency, disclosure and non-financial reporting.
- Although the domestic mutual fund industry is still far behind in incorporating sustainability issues, there is an opportunity here to raise awareness levels and encourage thinking on integration of ESG issues. 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.

Development strategies for private equity

The growth of PE funds in general and venture capital in particular is encouraging from a sustainability perspective; 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. 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.

APPENDIX A: DEVELOPMENT PROFILE

Development Indicators

Table 23 provides information on selected development indicators for India.

The World Bank/IFC annual *Doing Business* survey of 181 countries worldwide provides a quantitative measure of regulations for starting a business, dealing with construction permits, employing workers, registering property, getting credit, protecting investors, paying taxes, trading across borders, enforcing contracts and closing a business—as they apply to domestic small and medium-size enterprises. India ranked 122nd out of 181 economies in the 2008 survey (Table 24). By comparison, the other BRIC economies of Brazil, Russia, and China ranked 124th, 120th and 83rd respectively. (The top three ranked countries globally were Singapore, New Zealand and the US).

Figure 18 illustrates India's ranking in the Doing Business Survey and in several other commonly used international benchmarks covering issues such as corruption, human development and competitiveness.

Figure 18: International benchmarking



Table 23: India - selected development indicators

WORLD VIEW		
Population, total (millions)	2007	1,123.32
Population growth (annual %)	2007	1.2
Surface area (sq. km) (thousands)	2007	3,287.3
Poverty headcount ratio at national poverty line (% of population)	2000	28.6
GNI, Atlas method (current US\$) (billions)	2007	1,069.43
GNI per capita, Atlas method (current US\$)	2007	950
GNI, PPP (current international \$) (billions)	2007	3,078.73
GNI per capita, PPP (current international \$)	2007	2,740
PEOPLE		
Life expectancy at birth, total (years)	2006	64
Mortality rate, under-5 (per 1,000)	2006	76
Immunization, measles (% of children ages 12-23 months)	2006	59
School enrolment, primary (% net)	2006	86
Prevalence of HIV, total (% of population ages 15-49)	2007	0.3
ENVIRONMENT		
Forest area (sq. km) (thousands)	2005	677.0
Agricultural land (% of land area)	2005	60.6
Improved water source (% of population with access)	2006	89
Improved sanitation facilities, urban (% of urban population with access)	2006	52
Energy use (kg of oil equivalent per capita)	2005	491
CO2 emissions (metric tons per capita)	2000	1.1
Electric power consumption (kWh per capita)	2005	480
ECONOMY		
GDP (current US\$) (billions)	2007	1,170.97
GDP growth (annual %)	2007	9.0
Inflation, GDP deflator (annual %)	2007	4.3
Agriculture, value added (% of GDP)	2007	18
Industry, value added (% of GDP)	2007	29
Services, etc., value added (% of GDP)	2007	53
Exports of goods and services (% of GDP)	2007	21
Imports of goods and services (% of GDP)	2007	24
Gross capital formation (% of GDP)	2007	38
STATES AND MARKETS		
Time required to start a business (days)	2007	33
Market capitalization of listed companies (% of GDP)	2007	155.4
Military expenditure (% of GDP)	2007	2.5
Fixed line and mobile phone subscribers (per 100 people)	2007	24
Internet users (per 100 people)	2007	17.8
High-technology exports (% of manufactured exports)	2005	5
GLOBAL LINKS		
Merchandise trade (% of GDP)	2007	31
Net barter terms of trade (2000 = 100)	2005	105
External debt, total (DOD, current US\$) (millions)	2006	153,075
Short-term debt outstanding (DOD, current US\$) (millions)	2006	11,971
Total debt service (% of exports of goods, services and income)	2006	7.7
Foreign direct investment, net inflows (BoP, current US\$) (millions)	2006	17,453
Workers' remittances and compensation of employees, received (US\$) (millions)	2007	27,000
Official development assistance and official aid (current US\$) (millions)	2006	1,379

Source: World Bank – World Development Indicators database

Table 24: *Doing Business 2009 – India’s profile*

Ease of...	Doing Business rank (out of 181 countries)		Change in rank
	2009	2008	
Doing Business	122	126	+4
Starting a business	121	114	-7
Dealing with construction permits	136	131	-5
Employing workers	89	89	No change
Registering property	105	114	-9
Getting credit	28	25	-3
Protecting investors	38	33	-5
Paying taxes	169	167	-2
Trading across borders	90	81	-9
Enforcing contracts	180	180	No change
Closing a business	140	140	No change

Source: *Doing Business 2009 (World Bank/IFC)*

Millennium Development Goals

India’s progress towards achieving the Millennium Development Goals (MDGs) is summarised in Figure 19.

India’s achievement in poverty reduction is one of the leading factors in the global action against poverty. The Millennium Project Report states that “with more than 2.3 billion people in these two countries (China and India) alone, their major advances in poverty reduction drive developing world averages.”

India’s Tenth Five-Year Plan (2003-2007) included targets of human development that can be monitored, consistent with, but more ambitious than MDGs. The Eleventh Five-Year Plan (2008-2012) proposes state-specific targets. The Government has launched several large programmes with regard to the MDGs. The areas that require redoubled efforts include literacy, nutrition, maternal mortality and child mortality. The responsibility of implementing most of the social sector programmes relating to the Goals lies with the provincial governments.

The National Rural Employment Guarantee Scheme, with an annual allocation of US\$2.5 billion, guarantees 100 days of work to every household. The Jawaharlal Nehru National Urban Renewal Mission has allocated US\$7 billion over a seven-year period to provide basic services to the urban poor in 63 major cities. The Sarva Shiksha Abhiyan (Education for All Campaign), launched in the year 2000, is a national programme to make elementary education accessible to all. The National Rural Health Mission is focused on basic health-care delivery systems through a synergistic approach focusing on sanitation, water, nutrition, and health care.

A major task for India is the improvement of service delivery and capacity development, at district and local levels, in order to implement and monitor very large programmes. Social, economic, and political inclusion, decreasing the incidence of violence (gender/caste-based) and reduction of regional disparities require concerted efforts to promote greater access of vulnerable groups (such as women, dalits, tribal groups, and religious minorities) to basic services, including credit and social security, opportunities for decent work, and participation in decision-making. The Eleventh Plan addresses these challenges through a mix of resource allocation, incentives for institutional reform of the delivery system, and public-private partnerships.

Critical policy and plan documents of State Governments, such as Annual Economic Surveys and the Eleventh Five Year Plan, now have human development reporting integrated into them. At the state level, Madhya Pradesh has had a series of Missions on health and education, including iodine deficiency, since the mid-1990s. Since 2006, the government of Maharashtra has focused the Maharashtra Human Development Mission around the MDGs. Its objective is to meet the eight Goals in 12 districts ranking low on the Human Development Index. Additionally, the concept of human development is being increasingly integrated into district planning through district-specific Human Development Reports (HDRs).

The Government of India has identified 250 such districts for which a Backward Regions Grant Fund provides financial support for district planning and programme implementation. At the city level, the Delhi HDR has specified Delhi Development Goals, customizing the MDGs to a purely urban context. At the national level, a concerted effort is being made to implement the Eleventh Five-Year Plan in collaboration with civil society organizations across the country.

Figure 19: India's progress towards the Millennium Development Goals (source: UN MDG Monitor)

