International Research Journal of Management and Commerce
ISSN: (2348-9766)
Impact Factor- 5.564, Volume 4, Issue 11, November 2017
Website- www.aarf.asia, **Email** : editor@aarf.asia , editoraarf@gmail.com

CAN ETHICS AND RETURNS MOVE TOGETHER?

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ABSTRACT

Ethical investing is a recent investment niche emerging in India. It emphasize on consistency of investments with one's values and morals. It has gained popularity among institutional and individual investors due to increase consciousness and awareness about how businesses are exploiting society, environment and law for their own benefits. The values inherent in ethical investments- equity, fairness and justice can help the global economy to traverse the period of crisis. Investors through ethical investments can play crucial role in bringing the needed change in corporate behavior and practices and ensure that every aspect of corporate is ethical. The purpose of this paper is to gain insight about Ethical funds in general and Taurus ethical funds in particular and empirically examine the performance of Taurus Ethical funds vis-à-vis NIFTY 500 which is its benchmark index.

KEY WORDS: Socially Responsible Investments, Ethical funds, Shariah law, Taurus ethical funds, NIFTY 500

INTRODUCTION

The evolution of Socially Responsible investments dates back to 1960's when people expressed their anger to Vietnam War by boycotting the companies which were providing weapons for war.

The period of 1970's witnessed increasing concern for labor and environmental issues. By 1980's-1990's Socially Responsible investments saw rapid escalation because of growing concern for environment, corporate scandals and increasing labor exploitation by companies, Domini Social Index was also launched during this period. Socially Responsible Investments is capturing attention of masses today. But despite the fact, that it has been into existence since nineteenth century it is still at nascent stage, especially in India. This section aims to develop basic understanding of Socially Responsible Investments. In simple words SR investing is: "Integrating personal values and societal concerns with investment decisions" (Berry, 2015). Socially responsible investors are different from conventional investors as they do not limit themselves to traditional risk-return parameters but moves beyond, and pays equal rather greater attention to social, economic and governance parameters. A socially responsible investor is "other oriented" and not "self oriented" (Gardner J. M., 2004). Prior to investing he ensures that company treats its employee, suppliers, creditors, and customers well, it gives equal employment opportunities to backward classes and differently able people, it makes fair and adequate disclosures, it is transparent in its operations and also its does not affect environment adversely. A socially responsible investor invests in stocks of socially responsible companies and penalizes the stock of companies which are not socially responsible. If all the investors starts behaving in responsible manner then "anti-social" companies will be driven out of market as there will be no demand for their shares (Bhandari, 2015).

The main objective of this paper is to gain insight about Ethical funds in general and Taurus ethical funds particularly and empirically examine the performance of Taurus Ethical funds vis-à-vis NIFTY 500 which is its benchmark index. This will help the investors to know how Ethical funds have performed and will aid them in making their investment decision.

REVIEW OF LITERATURE

There are two views in the literature concerning the effect of incorporating social concerns in the investment process. According to the first view, it is argued that SR investors 'do good, but not well', and sacrifice investment performance in pursuit of their principles (Gardner J. M., 2004).By being socially responsible, investor introduces a permanent bias in his portfolio either by eliminating some stocks or by concentrating on particular stocks. This makes socially responsible investor's portfolio less diversified. This also brings commonality among the assets in the portfolio thus making it more homogeneous (Milani, 2015). This increases portfolios exposure to single asset which implies greater difference in composition of investor's portfolio and market portfolio hence whenever anything good or bad influence a single security investor's portfolio will be more sensitive to such changes than market portfolio (rudd, 1981). While investing individuals make decisions on the basis of their own moral values, which are not observable and may show considerable heterogeneity also sometimes investors are vague over their own understanding of what constitutes SRI, on the other hand firms must reliably inform funds of their performance on social criteria so as to assure safety of investors fund and fund managers then must be able to reliably inform investors of the portfolio composition and characteristics the underlying challenge is of obtaining a definition of ethical investment on which an effective audit mechanism can be developed to confirm compliance (Rhodes, 2010).This is referred as problem of Information asymmetry. The second view, 'doing well by doing good', claims that a firm that considers ethical principles in its strategy can be expected to perform better than an ordinary firm (Ladha, 2014). Environment friendly products, processes and systems can improve profits either by way of enhanced sales which can be because of higher demand of socially responsible firms products, competitive advantage by integrating environment management practices in all stages of the manufacturing process to reduce pollution, increase in market values due to adoption of a more responsible stand towards environment or receipt environmental awards or Cost reduction because of less conflicts with environmental protection groups save the firm from costly litigations, adverse media and public attention and government regulations (Goldreyer, 1999). At the portfolio level, socially responsible investments may have superior or inferior performance. For instance, (Diltz, 1995) conducted a study which suggests that applying social screens neither hinders nor helps portfolio performance and abnormal returns. (Boyer, 2009) suggested that number of firms in solar and biofuels is highest making them as the most developed sectors, while the least developed is the geothermal industry and U.S. is leading in all sectors with highest number of firms in each sector. (Pattanayak, 2011) conducted a study in which content analysis has been used to measure the extent and nature of disclosure in 22 core sector companies across oil and petrochemical industry, mining and minerals, cement and steel industry with the help of certain environmental themes showed that environment disclosure are not quantitative and incomplete they do not indicate the company's contribution towards environment betterment. Meaningful information that relates to environmental costs and liabilities must be disclosed in annual reports so that it can assist investors in taking investment decisions. (Bhandari, 2015) found that ESG and GREENEX provided significantly higher returns than other portfolios especially during crisis and post-crisis periods by using various risk adjusted measures. Socially responsible stocks portfolios, despite having higher risk, outperformed the market portfolio. Socially Responsible stocks portfolios outperformed other portfolios even on the basis of net selectivity returns especially during crisis and post-crisis periods. This indicates that the compromise with respect to diversification, made by investing in socially responsible stocks portfolios was well rewarded in terms of higher returns.

TAURUS ETHICAL FUNDS

Taurus ethical fund was launched on 20 March 2009 with the objective of providing capital appreciation and income distribution to unit holders by investing in a diversified portfolio of equities, which are based on Shariah principles. Taurus fund was constituted as trust on August 20, 1993 with Taurus Investment Trust Company Limited as its trust company. Taurus Asset Management Company Limited (TAMCO) was appointed as the Asset Management Company of the Taurus Mutual Fund by the Trustee. It is India's first "*Equity oriented actively managed and diversified Shariah compliant fund".* Equity oriented funds invest minimum 65% in Equity shares and remaining in debt securities (Nangia, 2014) and active fund management strategies implies adopting different investment strategies to outperform market. "Shariah law allows investment in only those companies that do not engage in interest based lending, short-selling, excessive speculations, gambling or the production of alcohol, tobacco, weaponry or pornography and environment pollution. Shariah compliant sustainable finance is sub-set of socially responsible investment (SRI) and has clear policy regarding environmental or ''green'' issues as well as sustainable sources" (Hassan, 2009).As per Shariah law companies must adhere to these three basic principles:

- **NO INTEREST :** Neither can lender receive it nor can the borrower pay it.
- **PREVENTS INVESTMENTS:** In alcohol, tobacco, and gambling etc.
- **NATURE OF CONTRACTS:** Contracts should be in written and all terms and conditions must be clearly mentioned with no hidden agendas and implicit assumptions

Apart from this Shariah law requires formation of Shariah Board and makes Shariah audit mandatory (Hassan, 2009). Taurus ethical fund is an open ended scheme in which stocks can be redeemed and issued anytime. The Fund Managers select stocks for investment from the universe available from S&P BSE 500 Shariah Index which is the benchmark index for this scheme. The Scheme requires at least 20 investors and no single investor shall hold more than 25% of the corpus of the Scheme, in case of failure to comply with this requirement scheme will be wound up and the units would be redeemed at applicable NAV. The fund is open for subscription by overseas investors (Taurus Mutual Funds). An Investment Monitoring Committee has been formed which meets each month to reviews investments and disinvestments made since its last meeting.

As on 30 June 2017 it has asset under management of worth Rs.30.09crores.Fund offers high liquidity as units can be sold and purchased on all working days at NPV. Minimum application amount required for buying units in fund is Rs.5000 and multiples of Rs 1 thereafter. There is no entry load but it has certain rules for exit loads:

1. For sale upto any amount
    - 1% if exited on or before 180 days
    - Nil if exited after 180 days
2. In case of switching from equity to equity no exit load is applied however switching from equity to Debt will attract exit load applicable as mentioned above.

Fund has internal norms that limit its exposure to particular sector, industry or firm to ensure appropriate diversification. The scheme offers two plans Regular plan and Direct plan. Regular plan is for those who are seeking services of distributor and direct plan is for those applications which are not routed through distributor.

COMPOSITION OF PORTFOLIO

Taurus Ethical Fund invests only in Listed Indian companies and offers adequate diversification. Portfolio of Taurus Ethical funds consist stocks of 43 companies from different sectors. The companies are identified for investment on the basis of top down/ bottom up approach and in-depth market analysis apart from this market conditions, redemption flows and other external factors are also given due atttention.

Maruti Suzuki dominate the portfolio with 7.21% of total investments followed by Motherson Sumi with 4.62% of total investment. The difference of ~3% between top two companies is however large and requires more explanation in its support. Other firms from automotive industry are Apollo tyres and Exide Ind with 1.93% and 2.48% of total investments respectively. Another sector that dominates the portfolio is Oil & Gas , with Petronet LNG having highest share of 4.54% followed by IGL with share of 4.47%. Bharti airtel, Cipla & Biocon and Blue star have least share of 2.16%,0.94%,0.94% and 0.73% respectively[i] (Money Control)

If sector allocations are considered then the portfolio is underweight in Pharma (1.88%) and telecommunications (2.16%) sector while overweight in automotive(48.72%), Oil and Gas(39.66%),technology(32.22%), cement(28.98%), chemical(25.08%) and services(23.40%). These imbalances in weighting may make investors apprehensive and influence their investment decisions.

PERFORMANCE

The study analyses returns of Taurus ethical funds and NIFTY 500 and difference between fund returns and benchmark's return as per data available on August 04, 2017. NIFTY 500 represents top 500 companies based on full market capitalization. Only companies in the eligible universe can be included in NIFTY 500.

SELECTION CRITERIA FOR STOCKS IN NIFTY 500 (NSE)

1. Companies ranked within top 800 based on both average daily turnover and average daily full market capitalization based on previous six months period data
2. Companies traded for at least 90% of days during the previous six months period.
3. Securities will be included if rank based on full market capitalization is among top 350
4. Securities will be included if full market capitalization is twice of the last constituent in NIFTY 500

All the data for Taurus funds and NIFTY 500 was collected from money control's website. Money control started off as a financial portal that offers end-of-day stock prices and today it has become India's biggest store of news, analysis, data and tools on investing across diverse asset classes, personal finance, the business sector and the economy. It is the largest online financial platform in India (moneycontrol)

Table -1 FUND RETURNS V/S BENCHMARK RETURNS

(as on 4.august.2017)

	FUND RETURNS	BENCHMARK RETURNS	DIFFERENCE OF FUND RETURNS & BENCHMARK RETURNS
1 MONTH(%)	2.2	63.4	-61.2
3 MONTH(%)	3.7	2800.8	-2797.1
6 MONTH(%)	10.5	-24.0	34.5
1 YEAR(%)	8.2	11.5	-3.3
2 YEAR(%)	2.6	1.4	1.2
3 YEAR(%)	10.0	-0.6	10.6
5 YEAR(%)	15.8	4.9	10.9

SOUREC:http://www.moneycontrol.com/mutual-funds/nav/tata-ethical-fund/MTA010

Benchmark Index: NIFTY 500

RETURNS OVER 1 YEAR ARE ANNUALISED

Table 1 shows the result of returns over 1 month, 3 month, 6 month, 1 year, 2 year, 3 year and 5 year period ending on August 04, 2017. The table shows mixed results wherein sometimes Taurus fund outperformed its benchmark index and sometimes underperform. For instance in 6 month (10.5 v/s -24.0), 2 year(2.6 v/s 1.4) 3 year (10.0 v/s -0.6)and 5 year (15.8 v/s 4.9) Taurus funds outperform NIFTY 500. But in 1 month(2.2 v/s 63.4), 3 months (3.7 v/s 2800. 8) and 1 year(8.2 v/s 11.5) benchmark index outperformed Taurus fund. 3 months difference in returns is quite large(-2797.1)

DISCUSSION

There has been significant rise in demand of Ethical funds. Seeking to make investments that are consistent with one's values, investors have poured large amount of funds in Ethical funds. A complimentary tailwind is provided in the form of government subsidies, CSR rules and actions of pressure groups and public at large. Results of the study however shows that despite of generous support for Ethical investing, Ethical funds in general and Taurus fund in specific have not achieved significant and consistent higher returns.

There can be many reasons for such unsatisfactory performance. One is that Ethical funds in India are at early stage in their life cycle and incurring huge expenses on research and development. Investors have overestimated the profitability of ethical funds and failed to consider accompanying R&D cost. Another reason can be, Ethical investing is just a investment fad in which investors are putting their money due to nature of fund's investment policy and not because of funds performance, and funds are drawing benefit out of this by charging higher prices for ethical labels than conventional funds (C. Edward Chang, 2012).

Another area for concern is inability of Taurus ethical funds to obtain any rating from CRISIL and this can be detrimental for its future growth.

Further studies need to learn more about way in which Ethical funds generate returns. A challenge for ethical funds is to retain their identity and to prevent itself from walking on the footsteps of conventional funds overtime.

CONCLUSION

Ethical investing is an investment philosophy gaining popularity all over the world. However desire of investor to invest in companies which meet their value considerations has provided initial impetus to industry but in order to sustain in long run they will have to deliver competitive returns. The question addressed in this paper is whether ethical investments in general and Taurus ethical funds in specific sacrifices return performance? In this paper performance of Taurus mutual fund and NIFTY 500 is compared empirically. Results of the study indicated that there are times when Taurus fund has beaten its benchmark index and there are also times when it is beaten by its index. Taurus funds must do better in future to close the gap with its benchmark index. Meanwhile ethical investor should be selective in their choice of investment and should consider both long term and short term horizon for their investment decisions.

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