NSE's Ahimsa Index is not for investors looking solely for financial alpha

They seek returns and moral satisfaction, a choice that should not be judged by the same yardstick used for conventional investing

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Ethical investing has evolved over several decades in developed markets. | Photo Credit: Getty Images/iStockphoto

Conventional financial economics has rested on a simple assumption that investors are Homo Oeconomicus — rational agents who maximise wealth by weighing risk against return, with morality and personal values playing no role in investment decisions. This premise underlies modern portfolio theory, the capital asset pricing model and much of contemporary financial economics.

Ethicus — an agent who derives utility not only from economic gains but also from investing in ways that reflect personal values.

Broad-market benchmark

This centuries-old debate has also entered India's capital markets. With the launch of the Nifty 500 Ahimsa Index, the National Stock Exchange has introduced a broad-market benchmark explicitly inspired by the principle of "Ahimsa or non-violence", based on the categorisation provided by the Ahimsagain Foundation. Stocks forming part of the "orange" and "red" band as identified by the Ahimsagain Foundation are excluded from the index. Unlike conventional indices organised by market capitalisation, sectors, or investment style, the Ahimsa Index excludes companies engaged in businesses considered inconsistent with this philosophy, including animal cruelty, sin goods, and other ethically screened activities. Derived from the Nifty 500, the remaining 326 companies are weighted by free-float market capitalisation, making it a diversified benchmark suitable for ETFs and passive investment products.

This is not unfamiliar territory for the Indian capital market. Ethical investing has evolved over several decades in developed markets through indices such as the MSCI World SRI, FTSE4Good, the Dow Jones Sustainability Index, and the S&P 500 ESG Index. India, too, already has the Nifty100 ESG, Nifty100 Enhanced ESG, Nifty100 ESG Sector Leaders, and Nifty50 Shariah indices. The Ahimsa Index, however, is fundamentally different. In contrast, the Ahimsa Index follows a values-based exclusion strategy. Certain industries are excluded altogether irrespective of how well individual firms perform. It, therefore, resembles socially responsible and faith-based investing more than mainstream ethical investing.

However, the launch raises a deeper question than whether India needs another thematic index: should morality become an investment criterion? There is nothing irrational about ethical investing as a personal choice. The concern arises when ethical branding creates the impression that investors can satisfy their conscience without sacrificing financial performance. Unfortunately, there is no free lunch in investing.

Reducing the range

cruelty (Himsa). Investing works the same way. Every exclusion, in general, removes potential opportunities. Financial economics reaches the same conclusion more formally. Harry Markowitz's modern portfolio theory shows that the optimal risk-return trade-off is achieved by investing across the broadest feasible opportunity set. Restricting the investment universe shifts the efficient frontier inward, reducing diversification, increasing tracking error, and potentially lowering risk-adjusted returns. Moral preferences may be personally valuable, but they come with an economic cost that investors should recognise rather than assume away.

Second, perhaps the most influential academic criticism comes from Harrison Hong and Marcin Kacperczyk's work on "sin stocks". They argue that many institutional investors refuse to hold tobacco, alcohol, and gambling companies for ethical reasons. Reduced demand depresses the prices of these stocks, raising their expected future returns. Their evidence suggests that investors who avoid "sin industries" may unintentionally forgo a return premium. Ironically, the moral investor may sacrifice some of the market's most profitable opportunities. In contrast, a similar conclusion can be reached from a different direction. Lubos Pástor, Robert Stambaugh, and Lucian Taylor argue that as investors increasingly prefer ethical companies, they bid up their prices. Higher prices today imply lower expected returns tomorrow. Ethical companies are not necessarily better or poorer businesses, but they simply become expensive assets.

Therefore, ethical investing generates what economists call non-pecuniary utility rather than financial alpha. This is where the debate shifts from finance to welfare economics. Traditional finance evaluates investment success solely through returns. Welfare economics evaluates utility, which includes wealth but also incorporates values, identity, and personal satisfaction. An investor who knowingly accepts a slightly lower expected return in exchange for avoiding industries considered socially harmful may not be acting irrationally at all. The financial sacrifice is compensated by moral utility.

Reframing the debate

This insight fundamentally reframes the debate. Ethical investing, therefore, should not be judged by the same yardstick as conventional investing because it pursues a different objective. Investors in the Ahimsa Index seek both financial returns and moral satisfaction. Traditional finance values only the former; welfare economics values both.

Karma.

The final question is whether investors should outsource the act of morality to corporations rather than exercise it through their own choices as consumers, citizens, and philanthropists. Asking CEOs to resolve their moral trade-off might weaken accountability because they are neither appointed nor directly answerable to the moral standard. It makes corporate performance harder to evaluate: a clear objective such as long-term value creation is more transparent than an open-ended commitment to satisfy every stakeholder.

Viewed in this light, the success of the Ahimsa Index should not be judged by its alpha. Its true significance lies in whether it marks the emergence of Homo Ethicus in Indian capital markets or merely repackages morality as a marketing pitch for gullible investors.

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