Unlocking the Potential of Sustainability Financing: Exploring its Role in Economic Growth, SDGs, and Long-Term Returns

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Abstract

Sustainability finance has the power to accelerate a shift in the investments made towards funding and generating awareness of sustainability issues, thus catering to the economic vision as a whole which is transitioning from a short-term-centric to a more long-term-centric environment. The UN facilitated this shift through the introduction of the Sustainable Development Goals (SDG) in the year 2015. This has opened up a wide range of opportunities through globalization and trade across borders. Although opportunities are wide, it is seen that companies are unable to tap into the multitude of opportunities available. This review paper explores previous literature in the field and reports published by companies with an aim to understand the effectiveness of the role of the sustainability shift in financing economic growth and development. Additionally, it explores whether this transition plays a role in enhancing a company's capacity to harness long-term return potential. Moreover, it aims to provide insights into strategies companies can employ to leverage the opportunities created by the Sustainable Development Goals (SDGs).

Keywords: Sustainability finance, SDG, opportunities in sustainability, financing sustainability for economic growth, effectiveness of sustainability, long-term returns

Introduction

The focus has shifted from a short-term perspective to a more long-term sustainable approach to financing. The economy is transitioning from a profit and shareholder-centric model toward an increased environmental and social governance model. Emphasizing certain areas like sustainability development, low-carbon and green economy, and mitigation of climate change (Ryszawska, 2016). A significant power to accelerate the transition lies in the financial sector with respect to funding and bringing about awareness of sustainability issues. Supporting transition financing has gained importance in recent years. An essential function that is noted is its contribution to supplying funds and financial assets to emerging nations as they confront environmental and societal obstacles while progressing in their development path. Acknowledging the wide-ranging uses of transition finance can significantly bolster the shift toward a more sustainable and environmentally aware future (Caldecott, 2022).

The integration of Sustainability into the economy was done through the 17 Sustainable Development Goals (SDGs) by the United Nations introduced in 2015, as part of the 2030 Agenda document for Sustainable Development. It laid the foundation and has been acting as a driving force for the much-needed sustainability shift. Measures in the document aim to balance economic globalization whilst taking into account the protection of the environment. The primary intent of the implementation of the SDGs was poverty eradication and the creation of better health conditions for both developed and developing countries (United Nations, 2015). In recent years the lines between Globalisation and Trade have been blurred, they are seen to have a positive influence on sustainability. Which in turn opens the borders to free trade seen through the flow of financial capital, information and data, and mobility of people as well as goods and services (Tang et al., 2020). The two sustainability Indices which are the Human Development Index (HDI) and Environmental Performance Index (EPI) were found to depict strong relations when tested against various levels of globalization (Tang et al., 2020).

As the market for sustainable finance is expanding and is seen to become a primary focus area for policymakers and global investors (Bakken, 2021). Sustainable finance has been progressing in the direction of becoming mainstream finance (Siaba Serrate, 2019). This paper's objective is to understand the landscape of sustainable finance and investments and its role in economic growth, SDG, and long-term returns.

Research Methodology

Data collection and description

The search criteria selected to identify the body of literature for this study looks at the time period from the introduction of the SDG that is from the year 2016 to 2023 (to date), as this introduction was a major contributing factor in driving the sustainability transition (shift) in the economy. However, the paper leans more on data from reports for the current year (2023). Data for this study has been drawn from two sources, research articles and reports published by the United Nations and companies – this was done in order to look into a more holistic timeframe and give a view of the nature of the transition. The search criteria takes into account only the open sources of information available which is accessible through the web, the company's official reports as well as scholarly articles.

The search terms for scholarly articles encompass terminologies such as; *sustainable finance, sustainable development, need for sustainable finance, the contribution of trade and globalisation to sustainable finance, sustainable finance market size, sustainable finance market structure, sustainability transition, SDG and development*. Search criteria for company reports used are; *company reports on sustainable finance*, *and sustainability reports by top companies*.

The study looks primarily at journal articles and reports with English only as the vernacular language; publications without any apparent relationship to the objective were excluded.

Data Analysis

Based on the already published research in the field along with industry reports and the most recent report released by the United Nations (September 2023), the data explores the role sustainable finance plays with respect to three parameters Sustainable Development Goals (SDGs), economic growth and development, and finally the generation of long-term returns.

Sustainable Development Goals (SDG's)

The opportunities that the SDGs opened up are vast, and tapping into these opportunities becomes easier through globalization and trade. However, countries and companies are not able to take advantage of the multitude of opportunities that the sustainability economic shift has opened up (Leal Filho et al., 2019). The introduction of the SDGs by the UN is one aspect but how effective were these goals with respect to the economy is a question that we need to ask. To throw light on this as of today (2023) the global challenges that the world has faced and continues to face, such as armed conflict, the Covid-19 pandemic, natural disasters, and an increase in the cost of living (Inflationary conditions) have been noticed to be significant setbacks in terms of achieving the SDG by 2030 and progressing towards a more sustainable outcome (United Nations, 2023). The very title of the GSDR report published by the United Nations at the midway mark (United Nations, 2023) calls for a state of urgency where accelerations for Sustainable Development transformations are of utmost importance in the current crisis that requires rapid change.

The report (United Nations, 2023) further goes on to substantiate and make overarching claims of the global financial impact across three major areas. Firstly, the prevailing economic offset effect of the COVID-19 pandemic has disrupted and slowed down progress significantly across the goals where it was seen that small and medium-sized enterprises were impacted to a large extent on account of loss of jobs and recovery has been slow. Secondly, instability due to conflict and war resulting in huge spikes in prices of food and energy acting as a key driver for inflation, they are also noticed to be barriers to the progress of the SDG. Lastly, with the rising cost of living and inflation, many countries are noticed to face debt levers at a 50-year high (as of 2022) therefore limiting options for social protection investing which can help cope with rising costs. Overall, large financial gaps are noticed in the goals for developing countries and there are strong calls for the reformation of financial innovation solutions that have been developed, in order to bridge the gap between the financial imbalance.

So, what is this change? that we all collectively need to look at in terms of realignment with the SDG to strive for achievement, and tapping into the financial opportunities that they have opened up on a global scale. Also, the need to further re-align with the plan and move closer to the outcome from a sustainable financing and investment perspective. In light of the UN's report, big companies such as Morgan Stanley, Deloitte, PWC, and Mercedes were further noticed to hold sustainability summits and release reports in 2023 in order to address certain key target focus areas.

Long-term returns

Respondent leaders in an interview stated that thinking differently in the sustainability financing space is in turn proving to enhance and create value for businesses in the market (Bakken, 2021). As per a report published by Morgan Stanley's Institute for Sustainable Investing; institutional investors are increasingly embracing the concept of investing in companies or funds that strive for competitive financial returns while also taking into account their positive impact on society or the environment. This approach is experiencing a surge in popularity unlike anything seen before where 80% of asset owners reported actively incorporating sustainable investing in 2019. This represents a 10% increase when compared to Morgan Stanley's previous biennial survey in 2017. The rise in sustainable investing can be attributed to factors such as growing demand from stakeholders, the belief in the potential for favorable financial returns, and regulatory changes requiring more transparency regarding environmental, social, and governance [ESG] factors (Morgan Stanley, 2020). An added advantage is the return potential which is actively acting as a key driver for sustainability investing, as the asset owners are noticing potential in this area. Most surveyed investors were found to hold the belief that companies adhering to ESG-aligned practices have the potential to be superior long-term investments, hence driving the need for a more formalized ESG integration as the most relevant approach to sustainable investing (Morgan Stanley, 2020)

Add value to nature: The generation of returns becomes easier when value can be attributed to nature. Although nature provides trillions of dollars to the economy it still continues to be unpriced (Morgan

Stanley, 2023). Embedding SDG goals such as climate change into the very purpose and strategy of organizations, by doing this an organization is integrating the view into the very being of the enterprise to give nature a more holistic view (Deloitte, 2023).

Positive Synergies: Interlinkages between the goals need to be developed (United Nations, 2023). To address the gap between the need and financial investment - collaborations need to be fostered between the private (companies) and the public sector (Governments), along with combining international and domestic resources to address the challenges (Morgan Stanley, 2023). Existing models will serve as a guide for the shift needed in the generation of investments, to name a few models debt-to-nature swaps (conversion of debt to local currency resultant proceeds fund conservation activities) and impact bonds (debt instrument issued into the market where conservation project returns are generated, based on carbon credits) (Morgan Stanley, 2023). However, on a more contradictory front 30% of organizations stated that they do not have plans of lobbying governments for climate change initiatives and 21% further went on to state that sustainability performance for senior leader compensation would not be tied together (Deloitte, 2023). Only 32% of organizations in a survey were found to be working on collaborations. Change cannot be driven solely by organizations, collaborations with local and national governments can be more beneficial (Deloitte, 2023). Also, further Empowering the board can ensure that long-term views get captured in management decision-making (Deloitte, 2023). The transformation pace that is required needs collaborative approaches between industries and sectors and throughout regions and supply chains. Governments, businesses, and societies should work together in order to drive the transition and achieve shared sustainability goals (Deloitte, 2023).

ESG Investing: Bridging the gap between ESG ratings (which is an opinion) and the very nature of ESG as a foundational framework for investing. Investors should be made aware by companies that ESG is used to actively assess risks that they need to consider, this can play in their favor when it comes to making active ESG investments (Morgan Stanley, 2023). The echo chamber effect needs to be addressed as people are constantly fed information by social media algorithms that reassure their biases and preferences and do not challenge them (United Nations, 2023). Political misguided attacks on ESG have increased scrutiny on shareholder proposals and client engagement by companies, there is a lower number of shareholder proposals in 2023 (Morgan Stanley, 2023). NGOs (non-governmental organizations), CSOs (civil society organizations), Institutions and think tanks can play a major role in advocating change and promoting accountability, Young people should be further empowered as they have higher stakes in the future (United Nations, 2023) leveraging social media influence can serve as a means to establish accountability and foster constructive awareness among the general population. Governance of the ESG framework, identification of opportunities, and management of the risks associated with ESG integration need to be actively governed, it further allows for investor transparency, builds quality, and tenacity and further development of strategic business plans (Morgan Stanley, 2023). 56% of organizations claimed that sustainability investments have seen a slight increase of about 6% to 19% in comparison to the year 2022 (Deloitte, 2023).

Tapping into emerging markets: Emerging sustainable markets are large, and the more companies are able to tap into these markets the more long-term Investment opportunities and resultant economic benefits a company can derive. Garnering government support is crucial for successful transitions, as exemplified by India's leadership in the energy transition. Currently, India has about 180 GWH of renewable energy capacity, aiming to reach 450-500 GWH by 2030. Key stakeholders, including developers, state power companies, central authorities, and financial institutions like banks, are actively contributing to the government's vision. They recognize the substantial advantages of this transition, such as reducing carbon emissions and bolstering economic prosperity. Investing in renewable energy is notably more cost-effective than carbon-based sources, aligning with environmental and energy security

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objectives (Morgan Stanley, 2023). If not directly there are alternate requirements and opportunities that government policies create that result in trade pattern shifts such as sourcing large magnitudes of critical raw materials which opens up opportunities for suppliers to enter and bridge this gap where the requirement arises (Morgan Stanley, 2023). Sustainability investments by organizations have increased by over 75% over the past year (Deloitte, 2023).

Certain emerging markets that companies are anticipating a high return potential for results towards the SDG are:

Renewable energy transition investment market, decarbonization (Morgan Stanley, 2023)

Increase in domestic renewable energy capacity encouraging domestic manufacturing (Morgan Stanley, 2023)

Green hydrogen and green ammonia along with emerging innovative sustainable technologies and solutions, such as distributed power in regions with unstable governments (Morgan Stanley, 2023)

Financial investments required for climate change and climate action (Deloitte, 2023)

Investment in sustainability technologies for the present and future (Deloitte, 2023)

Green finance in the form of loans, bonds, and equity investments toward net-zero transition (EY, 2023)

Integrating into the sustainability-shift conversation: Owning the narrative of disclosing sustainability information to investors (Morgan Stanley, 2023) becomes essential for a company in order to garner support as well as create transparency and generate goodwill in favor of a more positive investment outlook that needs to be created. Prioritization of sustainability at a time of disruption (Inflation and Conflict), leaders of organizations are optimistic about the shift and embracing the dynamic environment. 66% of organizations stakeholders/investors are now on board more than ever with rising pressure from the group and changes are visible through the increased investments and action in the sustainability finance space (Deloitte, 2023). Sustainability has also been a contributor in the recruitment of talent into organizations, where they are concerned about a company's contribution in the sustainability front (Deloitte, 2023). A "Just transition" is a concept that has taken flight where companies are working to ensure that in times of challenges and crises, they want to bring everyone along, individuals struggling in the mortgage markets are receiving help and support from companies in terms of their energy bills (Deloitte, 2023).

Organizations are seen to take action in certain areas and receive more than 50% positive results with the implementation and transition with respect to the use of sustainable materials, increase in energy use efficiency, use of climate-friendly or energy-efficient technology/machinery/equipment, and employee training on sustainability. However, on the flip side with a lower percentage of 33% - 49% implementation results in the areas of development of new products and services that are climate-friendly, meeting of specific sustainability criteria by suppliers and business partners, updation and relocation of facilities, tying compensation of senior leadership to sustainability performance, Incorporation considerations into lobbying/ political donations. If companies are able to address the challenges in the lower implementation area it can move the needle towards higher results in sustainability (Deloitte, 2023)

Economic Growth and Development

The extent of development of a country's financial system was found to play a role in promoting and fostering economic growth and development (Moldovan & Andrada, 2015). It can be attributed to funding sustainability causes and a range of approaches that are sometimes used interchangeably to address specific needs. These comprise the use of funds for environmentally harmful companies to support cleaner endeavors and governments seeking financial support for projects that contribute to climate mitigation. Further involves incentivizing counterparties to improve their sustainability performance through financing mechanisms (Caldecott, 2022). Sustainable debt issuance saw a surge in the year 2021 to almost $200 billion (Goel et al., 2022).

However, a recent report published by the UN found that at the midway mark of 2030, a projected global backward trend is seen with respect to progress between the years 2020 to 2023 showing a dire need for attention in order to attain or even be close to the target achievement of sustainable economic growth by 2030 (United Nations, 2023). 50% approx. of the global GDP is dependent on nature, due to the current situation an economic reward loss of $10 trillion is anticipated by 2050 (Morgan Stanley, 2023). Economic outlook and climate change among the sustainability issues were ranked the highest as the most pressing issues that required focus in the upcoming years in the (Deloitte, 2023) report. Organizations are struggling to adopt initiatives with more long-term financial benefits as per the report by (Deloitte, 2023). The sustainability initiatives that are currently implemented see a 40 – 52% benefit in brand reputation and recognition, innovation in offerings and operations, customer satisfaction, employee well-being and morale, and climate change but in order for a shift to occur on a wholistic economic level there should be a higher level of benefit in financial areas such as investor returns, revenue from new businesses, cost of investment, asset values, increase in revenue from a long-standing business, these areas currently stand at a level of 24 – 31% (Deloitte, 2023).

Regulators have been placing a growing emphasis on sustainability reporting, with an increasing adoption of the Task Force on Climate-Related Financial Disclosures (TCFD) and emerging requirements mandating some form of assurance requirements for sustainability reports by companies (PWC, 2023). Transparency by companies will help drive sustainability success where ESG processes, metrics, and systems are important building blocks (PWC, 2023). Approximately three-quarters of surveyed investors would experience a more significant enhancement in their perception of sustainability if it were guaranteed at the same level as companies' financial statements were assured, in line with this requirement the "Big Three" definitive proposals for the transformation of sustainability reporting were issued by regulators, and standard setters of various jurisdictions in 2022. The focus and potential implications of all three proposals are different (PWC, 2023).

European Financial Reporting Advisory Group (EFRAG) – European Sustainability Reporting Standards (ESRS) as part of the CSRD, expected to be finalized by the end of June 2023. Focused on financial materiality and impact materiality and subject to regulatory reinforcement

ISSB – IFRS Sustainability Disclosure Standards, expected to be finalized by the end of June 2023. Focused on financial materiality, subject to individual adoption

The US SEC's Climate Proposal, which is still pending finalization, centers around enhancing and standardizing climate-related disclosures for investors. It places a strong emphasis on financial relevance and is subject to individual adoption

As per a report published by (EY, 2023), green finance is to play a crucial role in the transition of the economy to net-zero, but we see that the concept of green finance is still evolving and takes forms like bonds, loans, and equity investments. International banks are offering green loans, while various investors invest in green bonds to support eco-friendly initiatives. Venture capital firms support sustainable startups. Although it's in its early stages, there's recognition that achieving 'net zero' requires substantial investments, attracting private sector funds for sustainable projects. The Green Social, Sustainability, and Sustainability-linked (GSSS) bond market is growing, reaching $20 billion in India by January 2023.

Enhanced reporting standards like BRSR are expected to boost this market. Energy-efficient cooling presents a $1.6 trillion investment opportunity by 2040. International organizations like ADB and the World Bank are increasing funding for green initiatives in India to promote renewable energy investments and stakeholder confidence.

Conclusion

To conclude, the introduction of SDGs opened up the landscape of sustainable finance and investments., in turn creating a transition with a wide range of opportunities across the globe for companies to take advantage of by tapping into emerging sustainability markets that can help companies generate long-term returns. There is a further shift in focus that is seen where companies are re-aligning to ESG frameworks, and global sustainability reporting standards as well as working towards a more inclusive global sustainable environment where no one is left behind.

There is growth seen in new areas of finance such as green finance, ESG investing, and government policies to support a net-zero economic transition. Organizations further go on to have a more positive outlook when it comes to the prioritization of a more sustainable framework in times of crises such as these, which tells us that we are on the right track toward transition but much effort is needed in order to meet the SDG agenda by 2030 as the midway mark report by the UN does not currently paint a very rosy picture of where we stand at the moment. However, if companies are able to focus on a few key aspects laid out in this paper they will be able to tackle the transition from a more long-term perspective.

Prospective Requirements for Future Research

Some of the suggested further research required based on the current paper outcomes are listed;

Effectiveness of existing sustainable finance policies, deviations, and fixes that can be made in order to re-align with sustainability transition (policies that are working in certain nations can be looked at and compared against a more holistic view/approach). Practical approaches to scale and maintain existing sustainability models. Does standardized reporting help bridge the gap in greenwashing and ensure transparency? Enhanced funding solutions and investment prospects within the environmentally sustainable sector. The development of more positive sustainable synergies with the minimization of the effects of trade-offs in times of crises. Devising organizational initiatives to generate more long-term benefits in areas such as investor returns, revenue from new businesses, cost of investment, asset values, and increase in revenue from a long-standing business.

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