

# A study of Sustainability with special reference to Financial Management

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## Abstract

Sustainability is a concept which states the use of available resources of satisfying the present need without compromising the ability of future generation to meet their own needs. This concept of sustainability applies and affects every aspects of life. This paper studies the role of financial management in the concept of sustainability. Finance is a concept which talks about transfer the funds from the area of surplus to the area of deficit. This paper focuses on socially responsible investments (SRIs) which are considered as most important and prominent factor of sustainable financial management. In this paper we study how the business communities should utilize the finance so that their object will be achieved and they fulfill their social responsible without retaining their surplus fund. This paper also studies the sustainability challenges that the society is facing.

## Keywords

Sustainability, Financial management, finance, sustainable development, corporate social responsibility, financial market.

## Introduction

Every industry in environment is doing business for achieving some goals and objectives. Sustainability is the integrated concept of three aspects: economic, social and environmental. Industries are using resources from environment and therefore they are socially responsible to not only environment but also to every component of micro and macro economy. Sustainable development means that current and future generations should have the resources they need, such as food, water, healthcare and energy, without stressing the Earth system. (RAWORTH, 2017). Financial management is the efficient and effective use of finance for achieving the objective of business. We are talking about sustainable financial management, as we discuss the concept of sustainability; the financial management plays a major role. The financial management aims at allocating finance to area where it is required, further that allocated finance needs to be control i.e. where the company is using the fund. Business firms should inculcate the sustainability plan in the vision, mission statement and the strategic plan. The main objective of incorporating sustainability in strategic plan of business is:-

- a) To create long term economic sustainability,
- b) To generate values through a system of corporate social responsibility,
- c) To generate values through environmental management.

Sustainable financial management considers the interaction of finance between with the social, economic, environmental issues. Investor can exert influence over the companies they invest in towards sustainable business practices. Over the few decades the sustainable finance has go through different stages. The concentration is shifting from short term profit to long term profit creation. The business adopting sustainable business practices can only survive in long run and able to earn to create long term profit and win stakeholder's confidence.

### **A framework of sustainable finance:**

As the preceding survey on finance, ethics and sustainability has demonstrated, finance and capital market theory lack an explicit and integrated paradigm which could justify a term "sustainable finance". Finance, on the one hand, is still predominantly operating in the traditional neoclassical understanding as an ethical value-free discipline. On the other hand, academic, political and business awareness of sustainability has emerged at the firm level. Beside the so-called business case of sustainability, a growing number of investors, asset managers and financial intermediaries are willing to integrate sustainability criteria into their asset management processes. The financial industry is viewed as one of the fundamental stimulators for firms to adopt responsible and sustainable policies referring to environmental, social and governance goals. So far, the generally accepted term "sustainable finance" is just at the beginning of its evolution. A mere semantic combination of sustainability and finance would be misleading as there exists no general understanding of such a term. It is also not yet introduced and well-defined in academics. Soppe (2004) talked of "Sustainable Corporate Finance" when he discussed in his contribution the possible links between the concept of sustainability and traditional finance. It transmits mechanism between finance and sustainability, with a strong emphasis on financial intermediaries. He avoids creating any term with respect to sustainable finance and instead refers to socially responsible investments (SRIs). Indeed, this term seems to be the one most often used in academics and practice used the term in connection with banking that is related to ecological, social and governance criteria. Sustainable finance, therefore, is at first glance, best associated with the term SRI, which itself is interpreted and used variously. In the following section, the different approaches to definitions of SRI will be discussed.

### **Corporate sustainability and responsibility – a twin challenge to finance**

Capital market theory commonly envisages shareholders as the dominating stakeholders due to their property rights and their liability in the case of a default. Next to debt holders, they both provide the necessary liquidity for

the functioning of value which creates processes in firms. Both groups of stakeholders base their investment decisions on the strict quantitative trade-off between expected return and risk, outlined in models of standard capital market theory. As these models are commonly judged as (ethical) value-free, shareholders and debt holders are assumed to solely maximize their utility in the Fisherian sense, i.e. they maximize the income streams out of the firm to satisfy their impatience to consume. Moreover, such a notion of the firm as an ethical value-free cash flow generation system fits well with the ignorance of external negative effects caused by the production processes of a firm and its output. Managers are expected to act as agents of shareholders and debt holders to satisfy their income demands, disregarding the interests of third parties. In this sense, managers do not have to worry about the social or environmental costs of their work. Such a conception of management in terms of agency theory implicitly adheres to teleological ethics. The acceptance of a social responsibility by companies other than to make as much money for their stockholders as possible. Friedman refers to manager-led firms listed on the stock markets. He was not only worried about possible agency costs but also afraid of a disturbed social freedom if socially responsible managers would interfere in the labour division between the public and private sectors. It was Freeman (1984) who made the point about stakeholders as new target groups beside shareholders. Until then, agency theory ignored stakeholders, like employees, customers or non-government organizations (NGOs). But in the 1990s convictions rose that stakeholders might affect business objectives, can be critical for a firm's financial success and contest the shareholders' demands on a firm's free cash flows. The discussion about the role and the impact of stakeholders paved a path to sustainability that is currently dominating the academic discussions and efforts in practice – the responsibility of a firm, i.e. its management, to provide and sustain a socially and ecologically habitable environment. Comparable to the broad variety of interpretations of the term “sustainability”, the definitions of corporate social responsibility (CSR) are also manifold. With the concepts of CSR and sustainability at the firm level (corporate sustainability), a twin emerged in the last twenty years which in principle is different but very similar in the way they are materialized. At the firm level, it encompasses policies to manage additional non-financial environmental, social and governance objectives. To formulate ESG objectives and strategies and to derive appropriate activities for a firm is in most parts stakeholder-related and dynamic. A firm builds up social capital which can be an important part of a firm's strategic dynamic capabilities. In turn, it should allow the exploitation of future competitive advantages and generate higher cash flows. Stakeholder theory then addresses the question whether there exists a link between corporate social performance (CSP) comprising the measured quality of stakeholder management and corporate financial performance (CFP), gauging the financial success of the overall business.

## Selected areas of sustainable finance

This section focuses on firm-issued shares, bonds and related assets like indices. With respect to the capital markets, at present, nearly each asset class can serve as a vehicle to carry ESG criteria and to enforce impact. Capital markets offer SRI embodied in exchange traded funds, hedge funds, index linked bonds, life insurance contracts, sovereign bonds, private equity, venture capital, money market funds and bank deposits. Besides these financial market-related assets, in the following sections, an overview will be given about areas, which play a special role in sustainable finance. One category belongs to emerging (non-quoted) asset classes in SRI markets that are related to real investments like forestry, timber or real estate. The other category focuses on microfinance, besides investments in social business a representative of a combination of philanthropy and investing that intends a very direct and social impact. The residual part is devoted to an outline of further areas which have an intersection with sustainable finance but either have established an own research program (like carbon finance) or belong to established research fields (like valuation of the firm). Given this medium positive correlation, interesting questions could be how to find those firms that show the win-win effect in order to invest in them. The challenge in the future will be to find those firms that guarantee both, high financial and social returns.

## Carbon finance

The term carbon finance has been evolving since the Kyoto protocol was ratified in many countries after its proclamation in 1997. The core of the Kyoto protocol is the so-called flexible mechanism with three types which enabled the establishment of special carbon markets especially in Europe. Two of the flexible mechanisms are project-related. With the Clean Development Mechanism (CDM), Certified Emission Reductions (CER) can be created with projects which reduce green house gas (GHG) in developing countries. The Joint Implementation Mechanism (JI) allows the generation of Emission Reduction Units (ERU) with GHG-reducing projects in industrialized countries. Both reductions can be traded as Assigned Amount Units (AAU) of emission certificates at ex-changes according to the EU-Emission Trading Scheme (EU-ETS) which was installed in 2005. The EU-ETS belongs to the third type of flexible mechanism of the Kyoto protocol, the International Emissions Trading (IET) (United Nations Framework Convention on Climate Change 1998). For firms especially in the carbon-intensive sectors, the emergence of GHG-induced climate change, new regulations to reduce GHG emissions and the activities of NGOs towards climate-friendly policies have transmitted carbon subjects into the strategic and operational focus. New financial risks and opportunities occurred, with an increasing impact on balance sheets. New market-based instruments have been made available to cope with the new generation of carbon risks and to achieve environmental objectives. Carbon finance also encompasses investment opportunities in GHG emission



reduction projects and the creation of financial contracts tradable on the carbon markets. The privately initiated Carbon Disclosure Project (CDP). There are some institutional investors who address to firms the demand to make their climate risks transparent and to reduce their GHG emissions (CDP 2012). Another strand of carbon finance is the valuation of projects in the fields of renewable energy, their interaction in energy parks and the valuation of energy

## The role of financial system

The following are the functions of financial system

- Produce information *ex ante* about possible investments and allocate capital;
- Monitor investments and exert corporate governance after providing finance;
- Facilitate the trading, diversification, and management of risk;
- Mobilize and pool savings;
- Ease the exchange of goods and services.

The first three functions are important for sustainable finance. The allocation of funding to its most productive use is a key role of finance. Finance is therefore well positioned to assist in making strategic decisions on the trade-offs between sustainable goals. While broader considerations are guiding an organization's strategy on sustainability, funding is a requirement for reaching sustainable goals. Finance plays this role at different levels. In the financial sector, banks, for example, define their lending strategy regarding which sectors and projects are eligible for lending and which not. Similarly, investment funds set their investment strategy, which directs in which assets the fund invests and in which assets not. The financial sector can thus play a leading role in the transition to a low-carbon, circular economy. If the financial sector chooses to finance sustainable companies and projects, they can accelerate the transition. In terms of monitoring their investments, investors can also influence the companies in which they invest. Investors thus have a powerful role in controlling and directing corporate boards. The governance role also involves balancing the many interests of a corporation's stakeholders, including the interests of the environment and society. A rising trend in sustainable investment is engagement with companies in the hope of reducing the risk of adverse events occurring in those companies. Finance is good at pricing the risk of future cash flows for valuation purposes. As there is inherent uncertainty about environmental issues, risk management can help to deal with these uncertainties. Scenario analysis is increasingly used to assess the risk and valuation under different scenarios. When the potential price of carbon emissions in the future becomes clearer, investors and companies have an incentive to reduce these emissions. The key challenge is to take a sufficiently long horizon, because sustainability is about the future.

## Conclusion

Sustainable finance evolved primarily for the motivation of an increasing number of investors with an objective of making investments. The rational behavior and frictionless capital markets assumptions reduce financial transactions and allocations on capital markets to a quasi automatism. To overcome the distinguish principle between finance and investment, the investors intention is motivated by certain non-monetary objective. The breadth and frequency of studies sustainable finance reflect that sustainability issues affect many parts of economics and even finance. It is remarkable that in some of those fields, like in real estate and energy, researchers in finance could rarely be found. Every firm should include the concept of sustainability not only in finance but also in every aspect of society. Business takes from environment so it is their responsibility to give in return to it. Firms should use the resources as much as they need to satisfy their need and they are expected to preserve the resources for future generation.

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