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Green Finance. Some Considerations

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1. *Introduction*

In recent years, there is a greater public involvement and growing pressure on firms and financial institutions to behave more responsibly and sustainably.
An important step in this direction is the integration of ESG factors into corporate strategies and investment decisions. Sustainability and social responsibility are key factors for the long-term success of firms, and the adoption of sustainable practices can lead to tangible competitive advantages, such as a better reputation, the attraction of informed investors and greater customer loyalty, as well as being an ethical responsibility. This practice has also proven to be beneficial from a financial point of view. In fact, new financial products, such as sustainable investment funds and green bonds, have further fueled interest in sustainable investments, as well as the adoption of ESG criteria in many stock exchanges around the world.
The aim of this work is to verify the concrete existence of green finance. After a brief historical excursus on the topic (par. 1), the performance of green finance is analysed from a theoretical point of view (par. 2). In par. 4 the tools and some law-indications are identified and in par. 5 some conclusive considerations are drawn.
Keywords: *Green Finance*

2. Historical Reconstruction

When we talking about finance and investments, terms such as yield, return on capital and profit are frequently used. But, in recent years, a movement is spreading made up of investors who also care about the destination of their money, the so-called "socially responsible" finance. Initially, the phenomenon was defined as ethical finance, a term that over time has fallen into disuse as it seemed able to support the idea of finance even non-ethical. Since there is no univocal definition of "socially responsible" finance, nor a legislative framework of reference at an international level, this concept appears broad and includes very different products and actors. In general, socially responsible finance includes three main models of alternative use of money compared to traditional categories: microfinance, aimed at making financial resources available to subjects who are not able to provide the guarantees typically required by traditional banking channels; financing of non-profit initiatives concerning the third sector; socially responsible investment, or that particular form of differentiation of assets managed according to lines of social and environmental responsibility.
Green bonds, having a low rate of return and high associated risks, were initially not considered attractive by investors. Over time, however, a market of environmental, social and government ESG bonds has developed. The ESG bond market can be examined from different perspectives. A first aspect concerns the effects that sustainable finance has on the value of firms. ESG bonds are more expensive than standard bonds; in fact, they involve a higher cost due to the certification - by a third-party and independent auditor - of the compliance of the bonds with ESG criteria. However, they denote the company's attention to transparency and can favor an increase in the value of the firm over time thanks to reduced information asymmetries. Furthermore, ESG bonds could represent an interesting source of financing. Finally, the

attention to ESG aspects expresses not only an ethical constraint, but also a means to improve resilience and performance in a sustainable and socially responsible way. Therefore, it can be argued that ESG investments are a driver of change and innovation; firms seek to coordinate their corporate objectives with broader objectives of social well-being and environmental sustainability, a choice that allows them to support growth and competitiveness and achieve sustainable financial returns. The attention also to the non-financial conditions that characterize corporate activity expresses the awareness by firms that their financial performance cannot be separated from their environmental, social and governance responsibilities and activities: the value, risk and opportunities of a company are the result of the combination of financial and non-financial aspects. In fact, the integration of financial and non-financial reporting allows a complete holistic assessment of the firm and its commitment to transparency, responsibility and sustainability. This information is also very important for investors, historically more interested in financial returns, as it provides a more complete view of the companies in which they invest, their environmental, social and governance impacts and their choices.

3. Green Financial performance

Over time, funds focused on ESG-conscious companies have been a safe bet for investors. Sustainable investing and environmental, social and governance factors have become mainstream, with institutional investors using ESG data to identify risks and opportunities that are not captured by traditional financial analysis. This would confirm that sustainability has an impact on a firm's long-term financial performance. Sustainability-conscious companies achieve superior financial performance (McKinsey and NYU), confirming the existence of a positive relationship between ESG and financial performance. It can be deduced that sustainability, in addition to being an indicator of corporate social responsibility, is also a driver of value. A strong commitment to ESG can lead to better financial performance through several mechanisms: companies focused on good governance have reduced the volatility of stock returns and reduced the risks of bankruptcy. At the same time, firms attentive to reducing environmental and social risks have lower costs, greater operational efficiency and a better reputation. Integrating the sustainability report with the financial report is therefore not only a regulatory obligation, but a tool that allows the entire corporate structure to be reconfigured as a productive and sustainable system. In this way, compliance with sustainability regulations is more than a cost; it is a tool that allows an upgrade of the entire corporate structure. This will allow sustainable investments and finance to grow; banks' decisions on investments, loans and risk management will therefore also be based on the consideration of ESG factors. Furthermore, banks will have to offer sustainable finance products and services to meet growing customer demand and this could lead to the emergence of new financial instruments and products that support sustainable investments such as different types of green bonds, social bonds, etc. In this regard, it should be considered that ESG bonds represent a financial instrument with multiple potentialities. In fact, they are debt securities whose profits are invested by the issuer for a variety of environmental, sustainability and social objectives (improvement of energy efficiency, reduction of CO_2 emissions, protection of workers). The growing consideration and presence of these instruments in all financial markets testifies to their current and potential relevance.

Socially responsible investment (Eurosif -the European Social Investment Forum) obtains both financial and social returns through different criteria:

• inclusion of ESG factors in traditional financial analysis through a structured process based on appropriate research sources;

• identification of the best investments (best in class): without proceeding to any exclusion, the firms, sectors or countries that present the highest performance with respect to ESG criteria are selected;

• impact investing, referring to all investments in companies and organizations committed to producing an environmental or social impact in addition to a positive financial return;

• considerations based on exclusionary principles, in particular referred to socially responsible mutual funds, which imply the elimination of subjects, sectors or countries characterized by conduct considered harmful to society (production of alcohol, tobacco, weapons, gambling, pornography);

• active shareholding, which involves the creation of a continuous and systematic comparison between management and investors to guide mutual choices based on ESG parameters;

• thematic investments, focused on certain market niches, mainly consisting of green funds, operating in the sectors of environmental protection, alternative energy, water resource management or health.

Experts are focusing on the financial results of sustainable and responsible funds, which would soon be marginalized in the event of unattractive returns, since socially responsible investors do not seem willing to endure an ethical sacrifice. However, to date, the relevant data do not highlight significant differences in profitability between socially responsible funds and non-socially responsible funds. This circumstance explains the growing presence, in the markets of the main developed countries, of socially responsible funds, the only ones suited to aligning the financial focus and the social orientation of investors (Redondo Alamillos & de Mariz, 2022). In practice, compliance with ESG criteria promotes corporate performance both in purely social terms, influencing the allocation of resources and building customer loyalty (Boffo & Patalano, 2020), and in financial terms, increasing corporate value and profitability. Above all, the S (social) criterion has a positive correlation with corporate performance; attention to social practices increases brand image and customer loyalty, resulting in subsequent increases in market value that instead appear less connected to the governance criterion G (Boffo & Patalano, 2020).

Green bond markets can play a key role in financing the transition to a low-carbon economy and more sustainable growth (Sartzetakis, 2021). In particular, ESG securities are set to be a key financial instrument to channel financial resources towards green, sustainable and social projects. ESG securities are traded and offered mainly in the United States and China, while in Europe, in this sector, Germany and France stand out, mainly due to government influence. The expansion of the offer of these financial instruments is demonstrated by their greater weight in the assets of financial intermediaries. In particular, institutional investors are using ESG data to identify risks and opportunities that are not perceptible through traditional financial analysis. This shift reflects a deeper understanding that sustainability issues can have a significant impact on a firm's long-term financial performance. According to Riedl and Smeets (2017), social motivations have a greater impact than financial ones on socially responsible investment decisions, and in some cases, sustainability focus is considered a positive predictor of future financial performance, even in the absence of concrete evidence (Hartzmark and Sussman 2019).

4. Sustainable Finance: Tools and Legislative Indications

Given the positive relationship between sustainability and the economic and financial performance of the company, it is worth considering whether and how sustainable management can help reduce the financial risks associated with climate change or non-compliance with environmental regulations, and at the same time foster opportunities for growth and innovation. Climate change could produce income differences between territories, people and sectors, influence inflation, increase innovation, migration and public debt, alter energy markets and put pressure on financial markets. The latter, together with institutions, could also help the green transition by supporting climate-friendly investments. Among the tools that can be used are green financial bonds and portfolio allocation. In fact, more and more large institutional investors are taking inspiration from ESG criteria to change the allocation of bank credit in favor of green assets compared to carbon-intensive ones (Giglio et al., 2021). The banking sector plays a special role in the green transition as a strategic source of financial support for companies, as banks can direct credit to green companies. Some studies (Degryse et al., 2020; Kacperczyk and Peydro, 2021, Altunbas et al., 2021) highlight that banks' green commitments impact carbon emissions through the reallocation of credit from carbon-intensive to green firms, while loans granted to carbon-intensive firms to support the investments needed to reduce carbon emissions are less effective. Large non-bank institutional investors also play an important role in the green transition, as they manage a huge (and growing) number of investments. While mutual funds classified as low sustainability are abandoned by investors (Hartzmark and Sussman, 2019), the competition between funds is between investors with ESG preferences, who choose to finance more climate-conscious companies (Ceccarelli et al., 2020). The growing interest in sustainable and socially responsible investments has been reflected in a growing demand for green bonds considered compliant with the ethical values spread in public opinion. The Global Risk Report (2019) highlights the different environmental, social and technological, rather than economic, nature of the main risks, as well as their frequency and impact. This situation has made companies increasingly aware that their competitiveness requires the ability to manage these emerging risks. Society has also become aware of the new risks and needs and has adopted consequent consumption and investment choices. In this context, the new Sustainable Finance Strategy and the Action Plan on Sustainable Finance of the European Commission already include in 2021

- a taxonomy of sustainable economic activities, a necessary condition for orienting investments towards sustainable activities;
- a regulation requiring institutional investors and asset managers to publicly disclose how environmental, social and governance factors are integrated into their business activities and investment decision-making processes;
- the introduction of a new category of low-carbon benchmarks to help investors distinguish the carbon impact of their investments.

In this context, green bonds are attracting the interest of investors who want to diversify their portfolios by investing in projects with a positive impact on the environment. In addition to the signaling and reputational benefits that characterize them, they also have specific costs, represented by a more complicated compliance with market standards. Furthermore, a failure to allocate green bonds or the failure to achieve the expected environmental objectives could lead to further reputational costs. Over time, investors have begun to evaluate, in addition to the usual financial aspects (credit quality of the issuer, price, coupon, maturity), also the environmental content of the projects to be financed. In relation to this aspect, certifications carried out by independent third parties are particularly relevant, which improve the environmental and reputational impact of the company (Flammer 2021). A problematic aspect is the scarcity of data available so far, due to the recent affirmation of this market, to guide the choices of investors, who, therefore, still appear unwilling to take the risk (Bowman 2022). However, the growing importance given to sustainable and socially responsible investments has led investors to integrate ESG factors into their strategies.

5. Conclusions

The debate on climate and sustainability has often put firms under fire for pursuing profit without considering the consequences for the climate and society. Firms have responded in various ways: for example, already in August 2019, the Business Roundtable association, which brings together the CEOs of major US companies, declared that the purpose of the company is the creation of value for all stakeholders, not only shareholders but also customers, suppliers, employees and communities, contravening, driven by the global concern for economic, social and environmental sustainability, the thesis of Milton Friedman, who in 1970 argued that the purpose of the company should be exclusively profit.

Many large global financial firms have committed to fighting climate change, earning a credible environmental reputation. Before the regulations came into force, sustainable practices were adopted on a voluntary basis by a small but growing number of firms. These choices can be traced back to ethical reasons, to the existence of external pressure from regulators and stakeholders and to considerations of economic convenience, given the usefulness of displaying a solid reputation for sustainability on the market to access key resources such as credit, insurance premiums, participation in tenders and talent attraction. The most interesting aspect of these signs of change is that perhaps ethics and business can really meet, simply by changing the time perspective. In fact, if in the short term the objectives seem to be in conflict, in the long term the interests of stakeholders coincide with the interests of the firm and therefore with those of shareholders. However, the recent withdrawal of some units from their environmental commitments has called into question the authenticity of their sustainability objectives and their ability to resist external pressure. In the debates on this topic it has clearly emerged that for many firms the commitment to environmental sustainability has been driven more by reasons of image than by sincere conviction. Defining a transition economic model compatible with sustainable growth is therefore a key objective for policy makers, economic agents and financial markets in the coming years, an objective full of unknowns and difficulties, but essential, since the growing attention to environmental sustainability, social responsibility and corporate governance has changed the way firms operate and are valued by financial markets.

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