LIMITS OF GREEN FINANCE: A LITERATURE SURVEY IN THE CONTEXT OF GREEN BONDS AND GREEN LOANS

In 2021 Professor David Gilchrist and Dr. Rui Zhong from UWA Business School, The University of Western Australia, and Dr. Jing Yu from The University of Sydney Business School, published a systemic literature survey on the factors and potential benefits of corporate engagement in environmentally responsible practices in the context of green bonds and green loans.

In response to the rapid development of green finance the ADGM Academy Research Centre engaged Dr. Yu to write a summary of the research. The study highlights three key findings relevant to green investing and academic research in this field:

- Environmentally responsible practices not only enhance shareholder value but also benefit non-financial stakeholders.
- Green bonds and loans have experienced significant growth in the past decade. While there is extensive research on the corporate green bond market, there is still a knowledge gap regarding the drivers and consequences of green loans.
- There is a need for global efforts to adopt consistent definitions of corporate green activities and reconcile multiple ESG (Environmental, Social, and Governance) rating practices, with a focus on industry-specific activities.

The acceptance of global warming as a critical policy area by governments worldwide has increased the demand for solutions. Balancing economic growth with ecological sustainability is a crucial concern for both developed and developing countries. Sustainable investing has grown exponentially, attracting USD 35.3 trillion in 2020[1], driven by investor concern for global environmental sustainability and the need for businesses to retain their social license.

However, the rapid expansion of green finance has posed challenges. Questions arise regarding the primary purpose of corporations and how to balance profitability with broader sustainability commitments. The trade-off between economic growth and social priorities presents a challenge for corporate boards. The field of social investment is complex, with varied opinions on its development and operation. There is a growing literature focused on various aspects of sustainable investing, including debates on whether the global finance system is the best avenue for promoting ecological sustainability. It is essential to understand the economic and financial implications of corporate greenness and corporate social responsibility within the context of green bonds and green loans.

The research aims to identify key questions and opportunities for investigating the phenomenon of green finance. By finding solutions that reduce complexity and promote the development of a green economy, the objective of ecological sustainability can become a reality.

WHAT MOTIVATES FIRMS TO MAKE ENVIRONMENTAL COMMITMENTS?

Evidence shows that sound corporate environmental performance creates value. There are two significant benefits of corporate environmental engagement: insurance against future environmental disasters and building social trust with local communities, including customers, suppliers, and governments.

Companies can establish a green reputation to attract investors using various mechanisms. The focus of this study is on two fast-growing markets: green bonds and green loans.

GREENING THE ECONOMY BY GREENING THE FINANCIAL SYSTEM - GREEN BONDS

Greening the financial system is a crucial first step towards greening the economy itself. The concept originated from the G20 Summit in 2016. Research documents the mixed influence of green labels on corporate bond spreads, which can be explained by two competing motives for issuing green bonds.

Firstly, there is a financial motivation, with the expectation of higher performance and lower risk. Studies highlight a significant pricing premium associated with corporate green bonds compared to conventional bonds in the Chinese market. This premium is more pronounced for issuers with better corporate social responsibility (CSR) performance. Better CSR performance is linked to higher financial performance and lower risk. International green bond analysis indicates that companies issuing green bonds experience increased long-term value and operating performance, attracting long-term green investors and fostering green innovations.

[1] Global Sustainable Investment Alliance (2021)

The second motivation is non-financial, driven by social preferences and signalling that motivates investors to hold green assets. Non-financial motives result in a small negative premium between green and conventional bonds in the sample of international green bonds.

GREENING THE ECONOMY BY GREENING THE FINANCIAL SYSTEM - GREEN LOANS

Similar to green bonds, green loans are bank lending and investments designed to support the transition to a net-zero carbon economy through environmentally responsible projects that mitigate climate change. Major US banks, such as Wells Fargo and Bank of America, started dedicating resources to sustainable entrepreneurship as early as 2017. Since then, the use of green loans has grown exponentially (figures 1 and 2), with a total value surpassing USD 35 trillion as of 2021. Hong Kong SAR (China), Australia and Japan are the top countries issuing green loans.

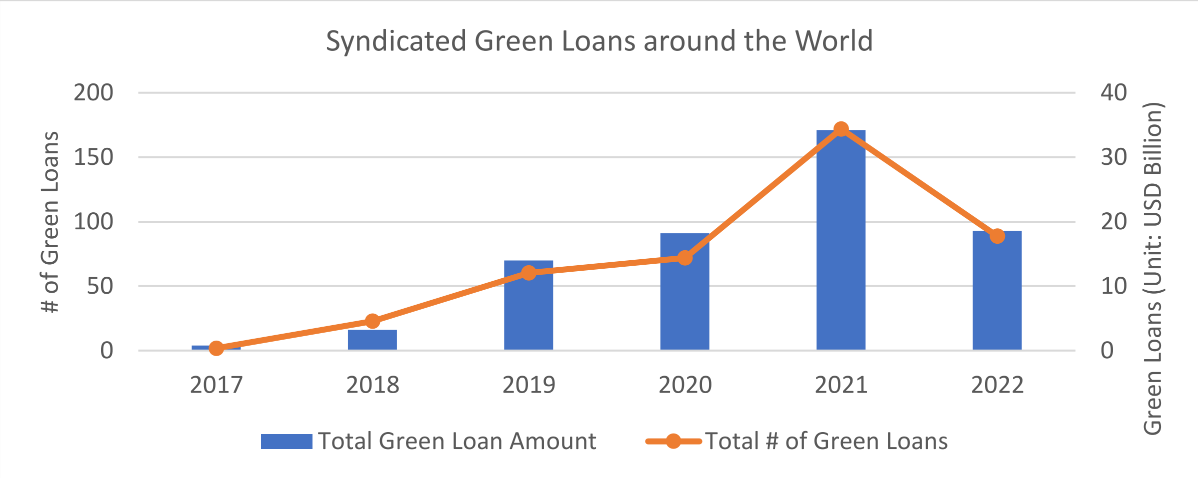

Figure 1. Growth of Syndicated Green Loans Globally (syndicated loans data from Refinitiv Loan Connector)

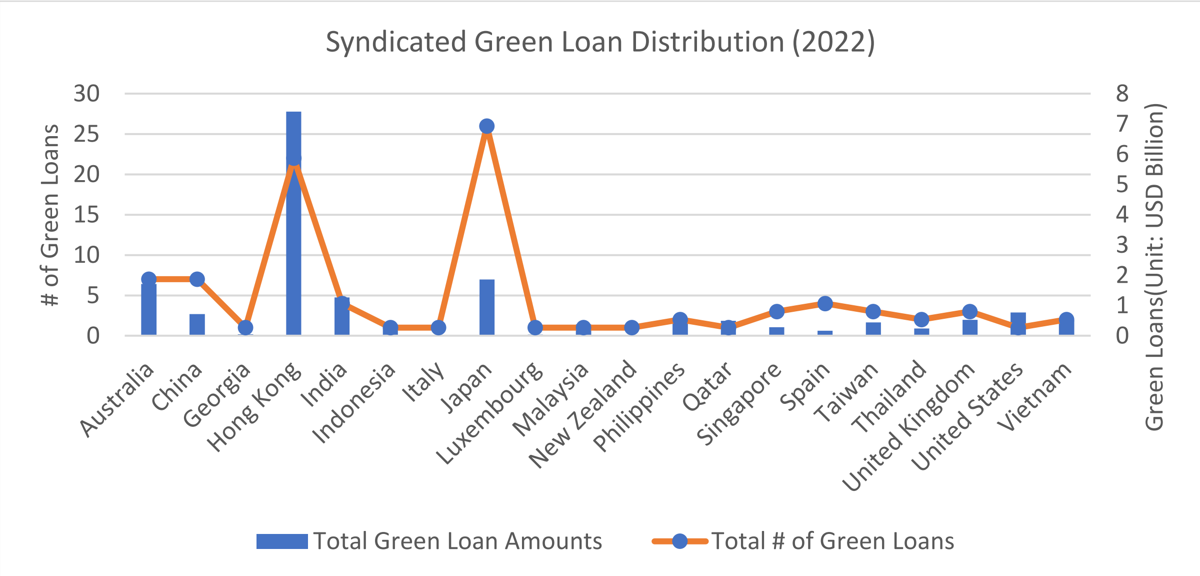

Figure 2. Syndicated Green Loans by Country (syndicated loans data from Refinitiv Loan Connector)

OPPORTUNITIES FOR FUTURE RESEARCH

There are several gaps in the existing work, which present opportunities for further research:

1. Most corporate environmental performance research focuses on a single-country setting, but country characteristics significantly influence corporate environmental behaviour.

2. While some studies examine the economic consequences of corporate environmental disclosures, there is a lack of examination regarding the actual content of these disclosures. This is crucial because there is no universally accepted guidance for companies, especially multinational ones operating in multiple jurisdictions, regarding their environmental performance disclosures. The introduction of the EU Taxonomy regulation in June 2020 is expected to have far-reaching implications, not only for companies operating in the EU but also for the development of a global reporting framework for corporate green performance. Research on these disclosures, aided by advanced textual analysis, informs regulators about the material environmental information that matters to shareholders and non-financial stakeholders.

3. A comprehensive evaluation of various rating systems is necessary to unify rating differences and focus on socially and financially material issues for investors. Some rating systems rely on corporate sustainability disclosures, while others track the impact of corporate environmental activities. It is recommended to prioritize corporate activity and identify specific environmental risks at the industry level.

4. To promote the global development of green finance through green bonds and loans, it is crucial to have a global framework that defines what qualifies as "green." Different jurisdictions face different environmental problems, leading to divergence in green definitions across countries based on their economic development stages and cultural tendencies.

Despite these challenges, the research highlights several important benefits of green finance for corporations and emphasizes the growing enthusiasm of market investors for green capital. To advance green financing, global efforts are needed to ensure market progression without market segmentation, improve consistency and transparency, align with materiality, and maintain global investor confidence.

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The original paper can be downloaded here:
https://www.mdpi.com/2071-1050/13/2/478