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The need for sustainable finance

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THE NEED FOR SUSTAINABLE FINANCE

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Bringing about sustainable or 'green' finance requires a convergence of policy and profitability – and it's not just the developed countries that are leading the way

It is estimated that between US$5-7 trillion of investment in green infrastructure globally would be required to mitigate the effects of climate change globally in order to meet the goals of the 2015 Paris Agreement.[i] It is clear that public finance cannot play a major role in funding this amount—the answer must lie in the private sector. However, goals for financial sustainability are often out of alignment with profitability goals in the real economy.

The Bank of England governor, Mark Carney, has stated that "there is a need to reset the financial system" so that the finance industry will be able to constructively help achieve the goals as set out in the September 2015 UN Sustainable Development Goals by 2030.[ii]

This is more than simply redeploying funds to support sustainability initiatives. It is about taking concrete action to develop solutions to current problems in sustainability. Financial innovation is emerging through the efforts of multiple players in the financial system, such as central banks, stock exchanges and accounting bodies. Much of the innovation is coming from the emerging economies in Asia, Africa and Latin America, such as Mongolia, Kenya and Bangladesh.

A COLLABORATIVE APPROACH

Green finance serves the interests of a sustainable society. The Sustainable Stock Exchanges (SSE) initiative is one example how regulatory bodies work with the private sector to bring about awareness and discipline with regard to sustainability practices. The SSE was founded in 2009 to introduce non-financial reporting for listed companies, encompassing environmental, social and corporate governance (ESG) dimensions.

This promotes corporate social responsibility on one hand, and the other increases business reporting transparency to encourage sustainable investment.[iii] 61 participating stock exchanges around the world, with a combined market capitalisation exceeding world GDP, collaborate on the following to encourage sustainable finance: teaching listed companies how to take part in sustainable reporting, issuing guidelines for ESG reporting, and sharing best practices on how private funds can be made available for sustainability projects e.g. ‘green bond’ issuance.

In Kenya, other than marathon runners and safari tours, one other thing the country is famed for in certain circles is peer-to-peer mobile payment platform M-PESA. M-PESA came about in 2008 in response to people having to send information and money to those in the Nairobian slums during the chaotic post-election period. From there, the system became increasingly adopted and widespread. **Nuru Mugambi**, Director of Communications and Public Affairs, Kenya Bankers Association, shared,

“The platform was so successful because the political economy and the culture were in place. In Kenya, before, M-PESA, if you wanted to send someone money, it would mean a five- to ten-hour drive. Now, it is done very quickly. We also have the culture to send money, whether it is to help pay for hospital bills or to send someone to school. So, Fintech exists in the context of society, and also whether innovation is accepted.

“Initially, the banks saw M-PESA as competition. But the central bank gave the approval for M-PESA to proceed on an experimental basis. Now, banks see M-PESA as coopetition, using M-PESA as a point of leverage to extend credit and other services.”

The financial innovation of M-PESA has brought about unexpected social benefits to Kenya. The privately-run M-Kopa, which was able to receive instalments payments through the platform, started offering solar energy in electricity-starved parts of the country. Mugambi recounted, “Regulation is behind innovation. M-Kopa was struggling to get capital because investors could not understand its cash flows and the product.”

Regulatory policy partnered with market innovation has thus helped to spur some businesses to bring about social good.

Making green finance sustainable

Piyush Gupta, CEO of DBS Bank in Singapore, notes that the interest in green finance has escalated in recent years due to the confluence of two factors. “Technology such as artificial intelligence has changed the economics of the world today,” he explained. “Previously, driving a sustainable development agenda was not supported by commensurate return on capital invested. Today, financial inclusion is more compelling both from a distribution and credit standpoint. Shareholders can be convinced to provide capital.”

The second factor driving green finance to greater importance is that sustainable development has been put firmly on the agenda. Gupta elaborated: “Sustainability was not on the DBS board agenda till two years ago. Now we have issued our own set of ESG guidelines and have been spending a lot of time thinking about it.

“Singapore, which wants to be the Fintech hub for Asia, has also done quite a lot in terms of regulatory development, such as the Monetary Authority sandbox. We’ve also built up platforms for financial inclusion and credit underwriting. Fintechs, banks and startups are starting to work together to solve problems.”

The road ahead

Simon Zadek, Visiting Professor DSM Senior Fellow in Partnership and Sustainability at SMU, talks about repurposing existing private sector products and services to support sustainability initiatives. Ant Financial, the Chinese payments platform which focuses on individuals and small businesses, has a wide reach. It has an estimated 600 million users, processes 170 billion transactions a year, and on days such as Singles’ Day, can peak at 83,000 transactions a second.

In 2016, Ant Financial leveraged on its extensive coverage and big data store to offer a green finance feature on its payment app. Working with the China Beijing Environmental Exchange, the company was able to calculate the carbon footprint for each of its users through their mobile usage.[iv] Users would be rewarded with carbon credits for performing better compared to their baseline carbon footprint.

“In the first three months of the service, 50 million people signed up,” Zadek says. “Carbon can be integrated into social identity formation through social media. Ant [Financial] has acquired a liability to plant a million trees.” This is a prime example of how private companies can repurpose technology for public good outcomes and public gain technologies.

It is important to note that the pursuit of sustainable finance at the end of the day is a strategic choice by governments, dictated by the political economy. On one hand, investors could be educated to fund, say, more renewable energy compared to coal. On the other hand, governments may decide that building a new coal plant could be the answer to creating more jobs. Policy and pricing need to go hand in hand; and regulators and the private sector will need to be aligned in order to collaborate on sustainability.