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Sustainable Investment Funds And Their Impact On Financial Market Performance

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Introduction

Over the last several years, there has been an increase in the significance of sustainable investments in the realm of global financial decision-making. The awareness of environmental, social, and governance (ESG) factors has increasingly led investors to integrate sustainability into their investment strategies. Pakistan, a developing nation with a rapidly expanding financial sector, describes a unique opportunity to explore the outcomes of ethical investment.

The prevalence of poverty, malnutrition, inadequate access to healthcare, and lower literacy levels are concerning indicators that a significant proportion of individuals, particularly in developing and underdeveloped nations, are experiencing substandard social conditions (Schoenmaker, 2018). In addition to social obstacles, global communities, and enterprises are confronted with significant environmental deterioration across multiple domains. In particular due to the increasing scarcity of water, air pollution and environmental degradation that is affecting our ecosystems and threatening human civilisation, the world seems about to reach a number of critical junctures. Meanwhile, efforts to establish a circular economy must be more consistent and well-coordinated. Environmental and climate change was ranked the top long-term global issue in the World Economic Forum's 15th Global Risks Report. The escalating social, environmental, and climate risks pose a significant threat to biodiversity, potentially resulting in its depletion for present generations and posing a formidable challenge to the future survival of humanity. According to Raworth (2017), only by pursuing sustainable development we can guarantee that future generations will also be able to live comfortably with enough supplies of food, water, medical care, education, energy, and clean air. Stoddart et al. (2011) posit that sustainability refers to allocating natural resources efficiently and justifiably within and between generations. According to Scholtens (2006), finance plays a essential role in facilitating the performance of the economy. Its primary function is efficiently allocating funds to the most productive

users, aiding in strategic decision-making. At a broader level, finance may also contribute to an company's sustainable aims by balancing tradeoffs, as Schoenmaker and Schramade (2018) highlighted. According to Scholtens (2006), the field of finance has the potential to impact businesses' environmental and social responsibility practices. Monitoring finance is deemed crucial as it constitutes a fundamental production element, necessitating the optimal utilization of financial resources to attain sustainable development. The conventional finance paradigm emphasizes the assessment of financial gain and potential hazards, whereas sustainable finance prioritizes holistically evaluating social, economic, and environmental advantages (Falcone & Sica, 2019). According to the International Finance Corporation (IFC) in 2007, the allocation of financial resources should be carried out to safeguard or not compromise financial returns, ecological sustainability, and societal well-being while producing various goods and services. Migliorelli (2021) posits that implementing sustainable finance policies and procedures has facilitated the provision of sufficient financial resources to support the transition towards a responsible society and an environmentally friendly economy.

The term "sustainable investment" (also known as "ESG" investment, which stands for "environmental, social, and governance") is becoming increasingly popular, refers to investment techniques that consider both financial return and social/environmental good. Sustainable investment may affect financial performance. Investing in firms or projects less likely to encounter regulatory penalties, reputation harm, or operational challenges due to environmental or social issues is common in sustainable investments. It can lower risk while also improving financial performance (Akhtar et al, 2020). As international norms change towards sustainability, banks regarded as sustainable may benefit from increased financial access. Investors and lenders increasingly seek organizations that share their sustainability objectives. There is an increasing desire for corporations to demonstrate social and environmental responsibility, particularly among younger generations. Banks that make long-term investments can recruit and keep these clients, enhancing their financial performance. Long-term profitability goals are frequently aligned with sustainable investment goals. Banks may address long-term survival and profitability challenges such as climate change and bad governance by addressing ESG aspects (Shafique et al, 2019).

The rise of the sustainable fund Market: Global trends

As the fund industry and companies increasingly pivot towards sustainability, recent years have witnessed a surge in sustainable funds, i.e., mutual funds and ETFs that describe themselves as targeting sustainable development-related themes or sectors, or integrating sustainability, impact or environmental, social and governance (ESG) factors in their asset selections in their prospectus or other filings. According to data from Morningstar and TrackInsight, the total number of sustainable funds reached 3,987 by June 2020, up 30% from 2019 (UNCTAD, 2020a). The AUM of sustainable funds nearly doubled from about $900 billion in 2019 to over $1.7 trillion, representing about 3.2% of the assets of all open-ended funds worldwide. The

sustainable fund universe comprises 3,435 sustainable mutual funds and 552 sustainable ETFs, with AUM of $1.56 trillion and $174 billion respectively. Equity funds account for 62% of sustainable funds by number, with the remainder split equally between fixed income (19%) and mixed allocation funds (19%). In terms of assets under management, equity funds account for a slightly greater share of total fund allocations at 66%, or about two-thirds of the sustainable fund universe. About half of the sustainable funds were launched in the last five years. From 2016 to 2020, the aggregate number of sustainable funds nearly doubled, while AUM more than quadrupled from $405 billion to over $1.7 trillion.

Sustainable Finance investment Strategies

Sustainable finance investment strategies are either negative/exclusionary or positive/integrated.

A. Negative (Exclusionary) Sustainable Finance

This category is typically risk screened against a range of non-financial performance metrics across ESG categories, that leads to a recalibration of the long-term risk profiles of, for example, high-carbon intensity companies. Strategically, such screening results in divestment from, or the avoidance of, ESG high risk investments. The most common risk screen is high carbon intensity, but other risks include failures in:

• Internal organizational structures, practices, and processes, such as effective internal accountability and transparent governance; strong worker relations; fair pay and safe working conditions; clear strategies to improve the inclusivity and diversity of the workforce; committed investment in human capital and local communities; using recycling models to maximize the effective use of resources

• External organizational effects and outcomes, such as respect for human rights and strategies to tackle inequality; and minimizing pollution.

An extension of passive screening that developed more recently is the more active use of voting rights to challenge corporate behaviour.[1]

B. Positive (Integrated) Sustainable Finance

This category typically aims to achieve a 'Double Delta'[2] of impact by providing both new, additional, capital and by focussing on high potential start-ups or high growth potential impact companies. Positive sustainable finance is often aligned with making an additional contribution towards one or more of the 17 UN SDGs. This is sometimes called Socially Responsible Investment. To date, the main categories for SDG investing have been SDG 8 (decent work and economic growth), 12 (responsible consumption and

[1] https://www.aberdeenstandard.com/en/uk/adviser/responsibleinvesting?gclid=Cj0KCQjwlvT8BRDeARIsAACRFiViyk2kUXQvp8PJWbmjhM53W_3bf20y88JkY2RMUbz8R7pTGU8idoAaAsdjEALw_ wcB

[2] https://www.credit-suisse.com/media/assets/microsite/docs/responsibleinvesting/the-double-delta-of-impact-investing.pdf

production), and 13 (climate action) with the least prioritized SDGs including 1 (no poverty), 2 (zero hunger), and 10 (reduced inequalities). Growing this market is of central importance to the achievement of the SDG targets by 2030, since there is currently an estimated annual shortfall of $3 trillion–$4 trillion in available finance. Positive sustainable finance investment strategies focus on providing new capital into high impact companies.

The Scope of Sustainable Investments—A Critical Appraisal

In the literature, sustainable investment practices are often described using overlapping and complementary terms, such as social, ethical, responsible, socially responsible, and others (see Cadman, 2011). In line with recent suggestions (Eurosif, 2010, 2011; Hoffmann, Scherhorn, & Busch, 2004; Juravle & Lewis, 2009; World Economic Forum [WEF], 2011), we regard sustainable investments as a generic term for investments that seek to contribute toward sustainable development by integrating long-term ESG criteria into investment decisions. With this scope of sustainable investments, investors' financial objectives are combined with primarily nonfinancial concerns. One needs to be careful, though, how this combination of financial and nonfinancial aspects works in practice. Investors are not necessarily homogeneous, and the attention to ESG criteria depends on the investor's objective and varies by asset class. Some investors' main motivation to incorporate ESG information is to improve returns and risk, whereas others have an additional motive to contribute to sustainable development. Also, many investors (such as large pension funds) spend considerably more resources on ESG in the domain of equity investments, even though fixed-income investments are a larger part of their portfolio, and despite recent evidence that ESG information also affects the pricing of credit risk of corporate bonds and bank loans (Bauer & Hann, 2014; Chava, 2014). More recently, some investors also shifted their attention to the impact of ESG criteria in real estate investments (Eichholtz, Kok, & Quigley, 2010).

When looking at the scope of this definition from a corporate perspective, two other concepts come to mind. First, the confluence of ecological and social concerns is often summarized as corporate social responsibility (CSR). Second, the contested (see Norman & MacDonald, 2004) concept of the triple bottom line promotes the simultaneous consideration of all three dimensions of sustainable development: economic, ecological, and social-ethical (Dyllick & Hockerts, 2002; Schaltegger & Burritt, 2005). Following these definitions above, sustainable investments should—at least from a conceptual point of view—be investments that are aligned with each of these three dimensions of sustainable development. From a practical point of view, considerable work is being done on establishing specific ESG criteria, many of which reflect industry particulars (Society of Investment Professionals in Germany & European Federation of Financial Analysts Societies, 2010).

However, a central paradox remains: Why do sustainable investments not actually spur sustainable development? To answer this question, an investment's contribution to sustainable development can be described from a systems perspective. It is important that the financial capital provided for investment

purposes is aligned with, and supports the existence of, humansocial and ecological systems. This relationship means that, in both dimensions, systems can be designed so that they are self-sustaining over the long term. For self-sustaining systems, the economic dimension cannot be omitted. Profitability is central in allocating resources efficiently, and thus to sustaining economic and business systems. In this context, corporate governance aspects have also been suggested to be relevant (Berrone & Gomez-Mejia, 2009; Cogan, 2006; Cremers, Nair, & Wei, 2007; Gompers, Ishii, & Metrick, 2003; Kolk & Pinkse, 2010). For example, board diversity and gender composition may affect firms' sustainability ratings and reputation (Bear, Rahman, & Post, 2010), and family-controlled public firms have been found to have a better environmental performance than their nonfamily counterparts (Berrone, Cruz, Gomez-Mejia, & Larraza-Kintana, 2010). The main focus of the following discussion is placed on the ecological and humansocial systems.

Growing economies sustainably

The establishment of indicators for eco-efficiency and reporting represents a significant step in the right direction. A management strategy called eco-efficiency, created by the WBCSD, can assist businesses in increasing their environmental performance while both satisfying customer demands and increasing profits. Along the entire value chain, it enables businesses to improve production processes, develop fresh, improved goods and services, and use less resources and produce less pollution. Ecoefficiency's ultimate goal is to qualitatively expand economies, or to add more value as opposed to turning resources like energy and raw materials into waste.

When the top management of the most successful firms demand that a business notion be quantified and reported upon, that concept is said to have "come of age." Additionally, the OECD has enlisted in its own eco-efficiency plan and started a number of cross-cutting projects on sustainable development. Additionally, you can tell the idea is going mainstream when financial analysts start requesting quantitative and comparable data from businesses in order to help them make investment decisions.

This is clearly evident in the recent formation of the European Eco-Efficiency Initiative (EEEI), one of the first regional efforts to solve environmental and social problems through an alliance of multiple players. Jointly launched by the European Partners for the Environment (EPE) and WBCSD, in partnership with the European Commission's Enterprise Directorate General, governments of EU member states and several European partners, the EEEI has two objectives:

- To install eco-efficiency as a leading business concept throughout Europe
- To integrate eco-efficiency into EU industrial and economic policies

By 2050, there will be ten billion people on the planet, making it difficult to guarantee that everyone has an equal chance for economic and social advancement. However, establishing a sustainable society necessitates a

fundamental shift in strategy, not just with regard to social and cultural factors but also in terms of production and consumption patterns. If correctly applied on a big scale, eco-efficiency is a potent engine for widespread, root-and-branch transformation and an essential component on the path to sustainable growth. By addressing the full lifecycle, supporting a move from products to services, encouraging green purchasing, and enabling sustainable consumption behaviours, it has an impact on the entire supply chain.[3]

Sustainability as an 'investable' concept:

Banks must understand how an organization's environmental performance affects its shareholder value because they are institutional investors. The management tool that will enable banks to assess the relationship between environmental performance and shareholder value is a system of metrics and reporting with cross-comparable indicators. A select few forward-thinking banks have already started to create their own set of measures for evaluating environmental performance. [4]

In order to give investors a clearer and more transparent picture of the financial implications of companies' environmental performance, banks now require worldwide standards for corporate environmental costs/savings accounting, auditing, and reporting methods.

The recent launch of the Dow Jones Sustainability Index is a testimony to the fact that the concept of corporate sustainability is gaining ground among investors. For the first time, a mainstream global index is tracking the performance of the leading sustainability driven companies worldwide (of which seven WBCSD members were selected out of an élite group of 18). As it states: 'Sustainability companies not only manage the standard economic factors affecting their business but the environmental and social factors as well. There is mounting evidence that their financial performance is superior to companies that do not adequately, correctly, and optimally manage these important factors.' The conclusion is that corporate sustainability has become an investable concept that increases long-term shareholder value.

Therefore, while generating returns for shareholders and investors is the main justification for businesses, focusing only on short-term profitability is no longer sufficient. As it develops, Eco-Efficiency Metrics and Reporting will significantly contribute to meeting the needs of financial markets. Our goal is that this framework would eventually give them a scorecard to recognise and reward eco-efficiency in company. As a result, sustainable banking will become a reality.

[3] Peng, M. W. (2004). Outside directors and firm performance during institutional transitions. Strategic Management Journal, 25, 453–471.

[4] Wright, C. (2012). Global banks, the environment, and human rights: The impact of the equator principles on lending policies and practices. Global Environmental Politics, 12(1), 56–77

Sustainable investment: the banks' perspective

More and more banks have realised that the relevance of sustainability issues is not limited to financial risks of environmental catastrophes, wars or other upheavals. Sustainability issues have entered the investment business in four steps:

1. Supply of ethical funds

2. Supply of environmental technology funds

3. Development of eco-efficiency funds

4. Extension to sustainable development funds by including social issues

Financial institutions are constantly joining this industry, and those who are already there have started to create a wide range of unique, customer-focused "eco-financial" and "socio-financial" products. Future asset management and general financial investment research policies at financial institutions should progressively take sustainability factors into account.

Challenges ahead:

Providers of Financial Services (PFSs) should pre-empt both environmental and own-sector regulations by enlightened self-interest. They should offer prioritised and sound scientific justification for new legislation that allows flexibility in the ways and means of achieving environmental goals. Economic incentives and market-based approaches need to encourage PFSs' involvement in environmentally and socially sustainable development, particularly financing efficient redevelopment of idle and under-used properties that have an element of real or perceived contamination.

To encourage their commitment to adequately account for environmental factors and incorporate them into routine operations, SMEs (small and medium-sized firms) in particular should get more proactive outreach from PFSs. Additionally, it is crucial to make sure that SMEs are aware of the resources, financial services, and goods available to them to handle their unique environmental challenges.

By setting (a) country-by-country and (b) sector-by-sector commitment ceilings that represent their "general" and "specific" environmental risks, PFSs should incorporate environmental components into consolidated risk management practise. Such ceilings ought to be applicable to all categories of a PFS's services and goods, as administered by multiple 'departments', as a whole, and as a supplement to a rating system of a PFS's clients operating in a specific nation or industry. As an additional early warning and problem identification service, a unique system of monitoring delicate topics like new environmental regulations and standards, punitive measures, accidents, etc. should be introduced.

PFSs, in particular insurance companies, should actively explore environmental prospects by providing a menu of varied and transparent products with higher policy limits and broader coverage, for longer time periods, and for lower pricing. PFSs may think about enhancing their own environmental capabilities by hiring more environmental specialists and forging long-term partnerships with reputable environmental companies that have a variety of sectoral and regional specialties in order to promote more proactive and enlightened management of environmental issues and make sure that these issues are prioritised on the economic development agenda. The capabilities and use of the Internet, offering extraordinarily broad access at minimal cost, should be significantly expanded, particularly as it allows institutions to pool together environmental and other 'brains' to manage a specific task, no matter where in the world they are located.

PFSs should continue to standardise their own reporting on environmental and social performance, and disclosure of information on environmental risks; they should also make it more transparent, coherent and focused.[5] PFSs' disclosure of environmental information should be comprehensive, systematic, material, timely and reliable, and it should cover operations worldwide, not just in their home countries.[6] Again, the capabilities of the Internet should be used by PFSs to speed up the secure exchange of information, application and delivery of standardised products.

In addition, transparency of environmental information will enable users of that information to make an accurate assessment of a PFS's financial conditions and performance, its business activities and the risks related to those activities. This needs to be complemented by an independent verification system and by consistency in the use of environmental terminology.

Environmental aspects are firmly embedded only in the operations of a select few 'large' PFSs, despite being widely regarded as being of growing concern to the sector. More Western PFSs, especially smaller ones, should begin committing to sustainability and creating EMSs as a result. They should also see environmental advances in the industry more favourably. To create a business "environmental risk rating" system that incorporates historical environmental and social performance in a way akin to credit ratings, PFSs should collaborate with other disciplines and industries. The 'environmental rating' that is being proposed will provide a 'one-stop shop' for getting a reliable evaluation of a company's exposure to environmental liabilities as well as of its general creditworthiness.

[5] Detailed and in-depth requirements developed by the US FDIC and SEC (www.fdic.gov and www.sec.gov) for assessing and pricing environmental risk and disclosure of information on environmental liabilities may serve as examples of good practice. The US FASB (www.fasb.org) has also developed guidance and standards for proper accounting for environmental contamination costs as well as disclosure and recording of environmental liabilities. Both FASB and SEC requirements insist on a full disclosure of environmental liabilities and a reserve commensurate with the exposure. In August 1999 the UK ONS for the first time included the Environmental Accounts as 'satellites' to the National Accounts (see www.ons.gov.uk).

[6] Environmental information disclosure by PFSs should be fair and 'non-selective' in the sense that public disclosures of important environmental material information should be a timely and comprehensive exercise that is not limited to analysts, major shareholders, or industry insiders

PFSs should also explore opportunities to utilise political risk insurance or guarantees (PRIG) offered by a number of MFIs and to seek expansion of their coverage to protect against host governments' potential breach of environmental indemnification or immunity agreements as well as against the risk that governments may change environmental policies, regulations and standards in the course of project implementation.

Conclusion:

The linkages between finance and sustainable development have been explored by many academics, and recent studies underline that sustainability can be useful in improving the stability of the financial system and that sustainability and ethical values can play a key role in finance .Being capital providers, banks can help address new economic realities linked to environmental and social (E&S) sustainability and can contribute to national sustainable development agendas (IFC 2017).

Banking business models and strategies are gradually integrating more sustainable behaviours. This signifies a fundamental shift in the way the banking industry has hitherto addressed the financial markets. Because banks can be "sustainable" while engaging in profit-making operations, this promising strategy can be seen as strategic in its objective and goals. This change suggests that the banks' promise might be a workable method to boost the value of the company while simultaneously benefiting society by encouraging sustainable development.

Banks currently participate in national and international business sustainability programmes, such as those run by the United Nations, and are involved in national and international sustainability programmes. They are also included in national and international sustainability indices, such as the Dow Jones Sustainability Index and the Financial Times Stock Exchange4Good (FTSE4GOOD). Sustainable banking can be seen as a rapidly expanding international sector that fosters crucial professional discussions addressing issues with information, culture, and communication on a global scale.

The adoption of a green agenda containing Green Finance (GF) is required at both national and international levels in order to properly manage societal concerns (such as climate change, resource depletion, etc.) that involve a sustainable transition. This necessitates an ongoing, transparent discussion about the opportunities, obstacles, and GF action priorities in each nation.

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