

Research Article

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Innovative Financial Economic Stimulation Tools For ESG-Transformation of a Company: Opportunities for Application and Specifics of Regulation

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**Abstract****Editorial Details***Double-blind review System*

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Objective: The search for ways to transition to a business model of sustainable development is a cutting-edge trend in the global economy. This movement has its own national features concerning the application and regulation of ESG principles. World practice has already revealed a clear relationship between the application of sustainable development principles and the growth of company profitability and its long-term prospects.

Method: The study relies on systemic and complex approaches in combination with a set of general and special scientific methods.

Results: The paper considers all possible solutions as a source of financial resources, including green bonds, lending with regard to the borrower's compliance with ESG principles, and green crowdfunding. Particular attention is paid to the process of developing and regulating the taxonomy of projects and financial instruments.

Conclusions: Popularization of the benefits of the concept of sustainable development among all market participants will eventually yield the result of improved business competitiveness.

Keywords: Sustainable Development, Green Bonds, ESG principles, Ecology, Investments, Social Responsibility, Impact Business.

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INTRODUCTION

In recent years, a problem at the junction of many fields of knowledge, such as economics, ecology, and law, has become particularly important due to the need to ensure the stable growth and development of the world economy in the face of limited resources and the increasing impact of human activity on the environment (Zainullina et al., 2022). This raises the need to develop qualitatively new approaches and principles of their regulation for the further development of business, which is coming into confrontation with the problems of social development and climate change.

Of particular interest is the increasingly wide-spread approach to business development based on ESG principles (Ribeiro, Antônio de Lima, 2022) that integrate environmental, social, and governance factors. The central idea behind ESG principles is to expand the main objective of business: along with generating profit, a company should strive to reduce (ideally, eliminate) its adverse impact on the environment (environmental), consider the interests of society (social), and adopt the best approaches to management (governance) (Galaktionov, 2021).

By now, a certain amount of experience has already been accumulated in the field of implementation and regulation of ESG principles. On the one hand, some researchers argue that there is a relationship between ESG factors and the development and high profitability of the company in the long term (Chernyshova, 2021). Another group of researchers (Jonsdottir, Sigurjonsson, Johannsdottir, Wendt, 2022) finds that the relationship between ESG and the financial performance of the firm has not yet been confirmed, as the literature is full of contradictory results and paradoxes. We are convinced, however, that the trend towards the development of these principles at the international level does exist, despite the difficulty of assessing the performance and regulating the activities of companies in terms of adherence to ESG principles.

Notably, the introduction of ESG principles in the strategic planning practice of the company nearly always leads to an increase in goodwill, that is, increases brand awareness (reputational effect) and creates a basis for the growth of the company's innovativeness. Conversely, companies that do not take environmental and social risks into consideration experience a decline in business value in the long run.

The novelty of the study lies in the further development of ways to transform business institutions and their regulation in accordance with ESG principles.

Research hypothesis: the complete transition to the principles of sustainable development and the construction of a green economy can only be attained with an appropriate legislative reform, as well as a high degree of involvement of financial institutions as regulators and key investors.

The study aims to provide substantiation for the ways to finance the transition of the economy to ESG principles with consideration of social and legal national features.

In the process of research, the following tasks are consistently solved:

- the path of development and implementation of ESG principles in world practice is traced;

- approaches to ranking corporations with respect to the implementation of sustainable development principles are considered;
- the methods of financing ESG transformation, including bond issuance, attraction of specialized loans, and crowdfunding, are analyzed.

METHODS

The study relies on systemic and complex approaches in combination with a set of general and special scientific methods (Silva et al., 2022). Literary sources are analyzed through the methods of economic comparison, observation of processes, description, method of graphical representation of data, analysis, and analogy. The comparative method is employed to consider and summarize international practices to ensure environmental security, as well as to compare the Russian experience with it.

The normative basis of the study includes the current normative legal acts used in the regulation of environmental safety. The theoretical and methodological basis of the study is provided by fundamental and applied works of Russian and foreign researchers in the field of environmental protection and national security in the areas of the environment and economy. The research hypothesis is tested using official statistics and other information on the topic available on the Internet.

RESULTS AND DISCUSSION

The key conclusions reached in the course of the study are presented in Table 1.

Table 1. Results of the study

Current state of ESG transformation	In the world, ESG transformation began 10-12 years ago and is developing intensely. There is an increase in green investments and funds and a rising interest in the securities of companies with a high place in the rankings of ESG-oriented corporations. In Russia this direction is only beginning to develop, growing out of the usual social responsibility of business.
Solutions to problems	The need to change the measures of legislative regulation of ESG transformation of business has been revealed. It is noted that methods of stimulating changes need to be developed, the existing rankings have to be brought into a unified system, and the leading role of banks in this transformation should be outlined.
Main methods of financing the transition to sustainable development, considering the social and legal specifics	The issuance of green bonds is seen as the main method of financing. In addition, it is necessary to further develop special types of lending to companies that have confirmed their active adherence to the principles of sustainable development. Green crowdfunding is considered an alternative

Green bonds: placement and regulation

The first ever issuance of green bonds (Iakovlev, Bogacheva, 2016) (bonds issued to attract financial flows to projects with a pronounced environmental focus) was performed by the European

Investment Bank in 2007 under the name Climate Awareness Bonds. In 2008, the International Bank for Reconstruction and Development issued bonds that were directly labeled as green. In Russia, the first issue of green bonds in the country was placed in 2018 by the company Resource Conservation of the Khanty-Mansi Autonomous Okrug.

The priority areas for investment of funds raised through ESG bonds are such sectors as energy, construction, and transport networks. Another important field is activities aimed at preserving freshwater resources and reclaiming fertile land (Figure 1).

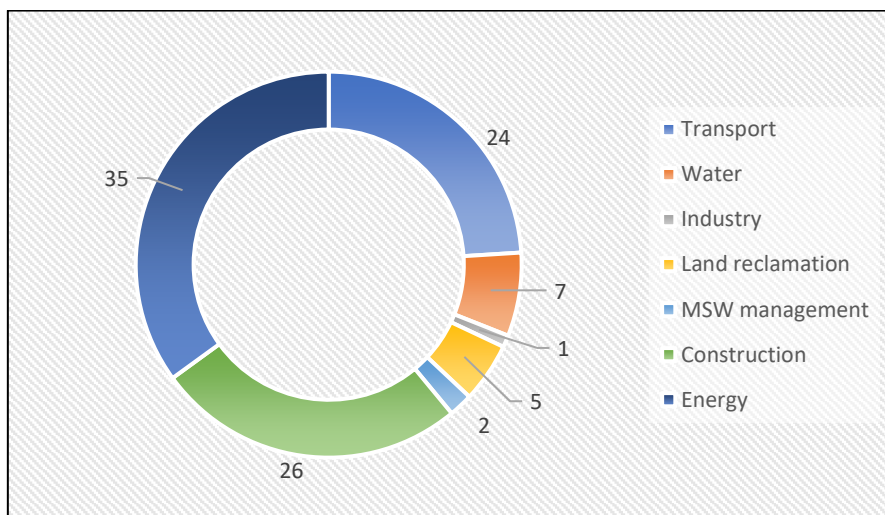


Figure 1. Directions for the use of funds from the global issuance of green bonds (compiled by the authors)

In financial markets, there is an influx in the popularity of the so-called ESG investment. The most explosive growth was observed after 2012 (Figure 2), which largely owes to the predominance of the Millennial generation - people born between 1980 and 2000 - among investors. This generation is distinguished by such values as environmental friendliness, the fight against negative man-made impacts on nature, and the pursuit of clean energy sources. Experts believe that by 2025, the total value of ESG assets in the world will amount to nearly \$140.5 trillion. Compared to 2018 levels, this translates into a five-fold increase.

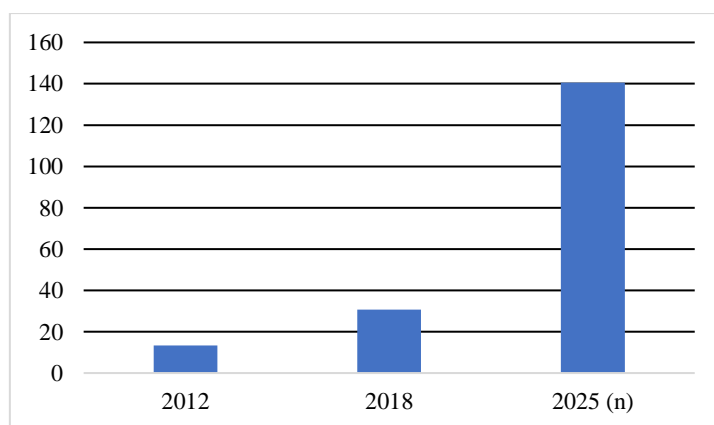


Figure 2. Dynamics of the total volume of global ESG assets, \$ trillion

In the period from 2012 to 2021, a system of regulation and control over companies' compliance with ESG principles was established across the world. The main regulatory initiatives focus on the areas of responsible green investment aiming at the global transformation of business in accordance with the said principles. In 2017, the Central Banks and Supervisors Network for Greening the Financial System was created. The year 2019 was marked by the creation of the Global Investors for Sustainable Development Alliance.

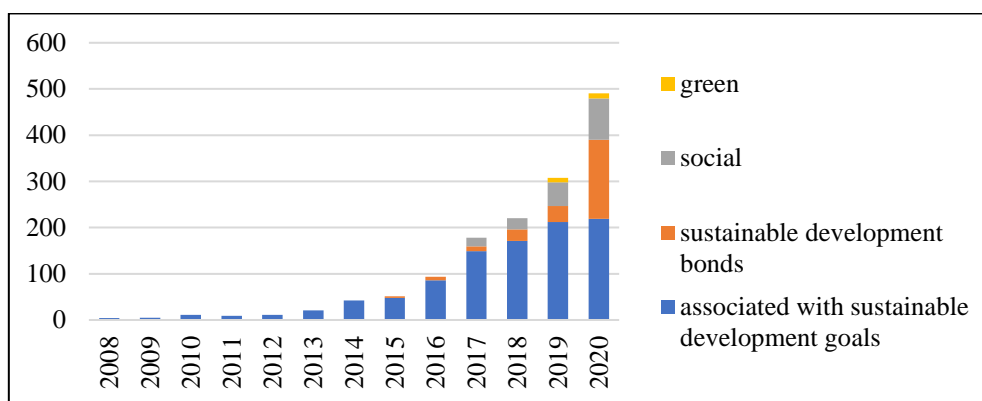


Figure 3. Global volume of ESG bonds, \$ billion

ESG investment

The introduction of ESG elements into the investment strategy arouses the interest of modern investors, as it gives them a way to manage the long-term prospects of the investment portfolio (Figure 3). Additionally, according to the considered approach, interaction and close cooperation of the company with shareholders is highly appreciated (Kondratenko, 2022). As a result, investors gain the opportunity to form their investment portfolio based on the alignment of the company's and the investor's values. This approach to investment is referred to as conscious capitalism (Kenton, 2022).

Meanwhile, it is noted that investments in companies with ESG values and programs do not lag behind in terms of efficiency or return from the usual, ordinary investments (Karimova, 2021). In the long run, the return on an investment portfolio formed with ESG factors in mind will even slightly exceed the average return on a portfolio with similar securities, but without the aforementioned focus. At the same time, according to the Morgan Stanley Institute for Sustainable Investment (Rhiannon, 2021), the risks of an ESG portfolio can be estimated as lower.

For a number of years, international banking practice has been applying a special approach to lending to organizations that base their activities and implement projects on the principles of sustainable development. Encouraged by governments, such lending programs ultimately benefit all participants (Adygezalova et al., 2022). ESG or green ratings are used to determine the appropriateness of lending to individual borrowers.

At the moment, several dozen different ratings of companies that support the principles of sustainable development are already being compiled and taken into account in world practice. In the US alone, there were more than 850 such corporations in 2021. Over 160 information and statistical agencies around the world calculate ESG ratings and publish ESG data (Gorchakov, 2021). A few of the

most reputable ratings include RobecoSam (S&P Global), Sustainalytics, MSCI, CDP, ISS, Vigeo Eiris (Moody's), FTSE Russell, and FTSE4Good.

A 2020 survey conducted by EY among investment, insurance, and pension funds indicates that about 98% of them necessarily consider the issuer's ESG rating when forming their investment portfolios. Among the rationales for this approach, interviewees point to the proven direct correlation between compliance with ESG principles and the profitability of the issuer's securities. Moreover, the absence of major environmental risks always has a positive effect on a company's capitalization because there is no risk of major pollution fines, reputational losses, or lawsuits.

Different agencies often assign quite dissimilar, sometimes directly opposite, ratings to the same company or product. Hence, global sustainability regulators have now taken note of the need to unify and standardize ESG rankings.

Russia is still characterized by a very weak system of incentives for ESG transformation of corporations (ESG rating of Russian companies in 2022, January 17, 2022). A review of initiatives in this area suggests that relatively cohesive programs and projects potentially capable of producing any social and economic impact have so far been developed only by the largest corporations, such as Sber, Gazprom, Russian Railways, Polymetal, and a number of backbone industrial, financial, and infrastructural institutions. Developed European countries and the US are at least one step ahead of Russia in terms of sustainable development (Figure 5).

So far, financing for the transformation of the Russian economy and individual companies in accordance with sustainable development principles has not yet gathered enough momentum. The main impediments in its way are imperfect legislative regulation, insufficient awareness of potential investors (primarily institutional investors), and the low popularity of ideas about the development of impact business in the Russian business community.

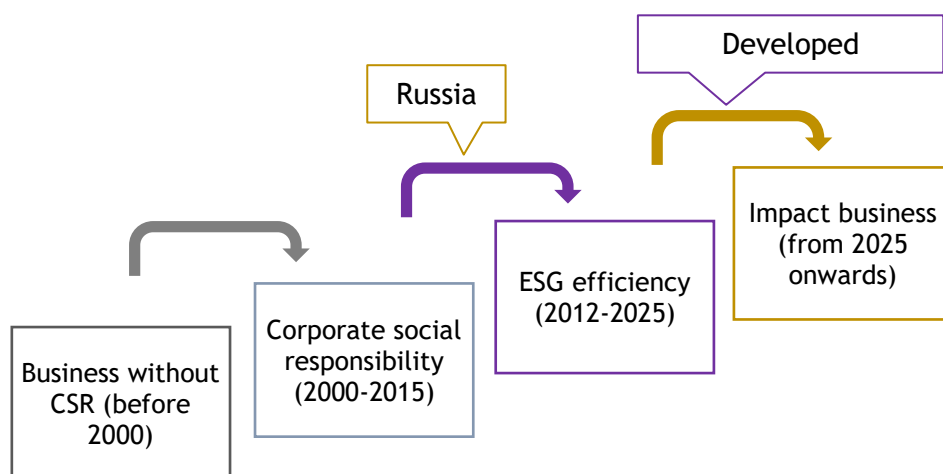


Figure 5. Stages of ESG-transformation in Russia and worldwide

Crowdfunding

Developments in the sphere of crowdfunding as a component of green finance began in 2015 as part of the United Nations Development Program (UNDP), which defined crowdfunding as an innovative method of financing sustainable development goals. The total amount of money raised by the global crowdfunding infrastructure in 2019 is over \$6.9 billion. If the growth rate withstands global negative factors, it will reach more than \$12 billion by 2023 (Crowdfunding, worldwide, 2019).

Foreign studies based on data from the largest crowdfunding platforms (Vismara, 2018) demonstrate that the orientation of equity crowdfunding campaigns on sustainable development considerably increases their attractiveness to potential investors. This method of funding allows detecting projects with significant social and economic efficiency. In addition, a focus on environmental issues is conducive to the success of technically complex and creative projects.

Green crowdfunding can be regarded as an instrument of direct participation of the public in funding green projects. This method becomes especially relevant at times of national and global crises with the uneven decline of the markets. In such cases, private investors from other regions and countries are attracted to financing relatively easily (Nefedova, Maysuradze, 2021; Stryabkova et al., 2021).

In Russia, green crowdfunding has not yet gained much popularity. However, in February 2021, one of the country's most prominent crowdfunding platforms, Planeta.ru, proposed a new category of projects - Environment and Nature (Ignatenko, 2021).

CONCLUSION

The conducted research shows that the complete transition to the principles of sustainable development and the construction of a green economy can only be attained with an appropriate legislative reform, as well as a high degree of involvement of financial institutions as regulators and key investors. In this respect, Russia is at the very beginning of the path of economic transformation in accordance with the principles of sustainable development. Next to Europe and the United States, the contrast is particularly noticeable, as the lag is significant.

Nevertheless, innovative mechanisms and green financing instruments are gradually emerging in Russia. A very promising way of raising funds is green crowdfunding, which can be used to launch the most daring startups that align with the goals of sustainable development and have an environmental agenda.

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