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Green Finance

KEYWORDS

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ABSTRACT *Green finance is a phenomenon that combines the world of finance and business with environmentally friendly behaviour. It is an arena for many participants, including individual and business consumers, producers, investors, and financial lenders. Green finance can be expressed differently depending on the participant, and it may be led by financial incentives, a desire to preserve the planet, or a combination of both. In addition to demonstrating proactive, environmentally friendly behaviour, such as promoting mass transit or the recycling of used goods, green finance is about avoiding the promotion of any business or activity that could be damaging to the environment now or for future generations.*

INTRODUCTION

Financial institutions that extend lending to individuals, small businesses, or large corporations can do so in an environmentally friendly manner. In this type of green finance, loans are used to promote the proliferation of renewable energy, for instance. A lender could finance the development of a solar power plant that generates power from the sun and panels installed on the roof of a building or residence. Wind power generation is another type of business that would win favour with green financiers. These companies develop expensive wind farms that use large turbines onshore and offshore to capture the wind and generate energy.

Energy producers, who use fossil fuels, including coal, are not likely to participate in any type of green finance. Coal is a traditional power source that releases emissions into the air, substances that are largely considered harmful for the environment. As a result, a coal producer is the type of company that a green finance participant would likely avoid. Clean coal emits fewer emissions but may never be classified as a green investment.

Another way to encourage green finance is to offer environmental incentives to market participants. Small businesses that are not even in the business of clean energy can participate because this is an extremely proactive form of green financing. For instance, a company that sells vehicles may focus on selling cars that are designed to use a hybrid fuel combining both fossil fuels and renewable energy. This business might offer customers an incentive to purchase a car, for example, and in exchange for every vehicle that is sold, the dealer will purchase and plant a tree to promote a clean environment.

Venture capitalists, or firms that extend financing to start-up companies for growth, actively participate in green finance. Many clean energy firms are behind emerging technologies that are expected to produce a greater portion of the world's power in the future. Venture capitalists specialize in risky and emerging technologies and, as a result, tend to have a hand in green financing.

Green finance explained

There is no internationally agreed definition of green finance. The term describes a broad range of funding for environment-oriented technologies, projects, industries or businesses. A more narrow definition of green finance refers to environment-oriented financial products or services, such as loans, credit cards, insurances or bonds

1. Green investing recognizes the value of the environment and its natural capital and seeks to improve human well-being and social equity while reducing environmental risks and improving ecological integrity.
2. Other terms used to describe green finance include "environmentally responsible investment" and "climate change investment".

How it works

Green industries and technologies are all at different levels of maturity, thus, requiring different levels of funding from different sources of capital. There are generally three sources: domestic public finance, international public finance and private sector finance. Domestic public finance refers to the direct funding by a government while international public finance refers to funding from international organizations and multilateral development banks; private sector finance consists of both domestic and international funding sources.

Green financing can be packaged in different ways through various investment structures. Green finance is a core part of low carbon green growth because it connects the financial industry, environmental improvement and economic growth (figure 1): "One missing link between 'knowing' and 'doing' in the transition to green industry is 'green finance'. All green industrial propositions cost money, and many green industry business models are more often than not untested or unconventional. Therefore, traditional finance may find it difficult or commercially unattractive to finance these green industrial propositions.

- Generally, governments pursue the following objectives through green financing measures
- Establish and secure funding for green industries and green growth
- Support low carbon green growth by developing new financial products
- Attract private investments to build and sustain green infrastructure
- Strengthen corporate disclosure of green management

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practices and expand financial support for those businesses that apply them
- Set up markets for environmental goods and services, such as carbon markets featuring carbon credits.
- If past trends can be taken as an indicator, then green investments possess great potential for growth in the future, especially for promoting clean energies

Infrastructure finance
Much of the public investment in green growth relates to infrastructure. Governments of developing countries now have the opportunity to put infrastructure in place that will result in a better long-term management of resources, which will, in turn, channel private-sector capital into those investments. Infrastructure financing is generally project-based, with renewable energy and energy efficiency projects taking up the largest share of financing capital.

Financial assistance for industry or firms
Some green industries need government financial assistance to mature or to become more competitive against well-established "brown" industries. Governments can give financial assistance to encourage businesses to invest in emerging green industries. They can also develop regulatory policy frameworks to help ease the access to financing from private investors or financial markets.

Promoting financial markets
Financial markets are an important source of green finance for publicly traded firms. Many institutional investors have adopted responsible investing, especially related to climate change, as part of their investment process. Government support for environmental social governance schemes provides credibility to programmes, such as the Carbon Disclosure Project and eco-label initiatives, and encourages firms to become more environmentally responsible and thereby benefit from green financing schemes.

Environmental social governance
Environmental social governance describes the environmental, social and corporate governance issues that investors consider in the context of their corporate behaviour. Although there is no definitive list of such issues, they typically display one or more of the following characteristics:

- Issues that have traditionally been considered non-financial or non-material
- A medium- or long-term horizon
- Qualitative objects that are readily quantifiable in monetary terms• Externalities (costs borne by other firms or by society at large) not well captured by market mechanisms
- A changing regulatory or policy framework
- A public-concern focus

Source: United Nations Environment Programme and WBCSD, Translating ESG into Sustainable Business Value (Nairobi, 2010)

Strengths of green finance
• Promotes technology diffusion and eco-efficient infrastructure:
Investment in environmentally sound technologies, such as clean energy, may help bring down their costs and expedite wider technology diffusion. Developing countries can avoid the development model of "grow first, clean up later" because a great part of the green investment flows into infrastructure. This situation provides the opportunity for a country to leap ahead to eco-efficient infrastructure. The responsibility then falls on governments to develop infrastructure that will result in better long-term management of resources, which will in turn increase a country's competitiveness and channel private-sector capital into domestic green markets.

• Creates comparative advantage:
Low carbon green growth may inevitably change from the current voluntary nature to a mandatory strategy in response to the rising pressures emanating from climate change and other environmental and economic crises. Expanding green finance today will mean a comparative advantage once environmental standards become stricter.

• Adds value:
Businesses, organizations and corporations can add value to their portfolio by enhancing and publicizing their engagement in green finance. Thus they can give their business a green edge and thereby attract more environmentally conscious investors and clients alike.

• Increases economic prospects:
Governments promoting green finance help buffer their societies against the time when resources become scarce by establishing and promoting domestic markets for alternative resources and technologies. They increase their economic prospects further by dipping into the new markets that possess great potential for employment generation. Because governments are primarily interested in maximizing the welfare of multiple generations, green financing mechanisms are particularly appealing in that they foster projects and developments that bear sustained benefits, especially in the medium and long terms.

Challenges to green finance
• Present and projected Competitiveness:
Private investment in green growth in developing countries is constrained by both activity-specific and country-specific barriers that adversely affect the attractiveness of such investments, both in terms of investment returns and risk management. Increasing private investment in green growth will depend on the extent to which these investments become attractive relative to other opportunities, both domestically and internationally. Because international investors can look across different countries for opportunities, governments may need to implement a series of public interventions to make green investment opportunities more attractive.

Low Carbon Green Growth Roadmap for Asia and the Pacific: Fact Sheet - Green finance
• Mispricing and no pricing of risks:
The overall investment and policy environment of a country contributes to its effectiveness in attracting private investors. The capital markets in some countries are not effective in pricing green growth-related risks. The extent to which the market misprices these risks or refuses to price them represents a barrier. In general, these risks include those associated with new technologies or processes that are not well understood and those related to the design, stability and transparency of domestic policies.

Market distortions and shortcomings:
As long as subsidies for fossil fuels and the failure to internalize environmental externalities continue to distort the market price of energy, investment in green energy will have a hard time yielding attractive returns for investors. Adding to that is the limited number and diversity of green finance products and respective markets in which

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they can be traded.

• Competing objectives:
While private investors aim to maximize the risk-adjusted returns for their investments, public green finance providers seek to achieve the highest possible environmental improvement and host-country policymakers are interested in achieving the best development prospects.

• Limited capital and limited awareness:
Many small- and medium-sized businesses are characterized by limited liquidity and access to capital, which hinders their participation in the green financing sector. The prevailing myopic time horizon of business strategies, which ignore benefits of green industries that lie in the far future, is another fundamental hurdle to private investments. Adding to that is the lack of experts who understand the complex relationship between environmental issues and financial markets.

• Regulatory gaps:
Another barrier to the expansion of green finance is the gap in adequate regulatory and technical infrastructure to measure, assess and analyse green business strategies and financing.

• Implementing strategies
Although there is no single best solution for the various situations and projects that demand green financing, there exist a number of interventions and measures that may be appropriate for common constraints and levels of development. In general, when businesses compare enabling environments for trade and investment, they look for: macroeconomic stability, potential for conflict and the degree of good governance, among other factors. Public interventions must address these topics and be applied in a manner that is transparent, long lasting and consistent if they want to stimulate private investment. The following describes the various policy options that can improve the regulatory landscape to overcome investment challenges:

Information-building policy:
Consumers, producers and investors all need to understand the positive economic and environmental effects of low carbon green growth. It is important they realize that this strategy poses an opportunity rather than a burden and that it will most likely transform from a voluntary path to a mandatory one in the long run. To improve the transparency needed for promoting a green financial market, impetus along the lines of corporate social responsibility needs to be expanded, such as the Carbon Disclosure Project or the UN Principles for Responsible Investment. It is also important to adopt stringent verification schemes for green technologies and green businesses to avoid confusion among consumers, to ensure that only those companies benefit from the green industry image that are truly part of it and to provide investors with the necessary information to make prudent investment choices.

Markets for green finance products and environmental goods and services:
An often-cited example of a greenmarket launched and developed by governments is the carbon market. In many countries so far, an emissions trading scheme was set up first; this included usually the enacting of legislation to govern membership, trading conditions and market surveillance for emissions trading. To ease the transition, governments can introduce pilot projects or voluntary trading schemes first and then slowly move to a mandatory trading system, encompassing lessons learned from the pilot phase, a legal base shift to "cap and trade" and the diversification of traded products.

Public financing: Because the cost of green investment projects, such as a renewable energy facility, is generally higher than conventional projects, governments should subsidize a portion in order to attract investors. Financing mechanisms include public competitive bidding, public procurement and public loans, grants or funds, like venture capital funds. In 2009, the carbon funds around the world held a total of US$16.1 billion in assets, which meant a 20 per cent increase compared with the previous year.

CONCLUSION

Thus by going green we are not only protecting the environment but saving our lives also, saving our future also. There is a proverb, "Charity begins at home". It means if we really want the world a better place, we should take the initiative. So we all should start taking steps to protect the environment by going green rather expecting others to do so. Harnessing Public Trade Finance to Foster a Green Economy in Developing Countries (16) In, ECAs have historically developed their activities without specific consideration of environmental and developmental principles. They are therefore not fulfilling their original mandate of supporting exports to risky overseas markets. They have focused their activities on developed and fast-growing economies, i.e. safe and profitable markets, and neglected developing countries.

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