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PROSPECTS FOR THE DEVELOPMENT OF ESG INVESTING

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Abstract:

The article highlights the role and significance of the "ESG" approach in achieving the objectives outlined by the United Nations' sustainable development goals, the criteria investors use for investing companies based on the ESG approach during the transition to a green economy. Additionally, it covers ESG factors and classify related risks, and highlights the benefits of using the ESG approach in the activity of national companies.

Keywords: ESG factors, ESG risks, green economy, financial instruments, green investments, responsible investments, socially responsible investments, green financing, green projects.

INTRODUCTION

The development of industrial production and the population growth from year to year are significantly boosting the demand of economic sectors and households for resources. As a result, factors negative impacts on the environment are increasing, as well as greenhouse gas emissions in nature.

Negative effects of climate change and the impact of the COVID-19 pandemic on a global scale create the need to revise the new sources and approaches that can provide economic growth. Thus, the implementation of strategic goals and measures to introduce the concept of a "green" economy in our country is regarded as one of the most pressing objectives of the present.

The low level of energy efficiency in economic sectors, high rates of outdated equipment and slow renewal processes, misallocation of natural resources, passively attracting of private businesses in development a "green" economy, prevents an achievement of national priorities and goals for sustainable development in the country.

For many years in global practice investing in branches of the economy was not a singular approach, that allows to achieve a positive social and ecological effects at the same time and to make a profit. In the global context, the private sector dominates in industrial production, and representatives of private businesses frequently prioritize making profit without paying adequate attention to social and ecological outcomes. Additionally, in many cases, due to the low profitability of state-owned industrial enterprises, there is a lack of financial resources to implement ecological and social programs at the same time. Environmental and social issues that are specific to countries under the influence of aforementioned factors have led to global problems. Consequently, these issues have contributed to the emergence of new types of financial instruments, extending the content of the investment decision-making process for investors. One of such instruments is the business management strategy founded on Environmental, Social, and Governance (ESG) principles, which is the primary focus of our research.

LITERATURE REVIEW

Based on the results of recent studies, it has been observed on a global scale that the use of sustainable development instruments in the economic system has become increasingly effective. Institutional investors are now emphasizing the importance of companies operating in line with Environmental, Social, and Governance (ESG) principles when making investment decisions. It is evident that international financial institutions are no longer indifferent to ESG issues and are actively encouraging companies to disclose information related to ESG practices, especially in countries where governments have taken significant steps towards ESG integration. The aforementioned evidence is supported by the following sources.

Currently, all chains of the financial sector are undergoing changes to incorporate sustainable development instruments. Sustainable development has evolved from a theoretical concept to a practical priority for businesses and investors. This, in turn, requires the effective formation and development of the responsible investment (ESG) market [1].

The adoption of ESG practices in companies is influenced by external factors, and the increasing interest of government policies and foreign investors play a significant role in this regard [2].

Responsible investments, also known as ESG investments, rely on environmental, social, and governance factors when making investment decisions. At the stage of transition to an information society and improving the standard of living of the population in evaluating the alignment of investment decisions with the intended goals, investors not only focus on economic profitability, but also consider ethical values and the personal development of individuals as priority aspects. When economic actors make investment

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choices, they consider not only a company's financial performance rates but also non-financial factors, such as its environmental conservation efforts and commitment to social responsibility [3].

The implementation of "green" financing policy, which is known as one of the forms of institutional innovation, strengthens financial restrictions for companies that do the most harm to the environment. This enables companies to positively transform their actions towards environmental sustainability. Through "green" financing policies, financial institutions and corporations can take more environmental and social responsibility, what can be an effective method of allocating resources and increasing the effectiveness of "green" development [4].

RESEARCH METHODOLOGY

The methodological basis of the research includes the theoretical rules related to attracting investments and funding in order to achieve "green" economic progress, which is provided in the concept of sustainable development. In the process of scientific exploration, a dialectical approach was used, it allowed for the dynamic study of economic phenomena in their interrelated manner. Various methods such as graphical methods, grouping and comparison method, analysis and synthesis were employed as system approach relative to the research subject.

ANALYSIS AND RESULTS

In advanced economies, institutional investors extend their evaluation beyond conventional financial reports and indicators when determining investment strategies lately. Most investors exhibit a heightened interest in acquiring supplementary insights into a company's operations, particularly concerning its environmental impact, conditions created for employees and availability of information on the company's business ethics.

In this regard, former UN Secretary-General Kofi Annan launched an initiative to encourage companies' adoption of ESG principles as part of their strategies, aiming to address climate change [5]. In response to this initiative, in 2004, a group of 20 major financial institutions published the "Recommendations for the Financial Sector," which defined the ESG term and its principles, providing guidelines for socially responsible investors. ESG principles have created an additional condition for the emergence and development of new financial instruments and criteria. They also served as a tool to address environmental degradation, global warming, and economic inequality between rich and poor countries.

The acronym "ESG" stands for "Environmental, Social, and Governance" that carries the meaning of respecting nature, employees, and society in a company's business operations. In broader terms, ESG refers to the sustainable development of commercial activities and encompasses responsibility towards the environment, a high level of social accountability, and the utilization of high-quality corporate governance principles. Investments focused on ESG are also referred to as sustainable investments. Such investment decisions are based on the analysis of a company's non-financial (ESG) information in addition to financial information.

In other words, ESG encompasses three core facets: environmental (E), social (S), and governance (G) factors. Investors leverage this framework, along with an examination of its constituent sub-factors, in conjunction with financial reports to inform their investment strategies. The structure and interplay of these ESG elements are visually represented in the accompanying figure (Figure 1).

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Ecologic (E) factors	Natural resource depletion;
	Ecological impact of the supply chain;
	Management of emissions and harmful gases;
	Combatting climate change;
	Social impact on the supply chain;
	Shortage and depletion of resources.
Social (S) factors	Human rights;
	Value of human capital;
	Local self-governance communities;
	Product quality;
	Working conditions and safety;
	Gender composition.
Governance (G) factors	Healthy competition environment;
	Transparency of the tax system;
	Risk management;
	Fighting against corruption;
	Business ethics;
	Corporate governance.

Figure 1. Classification of ESG Factors

Observing the factors depicted in the image, known as "ESG" factors, reveals environmental (E) considerations including natural resource depletion, supply chain impacts on the environment, management of emissions and harmful gases, and efforts to reduce and eliminate pollutants and waste. The social (S) factors include human rights and freedoms, the value of human capital, engagement with local communities, product quality, working conditions for employees and staff, and gender diversity. The governance (G) factors consist of a healthy competitive environment, the integrity of the tax system, risk management, anti-corruption efforts, business ethics, and corporate governance.

When examining the utilization of ESG factors within industrial companies, the analysis of environmental (E) factors covers various aspects such as the impact of emitting greenhouse gases into the atmosphere resulting from a company's emissions, and depletion of water sources due to resource use. It also includes adverse effects on flora and fauna, release of hazardous and radioactive substances, environmental degradation from the use of harmful chemical agents in production, adoption of 'green' technologies in the production process, utilization of renewable energy, and creation of products through the recycling of waste materials. These aspects are considered indicators of quantity, amount, and quality. (Figure 2).

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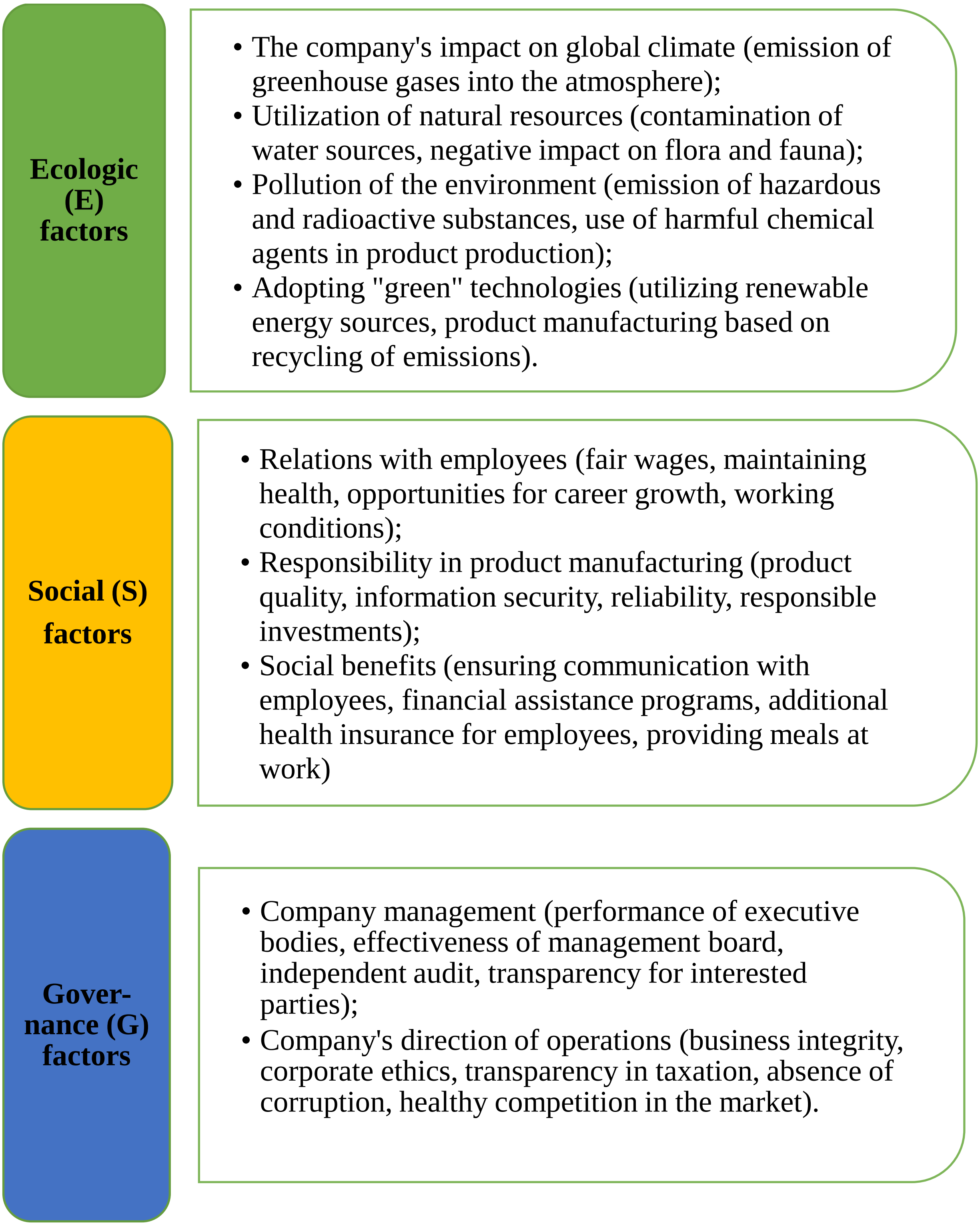

Figure 2. Evaluation of company compliance with ESG factors

When assessing a company's commitment to social (S) factors, it is imperative to consider various facets, encompassing the safeguarding of employees' rights, their well-being, and avenues for professional advancement. Additionally, critical aspects such as workplace conditions, product quality responsibility, information security, reliability, ethical investment practices, fostering transparent communication with

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employees, offering financial aid programs, enhancing employee health protection measures, and providing on-site meal options all play integral roles in ensuring current social advantages.

In utilizing the governance (G) factors within the ESG framework for a company, attention is directed towards the activities of executive bodies, effectiveness of the management board, implementation of independent audits, transparency for stakeholders, company management processes, adherence to corporate ethics, integrity in tax payment processes, prevention of corruption, and ensuring fair competition in the market.

When assessing a company's adherence to ESG factors, each of the three components (E, S, and G) is evaluated, and significant attention is given to achieving balance in their implementation.

Now, shifting our focus to the analysis of risks associated with ESG factors, it is important to note that these risks in company operations directly impact the environment, society, and management processes. ESG risks can substantially affect a company's assets, financial status, and performance. The following diagram (Table 1) illustrates the scope of the impact of ESG risks on a company's operations.

Table 1.
The risks related to ESG factors that can affect on activity of the company[1]

ESG factors	Risks
Environmental (E)	
greenhouse gas	The risks of increased taxes due to the emission of hazardous gases. The risks of production disruption and cessation of activities due to excessive emission of hazardous gases.
Climate change	Risks related to damages resulting from natural disasters (earthquakes, floods, etc.).
The pollution of the environment (waste)	Accidents, operational interruptions, or restrictions. Decline in company performance. Environmental degradation due to accidents.
Natural resources used	Depletion of non-renewable resources. Depletion of resources subject to replenishment (forests being cut down, water sources drying up). Depletion of biodiversity.
Social (S)	
The relationship with the employee	The risks of skilled employees leaving their jobs. Lack of employee motivation. Health-related risks.
The relationship with partners	The risks of prolonged production timelines or the risk of production delays.
The relationship with consumers	The risks of product and service quality deterioration and the decline in company reputation.
Corporate governance (G)	
Strategy	The risks of business investment attractiveness and the decline in stock value.
The composition and structure of management bodies	The risk with enough qualifications and skills of leaders.
The direction of the company conduct	The risk of loss of business reputation of the company.
Risk management and transparency	Full disclosure of information, not at risk of fulfilling their obligations.

The environmental, social, and governance (ESG) factors mentioned above can be more closely monitored in companies that prioritize their utilization. However, the role of ESG risks in a company's operations requires identifying their additional directions, evaluating them, and demanding their integration into conventional risks.

[1] https://cgi-russia.ru/ ESG 2022: актуальные риски и новые возможности для устойчивого развития компаний. 10.11.2022. – с. 5.

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As a result of climate change, the likelihood of production disruptions and infrastructure losses remains at a significant risk both now and in the coming years. For example, extreme weather events caused $100 billion in damages worldwide in 2019. In the first half of 2022, this figure amounted to $65 billion. By 2050, such incidents could result in damages totaling $8 trillion, equivalent to 3% of global GDP.

Since the adoption of the sustainable development concept at the "Rio+20" conference held by the United Nations in 2012, new investment models have emerged, emphasizing sustainable or responsible investment approaches. The purpose of introducing responsible investments was not only to obtain a certain profit for investors but also to enable companies to achieve positive social changes, reduce negative environmental impact, and adhere to ethical standards.

In addition to focusing solely on anticipated revenue when entering investments, investors would now stipulate the requirement for adherence to certain guidelines regarding the social, environmental, and ethical aspects, as well as corporate governance. This process gained momentum in Europe and North America in the 1960s.

One of the reasons that compelled investors to modify their investment strategies to align with ESG principles is the realization of the significant impact of socially responsible investments on the business's environment and society. Business representatives recognized the consequences of such impacts and, in turn, aligned investment projects with social, environmental, and managerial considerations. It is crucial for business representatives to understand the consequences of such impacts and incorporate social, environmental, and governance reporting into the implementation of investment projects.

Moreover, leading nations around the world are developing a comprehensive set of measures to promote socially responsible management and support environmental, social and governance initiatives through the actions of business representatives. At the same time, they are working towards aligning these efforts with national regulations.

It also should be noted that there is no definitive description providing a comprehensive explanation of responsible investment and its structural composition. Investors consider which ESG factors are most important to them, and they invest accordingly in the type of responsible investment they deem essential. The various types of responsible investment are illustrated in the following diagram (table 2).

Table 2.
Types of responsible investing[2]

Types of investment	Investment reasons	The type of investors	Investment description
Impact investing	To generate income for the company and have a positive impact on the social sphere and the environment.	private investors, management companies	Physical individuals who invest a portion of their joint ventures or pension funds through investment methods.
Sustainable investing	To find and select leading companies in sustainable development as part of the investment process.	Banks, International financial institutions, private funds	Providing equal access to financial services for the low and middle-income population, enabling them to benefit from financial services on par with higher-income individuals.
Ethical investing	When it comes to investment, companies that adhere to proper business ethics are selected.	fund management companies, investment banks	Supporting investment projects that align with ESG principles and values.
Green investing	Investment is made in companies that produce goods (products and services) that do	Private funds, management companies,	Investing in objectives related to business ethics.

[2] Source: compiled by the author on the basis of the official site https://unpri.org/ESG/definitions_for_responsible_investment_approaches_final_256878.pdf.

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	not harm the environment or in companies that utilize "green" technologies (energy and resource efficient).	investment banks	
Mission-related investing	Investments that align with the investor's specific objectives.	Private funds, insurance companies	Investing in projects that align with the company's ESG policies.
Investment network based on values (the value-based investing)	Investments based on the criteria accepted by the investor.	retirement funds, private funds	Investing in projects that align with the company's ESG policies.
Investment society (community investing)	Investments that prioritize social development.	Financial institutions that contribute to the development of the local community	Financial support provided by local companies and citizens to foster local community development.

In the World Bank's reports, thematic bonds such as GSS, GSS+, ecological, social, and governance (ESG), or sustainable bonds are recognized. Furthermore, thematic bonds, as a means of sustainable financing, include "green," social, sustainable, and sustainable development-oriented bonds. And, "blue" bonds refer to ocean-related projects, while gender bonds focus on social issues.

Thematic bonds are considered as valuable securities issued in capital markets. These bonds are associated with specific themes and initiatives, particularly addressing climate change, education, housing, ocean and marine conservation, nature preservation, and sustainable development objectives or activities.

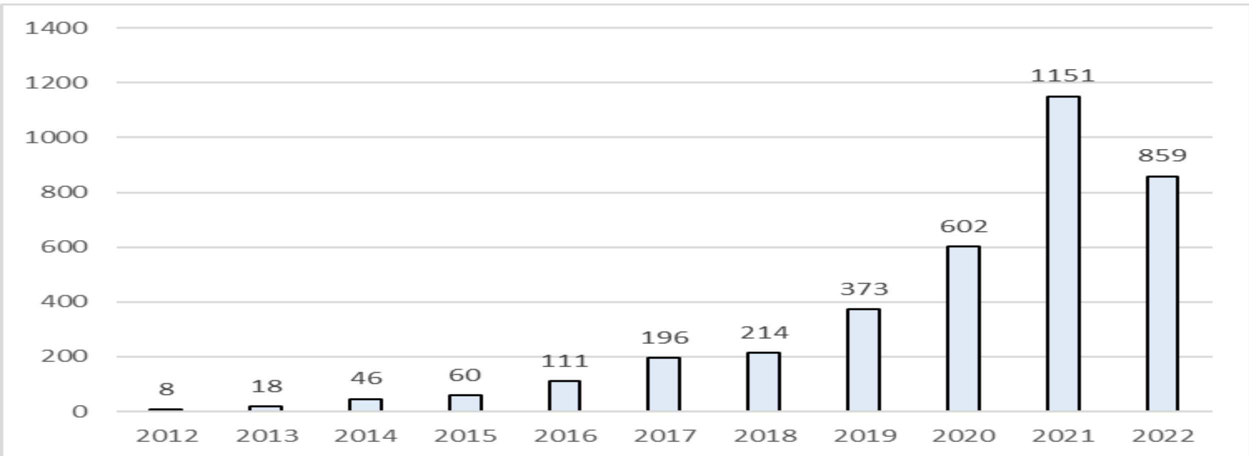

Figure 3. The global market for thematic bonds in 2012-2022 (in billions of US dollars)

If we turn our attention to the information regarding the global market for thematic bonds from 2012 to 2022 (Figure 3), bonds issued in the "green," social, sustainable, and sustainable development-oriented categories have exceeded a total volume of 3.6 trillion U.S. dollars. Thematic bonds had a total value of 132 billion U.S. dollars from 2012 to 2015, 894 billion U.S. dollars from 2016 to 2019, and surpassed 2.6 trillion U.S. dollars from 2020 to 2022. Interestingly, while thematic bonds issued between 2012 and 2019 accounted for a total value of 1.0 trillion U.S. dollars, the value for the most recent three years (2020-2022)

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alone equaled 2.6 trillion U.S. dollars. Overall, the issuance of thematic bonds has grown by a factor of 2.6 during 2020-2022 compared to the period of 2012-2019. This situation indicates that the growing interest of international investors in projects and activities supporting "green," social, and sustainable development goals in global capital markets.

CONCLUSION AND PROPOSALS

1. Transitioning to a sustainable economic growth model requires the establishment of a new rating system that includes certain macro indicators and provides the global governance institutions with necessary information for analysis. This rating system would enable the evaluation of countries' achievements in sustainable development based on the collection and analysis of relevant data. When countries fail to fulfill their obligations in achieving sustainable development goals, such as non-compliance with international agreements and violations thereof, they can be subjected to sanctions imposed by these countries.
2. It is essential to further enhance the environmental responsibility of state-owned enterprises in our country. In particular, the state should introduce a mandatory mechanism for submitting standardized reports in accordance with international standards to promote the inclusion of investments based on ESG (Environmental, Social, and Governance) criteria and ensure the protection of the environment and ecological safety.
3. The change in the international order and market regulations has led to the emergence of the ESG concept. This concept has introduced new dimensions in business operations and investment. Institutional investors, in particular, have strengthened their focus on companies' business and investment activities in terms of environmental protection, social and governance factors, as well as the identification and management of associated risks and opportunities. Drawing on international experience, it is in line with the state's goals to promote the implementation of the ESG concept in our corporate structures.
4. From 2012 to 2022, thematic bonds issued in the "green," social, sustainable, and sustainable development-oriented categories had a total volume of 3.6 trillion U.S. dollars worldwide. The issuance of thematic bonds reached 132 billion U.S. dollars between 2012 and 2015, 894 billion U.S. dollars between 2016 and 2019, and surpassed 2.6 trillion U.S. dollars between 2020 and 2022. This trend indicates the growing interest of international investors in projects and activities supporting "green," social, sustainable, and sustainable development goals in global capital markets. This trend presents an opportunity for our government and corporate entities to attract significant funds through the issuance of thematic bonds in international capital markets to support sustainable financing and initiatives.

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