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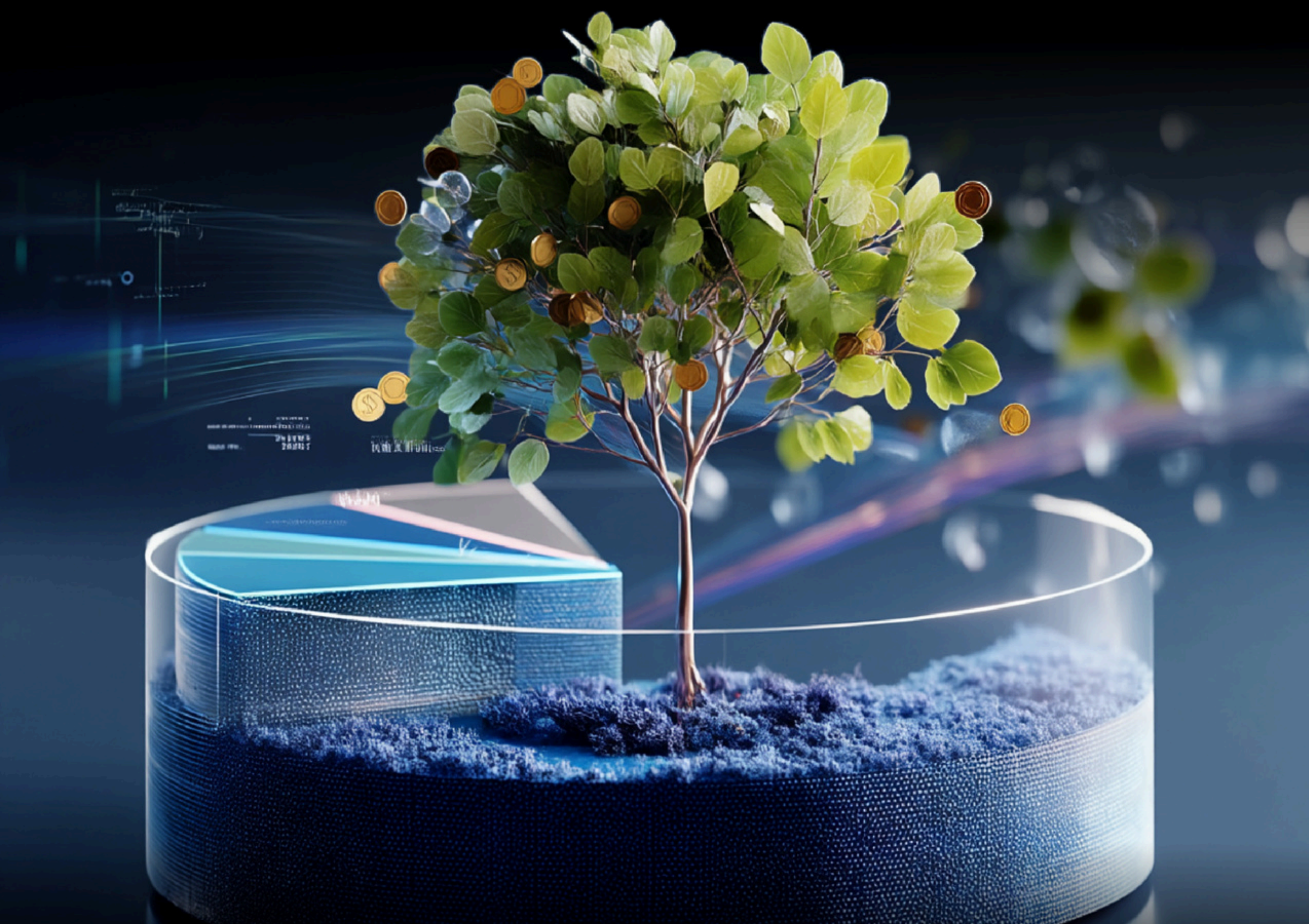
Opinion Piece



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Grow the Pie

Improving corporate sustainability with new financial sustainability-focused products

CORPORATE SUSTAINABILITY | ENVIRONMENTALISM | BIODIVERSITY

Today, the world faces the need for and desire for meaningful economic change: retooling the world economy to embrace sustainability, environmentalism, and biodiversity as essential components of all modern economic systems. New financial products that are sustainability-focused and available for everyone will be crucial to the success of this change.

Two of the most powerful forces shaping the world economy over the past three hundred years have been capitalism and democracy. Capitalism is not inherently tied to democracy; autocratic and socialist regimes exist that embrace capitalism. However, the proof is in the pudding that democracies paired with capitalist economies adapt more effectively to necessary and desired social changes because they are responsive to public demands and capable of implementing reforms. Capitalist democracies have proven resilient in overcoming economic and social crises, from industrial revolutions to financial downturns, by adjusting policies through public discourse and innovation.

Classic economic thinkers like Adam Smith (1776) and Joseph Schumpeter (1942) both wholeheartedly defended democratic capitalism as a powerful change agent. Smith argued that democratic capitalism promotes agency and personal choice, allowing people to influence economic outcomes, multiplying impact by reinforcing economic freedom, and driving societal evolution and broad-based prosperity. Schumpeter explained how democratic capitalism grants individuals the freedom to innovate and adapt, enabling the replacement of outdated economic structures with new, more effective systems.

Given this, why is so much of sustainable green finance only devoted to serving large institutions rather than involving the average person? There is a clear need to democratize green finance—best achieved through the creation of meaningful green securities accessible to everyone. These securities should help companies meet their environmental promises while allowing the average person participate in the economic benefits of sustainability and have a say in the environmental outcomes.

Capital markets are undeniably important in supporting sustainability practices and successful climate action from corporations. However, the focus on green bonds and the lack of green equity products represent missed opportunities for companies, investors, and Wall Street alike. Why are there no widely available, easily accessible green equity solutions for individual investors? It's time for Wall Street to offer new securities in the marketplace that enable tomorrow's blue-chip companies to be truly green.

While both debt and equity have their place in helping a company grow, bonds come with several drawbacks. Interest payments drag on revenue and profit until fully repaid. Interest must be paid back immediately, and there is often a delay of months to years before funds raised from bonds can generate income. Additionally, interest payments aren't an expense companies can economize on or skip—failure to make payments results in default. Finally, bond raises are typically more accessible for big corporations with large, predictable, recurring revenue streams. For smaller to midsize companies, the fixed-income markets can be challenging places to raise money without burdening the company. Yet all companies need money to fund their journey to sustainability. In terms of investors, corporate bonds are typically out of reach but for all the largest (typically institutional) investors. This means green bonds are failing to help the majority of companies and are failing to involve the majority of investors.

A quasi-equity option exists today: Green ETFs (exchange-traded funds). However, they are plagued with many problems and fail to meet modern investor needs. Traditional sustainability-focused ETFs don't address many investor concerns and needs. Often, there is a lack of stringent criteria to join the ETF, inconsistent and superficial screening of firms that are included, limited engagement and stewardship by the ETF fund manager, sector and geographic biases that result in overweighting, a lack of thematic focus, and the ever-present short-term performance pressure versus meeting long-term sustainability goals.

The world needs the creation of a true green equity—accessible to investors of all sizes and issuable by companies both large and small. Most importantly, the world is clamoring for creating this kind of new instrument. There is an undeniable appetite for green investment products of all shapes and sizes. Even after a slight backtrack in 2023, the market for sustainability and impact-focused funds is still at $30 trillion right now (Marsh 2023) and is projected to grow to approximately $50 trillion by 2025 (Castano), with expectations of continued acceleration. It's a sign that investors want to have their cake and eat it too—financial returns coupled with green outcomes are the expectation of many current and future investors.

It is well known that stocks generally outperform bonds over time due to the equity risk premium investors enjoy over bonds (at least for the last two hundred years or so) (Investopedia Team 2024). Stocks also benefit overall from a company's performance and a growing economy (there are no "bond splits"). Additionally, stocks are more liquid than bonds, and the stock market has a lower barrier to entry since most bond trading is over-the-counter (OTC) and limited to a handful of sophisticated investors with deep pockets.

So if most companies don't prefer bonds and most investors favor stocks, why not fund green transitions and green efforts differently? What might a green equity solution look like? What if there was a unique, dedicated stock issuance for green projects? Why not create a green equity tied to a company's sustainability and environmental commitments?

All companies, regardless of size, could issue green equities and other liquid securities to readily access the large pool of sustainability-focused capital to fund their green projects, transitions, and initiatives. These new green equities could serve as a powerful tool for any company looking to accelerate its green journey—whether already eco-conscious or just beginning the transition. They could even provide an incentive for carbon-intensive companies to take sustainability seriously. Issuing companies would also get direct access to retail green investors, as opposed to the larger institutional investors who typically purchase green bonds. Retail investors often have a longer-term time horizon for returns, which could be a meaningful advantage for carbon-intensive businesses whose management teams understand that achieving sustainability is a long-term process.

Additionally, issuing green securities would signal a credible commitment to improving environmental operations, processes, and impact—especially if an accountability component were embedded in the instrument. Depending on its design, CFOs could even leverage treasury stock as part of the return of a green security when projects and initiatives are completed successfully. Furthermore, the existence of a green equity instrument would keep the debt-to-equity ratio lower than issuing bonds and, depending on how it was structured and designed, could even give less control to outsiders than just another offering of common stock.

At the end of the day, investors want to invest in a greener, future-ready company that is better prepared to seize market opportunities, lower costs, and increase revenue. Green stocks offer an attractive alternative for companies seeking to fund their green commitments and green journey, and they should appeal to investors who want credible green products that still deliver shareholder value. To succeed, capital market solutions should better align fiscal incentives and business strategy with green principles and outcomes.

Finally, consider the upside for Wall Street and global financial hubs. A whole new class of securities means potential opportunities—more jobs, more trading activity, and more profits. Imagine the potential for value and wealth creation vis-à-vis the syndication, issuance, listing, and trading of new liquid equity security classes devoted to sustainability and available to small and large investors. Reuters and Bloomberg both forecast that the market for sustainability investment products is projected to grow from $30 trillion to approximately $50 trillion in the next few years. Global equity markets are currently in the neighborhood of $100 trillion market capitalization. Now imagine that market growing by $20 trillion (or more) by adding green equity products into the mix. The only question bankers, traders, and market makers should be asking is: Where do I sign up? That the storied institutions of Wall Street have not deciphered this yet is a mystery.

There is room for—and a pressing need to create—an authentic green equity product. A product that empowers investors of all sizes to have the same impact on a company's green initiatives that owning a modern plain-vanilla equity gives them a say in the daily financial operations and participation in the long-term success of a company. A new green equity instrument that allows companies to raise money for their sustainability initiatives while empowering any and all sizes of investors will be a crucial innovation to harness the power of democratic capitalism to deliver the change at scale in modern corporate operations that the world needs to meet its climate targets before it is too late.

Author

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About

The Digital Economist, based out of Washington D.C. is an ecosystem of 40,000+ executives and senior leaders dedicated to creating the future we want to see: where digital technologies serve humanity and life. We work closely with governments and multi-stakeholder organizations to change the game: how we create and measure value. With a clear focus on high-impact projects, we serve as partners of key global players in co-building the future through scientific research, strategic advisory and venture build out. We are industry-agnostic as most high-impact projects touch many different industries. Our portfolio ranges from energy transition to ethics in emerging technology.

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