

Green finance: how competition can bring polluting firms into the fold

Written by

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No company wants to be the dirtiest on the block. If there were a clear and consistent way to gauge and reward progress, even the most polluting firms would find the will and the funds to decarbonise

With more reporting rigour, banks, investors and other financial institutions could start working with all corporates to move away from fossil fuels towards cleaner energy. What this requires is accurate, harmonised data, standardised disclosure principles and a robust regulatory strategy – all of which are achievable.

Green finance needs transparent, consistent and mandatory metrics

Many investors now want to go green, but the green economy and infrastructure aren't big enough to absorb the vast sums required for change: estimates put the funding gap at \$2.7 trillion a year between current investment and what's required

to stabilise the climate. And the global economy continues to depend heavily on fossil fuels, consuming (pre-pandemic) the equivalent of 200 million barrels of oil a day.

Currently, green finance suffers from inconsistent metrics, hype and a lack of clear benchmarking.

But with transparent measures harmonised across sectors and backed up by mandatory reporting, money could be safely invested in even the greatest users of fossil fuel and help bring them in from the cold.

The planet needs everyone to take part

Investment is hampered by a narrow view of what's "good" or "bad" for the climate. We want financial institutions to work with all sectors, especially those with a poor starting point, and help build finance structures that will map out a transition path towards decarbonisation. It would be a dynamic process tracking the rate of improvement in recognised emissions and how much companies invest in decarbonising.

This will provide transparent benchmarking. Every company will have to declare how fast they are cutting Scope 1, 2 and 3 emissions - direct and indirect emissions, as well as those occurring further down the value chain. Companies must also declare how much money is being invested and from which pot (clear segment reporting and categorised capital expenditures plans are indicators of company intentions). These metrics will remain clear and consistent over time, but each corporate transition to decarbonisation will depend upon its own path.

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Being forced to report on these metrics could alter mindsets and change corporate strategy; clearly benchmarking against competitors would change behaviours. Requirements for subsequent years will depend upon previous performance.

The beauty of this system is that activities not traditionally seen as "green", such as decommissioning old power plants, or technological innovation, will also benefit from green finance. After all, they still need to take place if emissions are to fall.

Regulators, investors, banks and accountants

It would be naïve to believe companies will do this off their own bat. This requires a strong regulatory framework that will ultimately move reporting from voluntary to mandatory. Many of these standards will be country and sector specific, but a unified standard would help.

Investors, banks and financial institutions also have a critical role to play. Financial institutions have the power to transform behaviour not by divesting, but rather by urging a company to adopt decarbonisation initiatives. If funders don't see progress on pre-agreed metrics, they can dump their shares. Significant investors can influence climate disclosure and governance through proxy voting and engagement. Banks could offer more favourable financing to companies that play ball and transfer the cost to those who are polluting.

We're also calling on securities regulators and accounting agencies to incorporate segment reporting that classifies activities better in line with climate goals. Accounting firms could introduce reporting metrics as a matter of course.

The need for flexibility

Of course, there will be uncertainty, and every transition pathway will be subject to external shocks that we can't anticipate or account for. But this system allows for flexibility.

Companies themselves have proven adaptable, as have regulators. In the wake of the 2008 crash, we've seen far reaching regulation requiring banks to demonstrate capital adequacy and perform supervisory stress testing. If they failed on either quantitative or qualitative basis, their capital distribution plans were negatively affected. During the COVID-19 pandemic, we've seen companies adapt swiftly to shifting sands.

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We believe these measures, applied sooner rather than later, can shift the dial on decarbonisation, and channel funds towards companies and sectors that miss out on traditional green finance. But the longer we wait, the more drastic the measures

required, and the more companies will need to focus on change beyond their core business.

Although there is no finite date, we should treat climate change as a clear and present danger and react with the same energy that we have towards the pandemic. We're optimistic, we've seen now that significant change is possible at short notice.

This article draws on findings from [“Transition Finance: Managing Funds to Carbon-Intensive Firms”](#) by Charles Donovan, Milica Fomicov and Anastasiya Ostrovnaya from Imperial Business School's Centre for Climate Finance & Investment.

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Mili Fomicov is a Lecturer and leads clean energy research at the Centre for Climate Finance and Investment (CCFI), Imperial College London. She is also a Co-Director for the Singapore Green Finance Climate Academy and a consultant for Oxford Sustainable Finance Group, University of Oxford, where she is working on Thailand's net zero transition plans.

Read [Milica's Imperial Profile](#) for more information and publications.

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Forbes reports on Imperial's research that investment in companies that don't necessarily fit the "green" definition will be required if countries are to transition to lower-carbon economies

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