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SUSTAINABLE FINANCE AND ESG INTEGRATION: CAPITAL MARKETS AS DRIVERS OF GLOBAL CHANGE

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INTRODUCTION

The times that we live in have been driven by a growing sense of accountability among people. This generation of humans yearn for growth but not at the cost of environmental damage, they aim for progress but not at the cost of social inequality. If we analyze the global financial landscape trends then we witness growth of a transformative trend where there has been an urgency in addressing the problems like climate change, social inequality and challenges to the corporate governance. Through this paper I aim to analyze one of the transformative shifts, i.e., the Rise of Sustainable Finance which seeks to align the flow of finance with long-term ESG objectives. Capital Markets have become a catalyst for channeling investments that are aiming to advance global development goals. Previously the integration of ESG criteria in the investment portfolio seemed to be a niche, not many companies followed but with the awareness and accountability rising in this generation of people it has now transitioned into a common practice. It is expected that by the end of 2025 around 70 percent of the global investors would be incorporating ESG factors into their portfolios and we can say that because we also have a trend going on currently where the issuance of green bonds has reached record levels⁶⁷⁹. Therefore, through this paper my objective is to explore how capital markets are in the forefront of the transition to a more sustainable economy.

GRASP - EDUCATE - EVOLVE

⁶⁷⁹ BNP Paribas, *ESG Global Survey 2023: Taking Action – Institutional Investors Progress on the Path to Sustainability* (2023) <https://securities.cib.bnpparibas/app/uploads/sites/3/2023/12/esg-global-survey-consolidated-report.pdf>, accessed 7th July, 2025

The Evolution and Growth of Sustainable Finance

Sustainable Finance has seen exponential growth from being a niche consideration sought out only by a few individuals to being one of the central forces of the global capital market. This claim is based on the data which tells us that the sustainable finance market has seen an exponential expansion from \$6.71 trillion in 2024 to an estimated \$8.27 trillion in 2025, reflecting a compound annual growth rate (CAGR) of 23.1%.⁶⁸⁰ Now we obviously need an answer to the common question? What changed? And why have the companies been opting for sustainable finance? Well, this rapid growth in this sector is because of the increasing investor demand for responsible investment initiatives which focus on things like following the corporate social responsibility initiative, focusing on sustainable supply chains and renewable energy investments. If we see the future then the sustainable finance market is forecasted to reach \$18.79 trillion by 2029. This anticipation of a robust CAGR of 22.8% can be done because of the growing demand for reducing the carbon footprints, opting for sustainable choices and the growing rise for green bonds, etc.⁶⁸¹

If we see the origins of sustainable finance, it can be traced back to the days of ethical investing, where individuals used to make investments based on ethical considerations. This kind of approach rooted in such centuries old practice was given a formal structure during the times of anti-war and civil rights movement in the 1960s and 1970s.⁶⁸² This is the time around which the concept of sustainable investment emerged, "Emphasizing the need to meet present needs without compromising future

generations' ability to meet theirs."⁶⁸³ All this accumulated and by the 1970s we had inculcated the concepts like "Earth Day"⁶⁸⁴. Then came the integration of corporate social responsibility into the system where the corporate giants were made liable for what they were taking from society and they were held accountable and forced to give back to society. Companies that had integrated CSR and ESG into their firms started becoming attractive investment options and this encouraged more and more firms to actively integrate such sustainable options in their companies. The early 2000s saw the emergence of the term "ESG," notably with the 2004 "Who Cares Wins" report, which established the link between ESG actions and financial performance.⁶⁸⁵ In the 2010s ESG had shifted from a voluntary choice to a very smart financial strategy. Therefore, these sustainable regulatory options have been around for ages and today we have seen the highest adoption of the same because of the heightened climate crisis that we are dealing with. Today firms that incorporate such options are automatically seen as a responsible firm which cares for the future of the planet and thereby gives the investors an incentive to invest in those companies. Capital markets play a pivotal role in channeling the fund to sustainable options and ESG funding has become a standard instrument.

Capital Markets as Channels for sustainable investment

Capital markets are basically channels for sustainable development, as they facilitate the flow of Capital into areas that are prioritized in the pursuit of SDG. This sector has the power to channel financial resources towards projects that are focused more on sustainable

⁶⁸⁰ Research and Markets, *Sustainable Finance Market Report 2025* (2025) <https://www.researchandmarkets.com/reports/5997390/sustainable-finance-market-report> accessed 7 July 2025.

⁶⁸¹ Research and Markets, *Sustainable Finance Market Report 2025* (2025) <https://www.researchandmarkets.com/reports/5997390/sustainable-finance-market-report> accessed 7 July 2025.

⁶⁸² NextAgile, 'Historical context and evolution of sustainable finance' (13 April 2023) <https://www.esg.next-agile.co.za/courses/strategies-for-sustainable-investments/lessons/1-introduction-to-esg-financing-2/topics/historical-context-and-evolution-of-sustainable-finance-2/> accessed 7 July 2025.

⁶⁸³ World Commission on Environment and Development, *Our Common Future* (Oxford University Press 1987).

⁶⁸⁴ Library of Congress, 'Today in History - April 22: Earth Day' (Library of Congress, 22 April 2025) <https://www.loc.gov/item/today-in-history/april-22/> accessed 7 July 2025.

⁶⁸⁵ United Nations Global Compact, *Who Cares Wins: Connecting Financial Markets to a Changing World* (2004) <https://documents1.worldbank.org/curated/en/2809114889268799581/pdf/113237-WP-WhoCaresWins-2004.pdf> accessed 7 July 2025.

development and ESG objectives.⁶⁸⁶ The focus of Capital market towards a more sustainable finance has transitioned from being a niche to a mainstream analysis activity particularly from the time of adoption of the SDG goals and the Paris Agreement in 2015.

Capital markets offer a wide variety of instruments and products which are designed to attract ESG focused investment. Some of the tools for the same are- green bonds, Social Bonds, Sustainability-linked bonds, etc. If we think about the size of the global sustainable finance market it has reached a whopping value of \$5.8 trillion in 2022, which only highlights the investor interest in sustainable financial options.⁶⁸⁷ There have been several regulatory developments and changes in international standards like, for example, the emergence of taxonomies like the European Union and the International Sustainability Standard Board⁶⁸⁸. With the emergence of these concepts the investors can clearly identify the actual and genuine sustainable opportunities and therefore encourage companies to improve their ESG performance.

These advancements as perfect as they sound come with their own set of drawbacks. These concepts seem very exciting on paper but the penetration of these concepts into the developing and third world countries is still a challenge. The concentration of such concepts in the developed countries and the fear of ESG washing has prompted calls for the harmonization of such standards and proper structure for reporting.⁶⁸⁹ To address these issues, international organizations such as UNCTAD and the United Nations Global Sustainable Finance Observatory are working to

accelerate education, improve regulatory frameworks, and support the development of sustainability-themed funds that target both developed and developing economies.⁶⁹⁰ Capital Markets are only in their nascent stage when it comes to the flow of capital towards sustainable projects and therefore they have to work more on shaping the standards, practices and expectations that define the future of sustainable finance.

ESG criteria: Integration and Investor Perspectives

Today with the increasing focus that we are putting on recognizing ESG criteria into the decision-making process of investment portfolio, we can easily say that it has become a defining trend in global capital markets. An ESG oriented investment portfolio gives the investors an assurance of long-term value creation and proper risk management plan. According to the 2025 Global ESG Fixed Income Investor Survey by RBC Capital Markets, “over half of institutional investors now integrate ESG considerations into more than 50% of their investment mandates, with this practice particularly prevalent among investors with EUR and GBP mandates.”⁶⁹¹ ESG integration does not only have to do with ethical alignment but rather it is more about enhancing the portfolio of the company so that they have an appetite for risk in case of regulatory changes and market expectations.

If we look at recent research, it is seen that approximately upward of 85% of investors consider ESG to be an important factor while they make important investment decisions⁶⁹², in fact it has been seen that even though ESG might come at a cost like premiums, the

⁶⁸⁶ UNCTAD, ‘Capital Markets and Sustainable Finance’ (World Investment Report 2023) https://unctad.org/system/files/official-document/wir2023_ch03_en.pdf accessed 7 July 2025.

⁶⁸⁷ GMI Insights, ‘Sustainable Finance Market Size, Statistics Report 2025-2034’ (31 March 2025) <https://www.gminsights.com/industry-analysis/sustainable-finance-market> accessed 9 July 2025

⁶⁸⁸ Anastasios Sepetis, ‘A Holistic Sustainable Finance Model for the Sustainable Capital Market’ (2020) 9 Journal of Financial Risk Management 99 https://www.scrip.org/pdf/jfrm_2020060814384699.pdf accessed 7 July 2025.

⁶⁸⁹ SK Park, ‘Sustainable Finance in Global Capital Markets’ (2023) https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4124814 accessed 7 July 2025.

⁶⁹⁰ UNCTAD, ‘Capital Markets and Sustainable Finance’ (World Investment Report 2023) https://unctad.org/system/files/official-document/wir2023_ch03_en.pdf accessed 7 July 2025.

⁶⁹¹ RBC Capital Markets, 2025 Global ESG Fixed Income Investor Survey: Summary Results, available at https://www.rbccm.com/assets/rbccm/docs/insights/2025/2025_global_esg_fixed_income_investor_survey_results.pdf, accessed 9th July 2025.

⁶⁹² McKinsey & Company, ‘Investors want to hear from companies about the value of sustainability’ (15 September 2023) <https://www.mckinsey.com/capabilities/strategy-and-corporate-finance/our-insights/investors-want-to-hear-from-companies-about-the-value-of-sustainability> accessed 9 July 2025.

investors are seen willing to pay more for the same for their long term benefit. In fact, in much research that has been carried out it is seen that many investors put factors like ESG and CSR as a central factor in making investment decisions.

Basically, the transition of ESG incorporation among the companies has moved from being a niche sector to being a common inclusion strategy. Even investors have moved beyond basic screening to a more nuanced careening of companies' adoption of these policies. There is an increasing demand for standardized reporting framework of ESG ratings to make things clearer with regards to long-term value creation. Capital markets provide tools like green bonds, ESG themed financial instruments and sustainability-linked bonds. Therefore, with the increase in investor demand the capital market is becoming a catalyst for more sustainable investment.

Challenges and Headwinds

There are too many advantages to Investments aimed at long-term growth and sustainability but so are challenges and headwinds. Even though there is rapid growth in this sector and it is coming to the forefront as a topic for discussion by the investors, there are challenges which are acting as hindrances in achieving the full effect of the development. one of the foremost challenges in landscape for ESG growth and development, is the fragmented regulatory landscape. The laws are still evolving and there are so many times when it becomes unpredictable to decide as to what would be the next step. There are various jurisdictions who have a very different way of dealing with their ESG norms. For the EU the ESG norms are tightening while if we see the US there is a growing sentiment for anti-ESG measures.⁶⁹³ Since there are different approaches of various jurisdictions ending up in almost polarized views, it is seen that there is no uniformity for

the same. Since today business is cross-border and investments are not restricted to one state or country and multi-lateral ties are increasing every day, it is essential that we come up with a standardized policy which can act as a guidance for all the parties irrespective of which jurisdiction they are from. There are now emerging concepts of green washing where the companies exaggerate their sustainability credentials and these problems arise because there is a lack of ESG metrics and reporting framework.⁶⁹⁴ These things undermine investor confidence and discourage them from taking sustainable finance initiatives.

These problems can be solved if we come up with a proper ESG data collection and reporting method which is acceptable universally, this would increase the transparency and investor confidence. There subsequently needs to be an alignment in the political views about ESG standards and objectives. This would lead to lesser ESG litigations. We also need to put a thought on the sustainability of ESG and such clean energy sectors without government subsidies and financial incentives.

Future and Policy Recommendation

Through this paper we have clearly seen what has happened in the past, now the world has problems everywhere but what needs to be done is look for solutions, therefore there are few things that could be done to solve the problems that have come up with the incorporation of clean investing in the companies and by the investors.

The first and the foremost thing that needs to be done is the harmonization of global regulations and standardization of the same across the regions. This can be done by analyzing the reports from the international Sustainability Standards Board (ISSB) and the EU's Corporate Sustainability Reporting Directive (CSRD). This would ensure that the ESG norms are consistent and comparable with all the

⁶⁹³ ASUENE, 'What Will Change in 2025? A Complete Guide to ESG Disclosure Rules in the EU and US' (23 May 2025) <https://asuene.com/us/blog/what-will-change-in-2025-a-complete-guide-to-esg-disclosure-rules-in-the-eu-and-us> accessed 9 July 2025.

⁶⁹⁴ EcoActiveTech, 'The 5 Main Challenges of ESG Reporting and Best Practices' (25 February 2025) <https://ecoactivetech.com/the-5-main-challenges-of-esg-reporting-and-best-practices/> accessed 9 July 2025

jurisdictions.⁶⁹⁵ With the reduction in fragmented regulatory norms across the world the investor confidence would automatically be boosted and more funds would be directed in these sectors.

Next, we can work on disclosure requirements for ESG. If we have tight disclosure requirements then the problems like green washing can easily be resolved. The norms should be such that while the companies use the term “sustainable” and “ESG” they mean it rather than just using it as an attraction point of view. It is further important that we increase the use of innovative sustainability tools like the green bonds, carbon credits etc. Subsequently the divide between the developed and the developing countries needs to be bridged when it comes to Sustainable finance flows. There needs to be an alignment of corporate governance with ESG performance so that this concept is prevalent in the corporate strategy and risk management. The most important part is that there needs to be an increased international collaboration among the governments, regulators and investors to work together on adopting best practices. Even after this, we cannot just frame policies and leave it to be, we need a robust monitoring mechanism to see to the risks that are emerging out of this and take active measures to address it and rectify the laws.

Conclusion

The integration and usage of sustainable finance methods have fundamentally reshaped the global financial landscape and has put capital markets to the forefront. There has been emergence of concepts like social equity, corporate social responsibility and responsible governance. On analysis of Empirical evidence it is seen that when ESG implementation is done properly, it not only enhances the profitability of the firm but supports the social objectives of the

firm which creates a stronger investor and customer base for the company.

Achieving full potential of sustainable finances is not easy and comes with significant challenges like risk of greenwashing, no standardized regulatory measure and persistent inequality in terms of enforcement between the developing and the developed countries. There needs to be a proper channel to address the same and we need to come up with transparent standards which incentivize ESG adoption. Ultimately it is all a collective effort by all the parties like policymakers, investors and companies to come up with an effective way to get this implemented.

⁶⁹⁵ Pilario, ‘CSRD vs. ISSB Comparison: Key Differences and Similarities’ (13 November 2024) <https://www.pilario.com/press-release/csrd-vs-issb-comparison-differences-similarities/> accessed 9 July 2025