

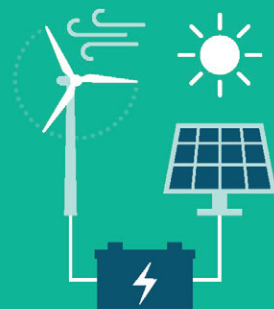
BUSINESS IN THE 21ST CENTURY

A Sustainable Approach



Edited by

CLAUDIA NELLY BERRONES-FLEMMIG
FRANCOISE CONTRERAS
UTZ DORNBERGER



Business in the 21st Century

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Business in the 21st Century: A Sustainable Approach

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Preface

This book focuses on how to achieve sustainable organizations in complex business environments characterized by ongoing crises such as the COVID-19 pandemic, political conflicts, market volatility, and global warming, taking as its framework the United Nations' Sustainable Development Goals (SDGs). Against this backdrop, each chapter offers contributions from different areas in the field of business and management, such as managing talent, finance, marketing, innovation, organizational behavior, environmental issues, and corporate social responsibility. Based on the work of scholars with expertise in a wide variety of disciplines, our contribution aims to provide a framework for other researchers, practitioners, managers, CEOs, and companies to address (and thereby survive) current challenges and to equip themselves to deal effectively with the aftermath of crises. This book examines a range of topics whose common thread is how to help companies generate value for society, stakeholders, and shareholders.

Incorporating SDGs entails viewing every aspect of business strategy through the lens of global goals. Attaining these development goals is vital for the prosperity and well-being of people, societies, and enterprises and is expected to lead to 380 million new jobs being created by 2030 (United Nations, 2020). Company managers need to ensure that these new jobs are sustainable and paying a living wage, not only in their firms' immediate operations but throughout their supply chains and distribution networks, helping investors to appreciate the value that sustainable business can create.

In the face of these evolving challenges, organizations must shoulder a huge responsibility. Although some personnel are aware of the importance of their company's commitment to SDGs, many of these firms are not adapting their business practices – often because CEOs and other management leaders have encountered difficulties in aligning their business strategies with the SDGs and in adequately integrating the measures they take into sustainability reports. We sincerely hope that this book can contribute to making this task easier. Each chapter features advice, examples of best practice, theoretical perspectives, and background context that can help companies determine how they can implement SDGs in a more effective and timely way. We hope readers will find the information that our team of experts provides in the following pages to be both pertinent and practical.

Prof. Dr. Claudia Berrones-Flemmig
Prof. Dr. Françoise Contreras and
Prof. Dr. Utz Dornberger

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Prof. Dr. Claudia Berrones-Flemmig
Prof. Dr. Françoise Contreras and
Prof. Dr. Utz Dornberger

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Chapter 1

The Finance Function and the Financial System Toward the Achievement of the SDGs: Literature Review and Lessons from the COVID-19 Crisis

Claudia Nelly Berrones-Flemmig

Abstract

The finance function and the financial system require finding a balance between wealth maximization, social and ecological aspects, and managing the triple bottom line of business sustainability. The main aims of this chapter are to: (1) describe (with the help of the literature review) relevant strategies in firms, financial institutions, and governments followed within the finance function on the way to achieve the Sustainable Development Goals, including the times of the COVID-19 pandemic, and (2) propose practical guidelines for CFOs and managers to respond to the new challenges, learn positive lessons from the COVID-19 crisis, and thus keep improving to achieve more sustainability in the finance function. According to [Lawson \(2020\)](#), the current finance function priorities mentioned in a global study are (1) risk management, (2) cash management, and (3) cost management and control. In the hardest hit industries (e.g., hospitality sector) from COVID-19 lockdowns, the continued innovation of the business model is an important key to create new revenue streams and secure a better level of liquidity ([Breier et al., 2021](#)). During the first phases of the COVID-19 pandemic, social entrepreneurship funds reported more returns that are positive, suggesting that fund managers have changed from a high-risk style to low risk regarding size and investment strategy ([Rizvi et al., 2020](#)).

Keywords: Finance; financial management; sustainable finance; COVID-19; SDGs; financial innovation; innovative financial instruments; sustainable financial system

1. Introduction

1.1 Background

The finance function and the financial system require finding a balance between wealth maximization, social and ecological aspects, and managing the triple bottom line of business sustainability. In other words, the profitability of a business should not be the only objective of a business; it is essential to find a balance considering ecological and social aspects as well.

In the last 30 years, the world has experienced huge social improvements and technological progress. However, despite the successes, the current global model of development is imperfect, and it has several areas of improvement ([Business and Sustainable Development Commission, 2017](#)). For example, natural disasters due to climate change have doubled in frequency since the 1980s ([Food and Agriculture Organization of the United Nations \[FAO\], 2015](#)). According to the [Institute for Economics and Peace \(2015\)](#), violence and armed conflicts cost the world the equivalent of 9% of GDP in 2014. In addition, lost diversity and ecosystem damage cost approximately 3%. Therefore, the Business and Sustainable Development Commission was created in Davos in January 2016. The Commission has mainly two aims: (1) mapping the economic prize that could be available to enterprises if the UN Sustainable Development Goals (SDGs) are achieved and (2) describing how business can contribute to accomplish these goals. Achieving the Sustainable Development Global Goals would create a world that is socially fairer, environmentally secure, and, at the same time, economically prosperous and more predictable, a suitable model for long-term growth if all the businesses contribute. However, a survey shows that half of the business community considers that this is only government territory ([Business and Sustainable Development Commission, 2017](#)). Currently, the pandemic has changed the way the business operates worldwide ([Lawson, 2020](#)). The uncertainty of the present world environment makes it hard for business to plan; real interest rates are historically low (even negative) in several major economies. Within these circumstances, several enterprises do not commit to longer-term investments. Many companies prefer sitting on cash, buying back shares, and paying high dividends ([Business and Sustainable Development Commission, 2017](#)).

Therefore, there are several efforts from relevant institutions to find a balance between the interests of the investors with the SDGs. A report from the [World Bank \(WB, 2020\)](#) explains bond investors and other capital markets stakeholders how all WB bond proceeds support the SDGs. The WB motivates investors to support the SDGs through issuing green bonds and sustainable development bonds. The WB also highlights the investors that the SDGs support and gives information for bond investors for assessing the sustainable financial instruments ([World Bank, 2020](#)). According to [Wang \(2020\)](#) within an FTSE Russel study currently, climate transition benchmarks are a key point for investors worldwide; they are looking for investment portfolio strategies according to the climate goals

of the Paris Agreement and “Paris-aligned” benchmarks, such as the Environmental, Social, and Governmental (ESG) criteria.

The connection of the SDGs considering pandemics is also present in the financial markets. During the first phases of the COVID-19 pandemic, social entrepreneurship funds reported more returns that are positive, suggesting that fund managers have changed from a high-risk style to low risk regarding size and investment strategy (Rizvi et al., 2020). Salisu et al. (2020) found that incorporating an uncertainty of pandemics and epidemics (UPE) indicator in the valuation of stocks, particularly during pandemics, is crucial for investment decisions, especially in emerging markets.

1.2 The Finance Function, the Financial System, and the SDGs

According to the World Bank (2017), the financial system has responded in the last years to the challenges of the time. The goal of sustainable growth is a global consensus and one of the greatest challenges of the twenty-first century (United Nations). The financial system will play a relevant role in this process. The United Nations provided a roadmap to propose an approach to accelerate the transformation toward a sustainable financial system. This proposal considers ministries, central banks, financial regulators, and private financial sector participants. The efforts of all the participants should reach a financial system that integrates sustainability into its operations, including the cost of positive and negative aspects that sustainability implies.

Lagoarde-Segot (2020) presented some pathways to finance the SDGs. However, for these purposes, it is important to reconsider relevant assumptions about the financial systems. This author uses a history of economic thought perspective related to the loanable fund theory, which comes to support the SDG finance strategies. It is necessary to discuss a set of financing instruments that would permit to bridge the SDG budget gap. Some of these mechanisms are the issuing of sovereign green bonds, the change of the European Central Bank’s collateral framework, the adaptation of capital adequacy ratios, and the establishment of a market of SDG lending certificates.

There are several SDGs related to the finance function, but in this chapter are considered mainly three SDGs, namely, SDG 1 (ending extreme poverty by 2030), SDG 10 (reduce inequality), and SDG 13 (climate change).

SDG 1: Ending extreme poverty by 2030 – to end poverty in all its form everywhere.

SDG 10: Reduce inequality within and among countries – to design a financial system oriented to reduce inequalities.

SDG 13: Climate action – to take urgent action to combat climate change and its impacts and keep creating innovative financial instruments to support this urgent action.

However, the world continues investing in high-carbon infrastructure at a rate that could commit us to a high damaging climate change (Alpha Beta analysis for the Business and Sustainable Development Commission, 2010).

1.3 Research Problem and Main Objectives

Considering the foundations, facts, and analysis described before, the main aims of this chapter are:

Describe (with the help of the literature review) relevant strategies in firms, financial institutions, and governments followed within the finance function on the way to achieve the SDGs, including the times of the COVID-19 pandemic.

Propose practical guidelines for CFOs and managers to respond to the new challenges, learn positive lessons from the COVID-19 crisis, and thus keep improving to achieve more sustainability in the finance function.

2. Literature Review

2.1 Finance and SDGs: Strategies Followed by Firms, Financial Institutions, and Governments in the Last Years

[Etzion et al. \(2019\)](#) highlighted that the SDGs represent a funding challenge that can contribute to financial innovation. One example of this is companies in the insurance sector, which have developed financial instruments for managing an increasingly unstable world: flooding, fire, storm risks, etc. One example of these kinds of financial instruments related to the aspects before is the catastrophe bond, which transfers high risk from insurers and reinsurers to the capital markets.

[Kedir et al. \(2017\)](#) estimated the additional investment necessary to achieve the SDG 1 (ending extreme poverty by 2030) in Africa. Africa requires an investment-to-GDP ratio and a financing gap-to-GDP ratio of 87.5% and 65.6% every year, respectively, from 2015 to 2030. Nevertheless, the estimations vary across subregions and levels of development of individual countries. The authors of this study mark the policy implications implied.

[Kahane \(2020\)](#) indicated that the capitalism model has supported economic growth, but not with respect to society and the environment. The United Nations set the SDGs in 2015, and trillions of dollars are invested annually to achieve these goals. However, the question still remains: how is it possible to obtain the necessary funding to finance these goals? [Kahane \(2020\)](#) highlighted the importance of including new metrics to the model that can be able to translate social and environmental benefits into monetary terms. This author proposes the solution that the governments of every country issue a special long-term bond, which covers the SDG investments with a high yield. This return may be enough to return a long-term pension or a social security (insurance funds) for all the population. In this way, it is possible to finance the SDGs and create the pensions and jobs for future generations.

[Makarenko et al. \(2018\)](#) highlighted the role of the Corporate Social Responsibility (CSR) of the financial sector institutions (mainly banks and stock exchanges) in SDG financing. The authors consider that Goals 1, 5, 8, 10, 13, and 17 are the most relevant to incorporate into the activities of the financial sector institutions. After an analysis of the current sustainability reporting disclosure of

these institutions, the authors of the study consider necessary the activation of their CSR mechanism and the restructuring of all business processes and the reorientation of their overall sustainability strategy. On the one hand, the authors propose that banks should use CSR mechanisms, new tools, and technologies to support the financing of the SDGs. On the other hand, the authors propose that stock exchanges should consider the ESG criteria and promote exemplary disclosure practices, as well as new markets and market benchmarks by listing companies.

Mendez and Houghton (2020) explored the role of multilateral development banks (MDBs) for generating norms of sustainable banking to attract and support green private finance. The authors summarized the three main obstacles for sustainable banking: (1) the uncertainty in the bankability of projects, (2) non-transparency in tracking sustainable capital flows, and (3) no global mechanisms able to make connections between green investment supply and demand. MDBs have been norm entrepreneurs proactive since the 1970s in building most of the basic norms and practices of sustainable banking for the private sector. In addition, the MDBs are the first contact for international governmental organizations and civil society organizations willing to establish a sustainable financial framework for development.

Rizzello and Kabli (2020) highlighted the debate in policy circles regarding Social and Sustainable Finance as an underdeveloped field of knowledge and as a practical area with high potential. In the practical field, the raising of public and private investments for promotion and supporting the SDGs is underlined.

Tham and Sigala (2020) identified possibilities from blockchain and cryptocurrencies for supporting sustainable tourism development goals. The authors conclude that blockchains have the potential to develop a more inclusive and sustainable tourism in the future: Blockchains and cryptocurrencies (as financial transaction capability) are able to increase trust and transparency.

In addition, the promotion of financial literacy is part of financial innovation through different trends and financial instruments worldwide. Accounting and finance applications and financial literacy campaigns are part of this trend in the field of small and medium sized enterprise (SME) development for better access to SME finance to overcome the information asymmetries between SMEs and financial institutions (Imanbaeva et al., 2017).

Furthermore, there are several businesses worldwide that have as a business model to promote financial inclusion for different segments. According to Yawe and Prabhu (2015), it is important to highlight that financial innovation is an important aspect of financial inclusion. The literature review of Yawe and Prabhu (2015) concludes that financial inclusion should go beyond the traditional banking sector. This includes the importance of partnerships among commercial banks and network operators providing mobile money services. This needs an appropriate institutional and regulatory framework where all the main actors participate: regulators of telecommunications, mobile network operators, and central banks. It is important to facilitate financial inclusion and at the same time continue with the strategies to eliminate global challenges, such as money laundering.

2.2 Financial Management and the COVID-19 Crisis: Strategies Followed by Companies During the COVID-19 Crisis

According to Lawson (2020), the impact of the pandemic is hardest hit in the tourism, travel, and hospitality industries. The current finance function priorities mentioned in a global study are (1) risk management, (2) cash management, and (3) cost management and control.

The qualitative study from Breier et al. (2021) concludes that in the hardest hit industries (e.g., hospitality sector) from COVID-19 lockdowns, the continued innovation of the business model is an important key to create new revenue streams and secure a better level of liquidity. The study is based on interview data from managers and main *stammgasts* for each case. The main results of the study indicate the importance of the *stammgasts* during and after the crisis to create new revenue streams and to improve the liquidity.

Tisdall and Zhang (2020) highlighted a lack of financial awareness in the Australian general aviation community in Australia, which is likely to inhibit flexibility in the sector and limit its ability to learn from the economic shock that COVID-19 represents. This chapter suggests several activities to enhance the quality of decision-making in this sector's leadership, such as improving its financial outlook and visibility to policymakers.

A study in the United States (Song et al., 2021) indicates that restaurants with larger size, a higher leverage, higher cash flows, lower Return on Assets, and more internationalization are more resilient to stock declines reacting to COVID-19 than other similar companies. In addition, dividend, franchising, institutional ownership, and managerial ownership did not show a significant moderating effect on the relationship between COVID-19 and the stock returns.

During the first phases of the COVID-19 pandemic, social entrepreneurship funds reported more returns that are positive, suggesting that fund managers have changed from a high-risk style to low risk regarding size and investment strategy (Rizvi et al., 2020). Salisu et al. (2020) recommended incorporating a UPE indicator in the valuation of stocks for investment decisions.

Heald and Hodges (2020) concluded that fiscal sustainability analysis warns that UK public finances became more unsustainable than before the pandemic. This chapter analyzes the nature and impact of budgetary responses to the pandemic in the context of the strengths and weaknesses of UK public sector financial management. They also highlight that the higher levels of debt and future increases in interest rates have as consequence a new stage of austerity and more centralization of public power and economic decisions.

3. Discussion/Outlook: Challenges to the Sustainable Development Goals in Relation with the COVID-19 Crisis

Currently, we are facing several new challenges worldwide related to climate change, social problems, and recently together with pandemics. However, it is important to take these crises and challenges as an opportunity to learn the positive lessons from them and to take some of the aspects learned in the

pandemic time in order to contribute to save the environment (e.g., the reduction of CO₂ emissions through traveling, less (and/or more conscious) consumption of resources).

Here, it is important to highlight the relevance of the changing role in the financial system and financial institutions as key players to finance the SDGs, to bridge the SDG budget gap. It is important to create a financial system that integrates sustainability (Lagoarde-Segot, 2020; World Bank, 2017) and/or social impact bonds. In addition, in this process, the role of the governments has a fundamental importance, since it is important to continue developing suitable mechanisms and financing instruments (public and private) to bridge the SDG budget gap and presently also the problems originating in pandemic times. Some of these mechanisms are the issuing of sovereign green bonds, the updating of the European Central Bank's framework, and establishing a market of SDG lending certificates.

Funding all these challenges can contribute to financial innovation (Etzion et al., 2019). Furthermore, innovative Fintech business models and financial institutions can contribute to the improvement of financial inclusion for different segments (women, migrants, etc.).

4. Conclusions and Implications for Further Research

This chapter presented some examples of positive lessons learned in companies (mainly within the financial system and the finance function) from these challenges. With the help of the relevant and recent related scientific literature, this chapter aims to contribute with practical guidelines for CFOs and managers to respond to the new challenges toward the achievement of the SDGs, taking in consideration the COVID-19 crisis and beyond. Therefore, the next section presents several concrete practical guidelines to respond to the new challenges all based on the recent scientific literature revised for this chapter.

Regarding the practical guidelines, a crucial element for the financial system is the incorporation of the SDGs within the CSR of the financial sector institutions (especially banks and stock exchanges). It is relevant that financial institutions activate their CSR mechanism and work in the restructuring of their processes and the reorientation of their overall sustainability strategy. A main practical guideline for the banks is the use of new tools and technologies to support the financing of the SDGs and for stock exchanges to consider the ESG criteria, promote exemplary disclosure practices, and promote new markets and market benchmarks by listing companies (Makarenko et al., 2018).

One practical guideline for managers in the hospitality industry is the continued adaptation of their business models and coming to more innovative business models to create new revenue streams and to improve the level of liquidity (Breier et al., 2021). The continued adaptation of the business model is crucial to survive. Some of these new business models may be based on digital solutions, and they also could contribute to take more actions to save the environment, to have a better resource management in companies.

For managers in the aviation industry, it is also important to promote flexibility in the sector and to improve the ability to learn from the economic shock through COVID-19. A concrete recommendation here is to include the financial outlook and visibility to policymakers (Tisdall & Zhang, 2020).

Other practical recommendation for the tourism industry is related to the current trends of digital technologies and currencies; blockchains and cryptocurrencies can be used for supporting the SDGs through the potential to increase trust and transparency (Tham & Sigala, 2020).

A relevant guideline for financial managers regarding risk management, investment decisions, and financial planning is to consider in the investment portfolio strategy the ESG rating criteria. This measure supports the environment and the social well-being, and, at the same time, it is a conservative strategy for companies that aim to a portfolio with low-risk strategy, especially in pandemic times (Rizvi et al., 2020).

A recommendation for entrepreneurs in different fields is the creation and adaptation of business models in the area of financial innovation, for the improvement of financial inclusion and financial literacy for relevant segments of the population (women, migrants, SMEs, etc.). The promotion of financial literacy (Imanbaeva et al., 2017) and financial inclusion (Yawe & Prabhu, 2015) can be able to contribute to support the achievement of several SDGs worldwide, this all together accompanied from a suitable regulatory framework.

Finally, further studies should explore the incorporation of the SDGs in the financial system (institutions and governments) and within the CSR strategy of the financial institutions (mainly banks and stock exchanges). In addition, it is important to learn more from the strategies to survive in pandemic times and for adaptation of their business models (considering the SDGs) followed in the different sectors, especially in the hospitality and aviation industries. The other relevant field to study is regarding the aspects of the risk management, investment decisions, and investment portfolio strategies considering the ESG criteria followed by companies in pandemic times. Furthermore, it is relevant to study more about new Fintech-based business models related to financial literacy and financial inclusion in different segments of the population.

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