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FINANCIAL MANAGEMENT AS A CATALYST FOR CONTINUAL BUSINESS (GREEN CAPITALISM) EXECUTION AND GROWTH

AHMAD HARASIS
Assistant Professor, Middle East University, Jordan.

Abstract

This study emphasizes the vital importance of financial management in enhancing sustainable business practices. It explores the necessity of publishing sustainability reports. It examines the influence of corporate sustainability on financial decisions, particularly in capital budgeting, along with strategies for assessing and reducing sustainability-related risks. The research establishes a link between financial progression and sustainability, featuring a detailed comparison of Islamic and Western financial models to illustrate the real-world relevance of these principles. In addition, the study presents a detailed predictive model aimed at identifying and assessing financial instability in various organizations. This model benefits diverse stakeholders, as it factors in non-financial and macroeconomic variables. This research provides a comprehensive view of the interaction between financial management and sustainability, offering critical insights for companies seeking to adopt sustainable practices in their strategic planning and operations.

Keywords: Financial Management, Continual Business, Execution, Green Capitlism.

1. INTRODUCTION

This research paper explores the pivotal role of financial management, an essential aspect of finance. It emphasizes the development of a comprehensive financial management structure, examining its importance in fostering sustainable business practices and the possibility of simultaneously achieving financial robustness and sustainable results. The study broadens its exploration to include how sustainability can be maintained, incorporating case studies that analyze the implementation of sustainability practices in the fluid financial sector. Through this analysis, the paper offers valuable insights into incorporating sustainability into financial operations, underscoring this dynamic field's potential difficulties and advantages.

2. LITERATURE REVIEW

2.1 Analysis of Current Corporate Sustainability Reporting and Its Impact on Firm Value

Antoun (2000) emphasizes that the essence of corporate sustainability reporting lies in analyzing a company's current and future performance. An increasing emphasis is on establishing more refined, flexible, and eco-friendly approaches to assess corporate performance. The optimal scenario encompasses an evaluation of a company's success based not only on financial metrics but also on social and environmental contributions. Most corporate sustainability reporting is undertaken voluntarily, often driven by a company's pursuit of legitimacy. Around the world, mandatory sustainability reporting is not a widespread legal requirement, leaving it to individual companies to voluntarily adopt these practices as a testament to their dedication to sustainability (Al–Ramahi, 2008).

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The legitimacy theory suggests that companies' motivation to undertake corporate sustainability reporting is to enhance their perception of legitimate and credible entities among their shareholders and stakeholders. This theory highlights a trend towards integrating traditional financial reporting with environmental aspects, providing a more comprehensive view of a company's performance. Adopting this integrated reporting approach has positively influenced the company's valuation in the eyes of its investors and stakeholders. The legitimacy theory is central to social responsibility, dedication to community service, adherence to legal standards, advocacy for environmental concerns, conducting environmental audits, and active involvement in conservation efforts. These factors are crucial for companies aiming to maintain and reinforce their legitimate standing within the community and among their stakeholders, as Gnanaweera (2018) outlined.

Corporate sustainable disclosures typically encompass a range of elements focused on environmental responsibility and sustainability. These include:

- Initiatives for environmental conservation and the specific areas targeted in these efforts.
- Actions aimed at reducing carbon emissions, contributing to the broader goal of climate change mitigation.
- The shift towards utilizing renewable energy sources as a sustainable energy strategy.
- Investments in environmental research programs signify a commitment to understanding and addressing environmental challenges.
- Increased adherence to and integration of environmental accounting or reporting practices, highlighting a company's commitment to environmental stewardship.
- Demonstrating the connection between environmental reporting or disclosure practices and overall financial management, showing how sustainability is intertwined with financial performance and decision-making (Tuwaijri et al., 2004).

Studies by Mensi et al. (2017) investigated the influence of sustainable practices on the financial performance of corporations. Aghion et al. (2007) discovered that sustainability efforts enhance the value of individual companies and contribute to shared value across various sectors. As corporations grow more conscious of environmental matters and incorporate these into their reports, it collectively reduces the carbon footprint across industries, thereby boosting value for shareholders and stakeholders.

Adopting sustainable methods within companies means environmental preservation generates additional value beyond traditional financial metrics. This shift towards environmental sustainability leads to improved public health and a better workplace environment, further encapsulating the essence of sustainability (Czarnitzki et al., 2011). As the understanding of sustainability grows, there is a noticeable increase in the importance placed on sustainable actions by companies from the perspective of stakeholders and shareholders.

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The adoption and reporting of sustainable practices by businesses are typically met with approval, enhancing their value in the eyes of shareholders and stakeholders. It is anticipated that corporate financial reporting will be more frequently accompanied by reports on sustainability efforts, showcasing a comprehensive approach to financial and environmental stewardship (Aghion et al., 2007).

2.2 Conceptual Building

- **Sustainability and associated crucial financial choices**

Financial decision-making is central to effective financial management, with its success often mirrored in the financial outcomes achieved. These decisions are integral to sustainable results, as financial management is designed to optimize returns for shareholders or maximize the benefits for both shareholders and stakeholders through strategic choices made by management.

Within capital budgeting, integrating sustainability into financial decisions is increasingly important. This involves selecting and endorsing projects that meet financial criteria and align with environmental objectives, thereby enhancing overall sustainability. A prime example is a project that shifts a company's energy use from high-emission sources like coal to renewable alternatives such as solar, wind, or hydropower.

Capital budgeting encompasses a detailed evaluation of prospective investments, weighing the potential returns against associated costs. This methodical approach prioritizes projects with the most favourable financial and sustainable returns, effectively blending financial prudence with sustainable development (Czarnitzki et al., 2011).

Pinto (2015) details that in the capital budgeting process, pivotal financial indicators such as the net present value (NPV) and the internal rate of return (IRR) are commonly used. The NPV involves deducting the initial investment from the total projected returns, where a higher and positive NPV suggests a project is preferable (Arslan & Zama, 2015). This calculation method takes the expected future returns and discounts them to their present value using standard factors, offering a more accurate projection of potential outcomes.

The IRR approach, while utilizing a similar principle as NPV, focuses on cash flow calculations. It is computed by subtracting the initial investment from the expected cash flows without discounting them. A project is typically deemed worthwhile if its IRR is greater than the desired rate of return. However, NPV is often considered a more comprehensive and reliable metric for project appraisal and selection than IRR.

Incorporating sustainability into these financial evaluation methods could involve adding an environmental conservation metric to the analysis, ensuring that sustainability factors are considered alongside financial viability. Alternatively, designating a part of the initial investment for sustainability efforts within a project can also ensure that environmental aspects are integrated into the decision-making process, thereby aligning financial objectives with sustainable development goals (Arslan & Zama, 2015).

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The cost of capital is essentially the expected rate of return that a company aims to achieve. In making capital budgeting and financial decisions, corporations can give precedence to projects that resonate with the sustainability priorities of their shareholders and stakeholders. When selecting such projects, two primary considerations come into play: integrating environmental sustainability measures in the project's execution plan and the project's potential to yield the highest financial return. Incorporating sustainability considerations into their financial decision-making processes allows companies to refine these processes. This balanced approach seeks to meet financial goals and gives due weight to sustainability objectives. It represents a holistic strategy that aligns with shareholders' and stakeholders' changing expectations and values, demonstrating a commitment to economic success and environmental responsibility.

Research on sustainability reporting has shown a link between corporate social responsibility (CSR) and the financial performance of companies. The main goal of this research was to analyze how financial performance, as a dependent variable, correlates with CSR, an independent variable. Findings from a Boston College Centre study highlighted several significant effects of incorporating sustainability in business operations. The study found that embracing sustainability practices notably boosted the reputation of companies. It also increased employee loyalty, indicating a greater probability of retaining staff. Another positive outcome was increased customer loyalty, meaning companies practicing sustainability were more likely to see returning customers, thus solidifying their standing in the market. Additionally, a notable decrease in waste was attributed to enhanced recycling and reuse efforts, which opened up new job opportunities. On the other hand, the study pointed out a potential issue: the reliability of corporate sustainability reports was occasionally dubious, primarily because sustainability reporting is not compulsory. This lack of mandatory reporting could lead to companies embellishing their environmental reporting to gain customer trust and showcase their commitment to stakeholders (Humpage, 2016).

Studies have shown that companies actively engaging in sustainable practices, especially those with robust corporate social responsibility (CSR) frameworks, typically exhibit higher profitability and greater size than those that do not adopt such practices. In this context, 'firm size' includes market capitalization, total asset value, or yearly turnover. These outcomes support the theory that firms prioritizing sustainability in their annual reports tend to make more astute financial decisions, leading to more favourable business results. This relationship highlights the significance of incorporating sustainability into business models, positioning it not only as a matter of corporate ethics but also as a critical contributor to financial achievement (Czarnitzki et al., 2011).

2.3 Islamic Finance: Sustainability

A study by Chong and Liu (2009) delves into how Islamic banking in Malaysia can integrate sustainability, particularly environmental sustainability, into its operations. This approach is in harmony with Islamic teachings and Sharia law, making it a culturally relevant addition to Islamic banking practices.

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The study outlines a multi-level strategy for implementing sustainability in Islamic banking. At the institutional level, it involves compliance with environmental laws, initiating awareness drives, and embedding sustainable practices in everyday banking activities. On a national level, it recommends developing guidelines and policies specifically designed for the Islamic financial system to encourage sustainability. Finally, at an international level, the approach includes adhering to global sustainability standards and embracing voluntary measures aimed at sustainable growth. This comprehensive strategy enables Islamic banks to meet sustainability standards locally and internationally and actively participate in the broader sustainable development agenda (Owusu et al., 2019). Deloitte Inc.'s research on Islamic financing highlighted initial challenges in securing funds for social and governance aspects, including sustainability, primarily due to restrictive capital markets. However, the situation in Southeast Asia, especially Malaysia, has been more promising, with Islamic finance increasingly embracing sustainability. This positive trend is driven by the rising demand among conventional investors and a growing appetite for green investments (Easmon et al., 2019).

Additionally, a study by Joseph (2017) found that the overall corporate risk disclosure has a minimal effect on the performance of UAE banks, encompassing both conventional and Islamic institutions. The research also noted notable differences in risk disclosure practices between these two banking types. A vital example of the convergence of sustainability and Islamic finance is the issuance of Sukuk bonds. Notably, in 2015, the Sukuk Ihsan program issued Sukuk bonds valued at $282 million, showcasing the increasing incorporation of sustainability considerations into Islamic financial products. This emerging trend indicates a growing need for enhanced green and sustainable practices within Islamic finance, adapting to the evolving landscape of the global finance industry (Mensi, 2017).

2.4 Financial distress prediction and sustainable growth

The research published in the Sustainability journal highlights that predicting corporate bankruptcy or financial distress is feasible by analyzing financial, non-financial, and macroeconomic factors. The study demonstrates that the accuracy of forecasting financial distress improves when it includes a combination of firm-specific financial, non-financial, and macroeconomic variables. It posits that the likelihood of accurately predicting bankruptcy increases when macroeconomic and non-financial factors are assessed with financial variables.

Specifically focusing on the Hong Kong Growth Enterprise Market (GEM), this study provides crucial information for regulators within Hong Kong's capital markets and serves as a valuable resource for investors and analysts interested in these markets. The study advocates for a holistic approach that considers all three types of variables – financial, non-financial, and macroeconomic – to enhance the precision of bankruptcy predictions. While the research is tailored to the Hong Kong GEM, its findings and methodologies are potentially applicable in other capital markets, emphasizing the need to incorporate diverse factors for effective bankruptcy forecasting (Neneh, 2016).

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3. RESULTS

Previous studies have consistently demonstrated a growing interest in the impact of sustainability on corporate financial performance, as evidenced by the steady increase in related research over time. Sustainable reporting, in particular, has been found to enhance individual firms significantly and share value across various industries. This increase in value is attributed to greater accountability in company operations, heightened ethical compliance, and more robust risk management, all of which contribute to improved overall company performance.

The research indicates that incorporating sustainability into financial management strategies and subsequent risk management practices leads to tremendous success for firms. This suggests that sustainability is not merely a corporate responsibility or ethical choice but is increasingly recognized as a strategic financial management construct that can drive a company to higher levels of success.

4. CONCLUSION

This research provides valuable insights into the relationship between financial growth and sustainability. It conducts a comparative analysis of both Islamic and Western financial models, evaluating their applicability in practical scenarios. Furthermore, the study presents a predictive model and guidelines for identifying and assessing financial distress in various firms, addressing the interests of diverse stakeholders. These guidelines rely on a comprehensive consideration of non-financial and macroeconomic factors. The case studies of Western financial systems and Islamic financial models exemplify a profound understanding of the interplay between sustainability and financial growth. Moreover, the research underscores the significance of sustainability-driven bankruptcy prediction, emphasizing its relevance for investors, analysts, and regulatory bodies in capital markets. This predictive approach encompasses a wide array of financial, non-financial, and macroeconomic variables, aligning with the fundamental principles of financial management in sustainability assessment.

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