IJARSCT

ISSN (Online) 2581-9429

International Journal of Advanced Research in Science, Communication and Technology (IJARSCT)

Impact Factor: 6.252

Volume 2, Issue 3, January 2022

Role of Financial Management in Developing Sustainable Corporate Practices

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Abstract: *This study demonstrates that financial management is crucial to the sustainability process. The research is predicated on the requirement of disclosing sustainability reports, basing financial decisions on corporate sustainability in capital budgeting and other related areas, and measuring and mitigating sustainability risks. The connection between financial growth and sustainability is discussed, along with a breakdown of the Islamic and Western financial model systems for the purpose of analysing the practical application of the concepts. The research concludes with the development of prediction model guidance for the identification and evaluation of distress in various enterprises for various interested parties based on non-financial and macroeconomic factors.*

Keywords: Financial management, sustainability, corporate risk

I. INTRODUCTION

Financial management is one of the most essential financial principles. This research study is based on the construction of an appropriate financial management framework in the analysis of the significance of sustainability and the achievement of concurrent financial and sustainable outcomes. The study expands on previous research on the preservation of sustainability and the subsequent case study examination of the implementation of sustainability in the changing financial sector environment.

II. LITERATURE REVIEW

2.1 Existing corporate disclosures about sustainable reporting and firm value

According to Habek and Wolniak (2015), corporate sustainability reporting and disclosure is founded on the principles of analysing existing and future company performance. There is a growing need for improved, more agile, and ecologically conscious methods of evaluating the performance of businesses. The ideal situation has been the development of a method for determining a company's success based on its financial performance and its social or environmental performance. Corporate disclosures associated with sustainability reporting rely heavily on the voluntarism and legitimacy approaches. Corporate entities in the majority of worldwide jurisdictions are not required to disclose corporate sustainability information, making the adoption of sustainability reporting a discretionary choice (Gnanaweea & Kunori, 2018).

The legitimacy theory asserts that the adoption of corporate sustainability reporting by businesses is motivated by their desire to look legitimate or trustworthy to stakeholders and shareholders. The necessity for corporations to improve their reporting from a financial model to an integrated financial and environmental reporting model has increased over time. This strategy has been observed and tested and shown to be effective. Among the qualities associated with the legitimacy theory include social values, community service, and conformity with the law, environmental advocacy, environmental audits, and related conservation initiatives (Patten, 1992).

Corporate disclosures on sustainability may be based on the following:

- Environmental conservation initiatives and related areas of focus
- Initiatives for the reduction of carbon emissions
- Adoption of renewable energy sources
- Investment in research projects for the environment
- Increased conformance and use of environmental accounting or reporting

- Exemplification of the natural connections between environmental reporting or disclosure and financial management (Tuwaijri et al., 2004).

Ellili and Nobanee (2016) and Alshehhi et al. (2018) investigated the effect of sustainable practises on corporate financial performance. Graham et al. (2005) found that corporate enterprises' efforts towards corporate financial reporting not only create individual firm value but also shared benefit across industries. More businesses become familiar with various environmental factors and incorporate them into their reporting systems. A country's overall carbon footprint is lowered, for instance, as a result of the aggregation of sustainable techniques by numerous entities and enterprises in various industries. Creating greater shareholder and stakeholder value is the essence of such a corporate initiative. In particular, the adoption of sustainable ways by businesses means that, despite the conventional emphasis on financial performance by various firm stakeholders, there is also greater value creation through a better protected environment. Technically, greater environmental awareness permits the continued beneficial health of people and a workable environment, hence contributing to the term's sustainability (Pablo et al., 2019). Through published studies, people have gained understanding and familiarity with sustainable concepts through time. Therefore, there has been an increasing trend or rate of stakeholders and shareholders attributing value to sustainable measures at diverse companies. The element of actualization of sustainable approaches adopted by companies and the following presentation of sustainable efforts and results to shareholders evokes shareholder and stakeholder support, which converts to value. As time passes, it is anticipated that a greater proportion of concurrently reported business financial performance will be supported by commensurately sustainable approaches by firms (Graham et.al ,2005).

2.2 Conceptual Building

Sustainability and related critical monetary choices

Financial management is primarily concerned with making key financial decisions. Typically, effective and efficient financial management is reflected by prosperous financial outcomes. Financial management decisions are the primary determinants of long-term sustainability. Financial management is based on concepts that aim to maximise shareholder returns or combined shareholder and stakeholder returns through strategic managerial decisions. In terms of capital budgeting, sustainability considerations can be included into financial decisions by selecting and approving projects with environmental features or activities as a means of attaining sustainability in light of the established sustainability targets. A excellent example is the selection and approval of a project that aims to switch a company's primary energy sources from traditional emitting sources such as coal power plants to renewable energy sources. Renewable energy sources include solar electricity, wind power, and hydropower (tidal or ocean power). The process of capital budgeting comprises the selection of the projects with the most probable and viable investment returns using a decision matrix. The capital budgeting process in financial management permits a comparison of costs and returns, allowing the selection of the project with the largest positive returns (Yilmaz & Flouris,2010).

Brewer, Garrison, and Noreen (2005) explain further that the capital budgeting process consists of superior financial indices, such as the net present value (NPV) and the internal rate of return (IRR). The net present value is a function of total returns minus the initial cost of capital, and the bigger and more positive the net present value, the greater the likelihood that the project will be selected (Arslan & Zama, 2015). For a more realistic analysis of anticipated outcomes, the net present value returns are discounted and summed as functions of expected future returns discounted to present value terms using typical standard discounting factors. Using the same assumptions as the net present value method of computation, except for the condition of net cash flows, the internal rate of return is calculated. To calculate the internal rate of return, undiscounted expected cash flows are subtracted from the initial cost of capital. If the estimated number is more than the project rate of return, the internal rate of return indicates that the project should be selected. In contrast, the net present value model is preferable to the internal rate of return when determining and selecting projects. In order to combine the financial methodologies for project selection with sustainability considerations, an additional project evaluation measure that simultaneously represents environmental conservation and the financial viability of projects can be incorporated into the financial evaluation. An alternative strategy may also include allocating a portion of the initial capital expenses to budget for sustainability initiatives in the event of a single project, so ensuring that environmental considerations are incorporated into the project (Arslan & Zama, 2015).

The cost of capital is the required rate of return for a business. Consequently, under capital budgeting financial decisions, corporations can choose a project with the necessary sustainability techniques in accordance with the current needs of shareholders and stakeholders. Therefore, the selection of a project can be based on two criteria: projects with environmental sustainability techniques in their execution model, and projects with the maximum return. Therefore, the financial decision-making process is enhanced as a result of corporations placing sustainability aspects and goals ahead of financial return objectives. Prior research on sustainability reporting has established a correlation between corporate social responsibility and financial performance. The primary objective of the study was to determine the relationship between the dependent variable financial success and one of the independent variables corporate social responsibility. According to the findings of a study conducted by the Boston College Centre, the incorporation of sustainability components boosted the reputation of businesses as the initial effect. The second effect or impact was an increase in employee loyalty, which enhanced the likelihood of enterprises retaining their work force, an optimistic outlook. Thirdly, there was an increase in consumer loyalty, which resulted in a greater likelihood of client retention and a stronger market position for the business when sustainability strategies were implemented. The sixth observation was that there was a rise in trash reduction, which can be attributed to recycling efforts, re-use initiatives, and even the creation of more job opportunities. On the other hand, the study also included observations regarding the decline in the accuracy of corporate sustainability reports due to the voluntary nature of sustainability reporting. This statement makes sense in the context of businesses seeking customer trust and engagement as evidence of stakeholder value through inventive environmental reporting (Schaltegger & Wagner, 2006).

Prior study has demonstrated that organisations with true sustainability initiatives have higher profitability and larger firm sizes compared to those that have not implemented similar strategies. In this instance, corporations with well-developed models for corporate social responsibility constitute the sustainability approaches. Specifics regarding a company's size include its market capitalization or share capital, total assets or annual revenue. Therefore, these findings lend credence to the concept that organisations that are sensitive to sustainability issues in yearly performance reporting make more effective financial decisions that lead to more successful corporate outcomes. (Cheng et al., 2014)

2.3 Prediction of financial distress and sustainable growth

By analysing financial indicators, non-financial variables, and macroeconomic factors, it is possible to anticipate corporate insolvency or financial difficulty of a company. The accuracy of financial distress prediction based on firm-specific financial, non-financial, and macroeconomic indicators is the subject of a study conducted and published in the sustainability journal. In addition, the study hypothesises that considering macroeconomic and non-financial variables in addition to financial variables improves the predictability of bankruptcy in companies. The study is case-specific for the Hong Kong Growth Enterprise Market (GEM) and provides the aforementioned information to regulators of the Hong Kong capital markets as well as investors or analysts who are potential investors in the Hong Kong capital markets. By extrapolation, the conclusions and findings of the study can be extended to different capital markets with a greater emphasis on all three elements (financial, non-financial, and macroeconomic) that determine more precise bankruptcy prediction (Opler & Titman, 2018).

III. CONCLUSION

In conclusion, the relationship between financial growth and sustainability is presented, along with a case analysis of the Islamic and Western financial model systems broken down for analysis of the concepts' applicability in the real world. The research concludes with the development of a prediction model guidance for the detection and evaluation of distress in various enterprises for diverse interest parties based on non-financial and macroeconomic factors. Under the sustainability topic, the case studies of Western financial systems and Islamic financial models demonstrate an accurate knowledge of the connection between sustainability and financial growth. As a function of sustainability, it has been recognised that bankruptcy prediction is crucial to investors, analysts, and regulators in capital markets, given the financial and macroeconomic variables that highlight the principles of financial management in sustainability measurement.

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