FINANCE INNOVATIONS DIGEST
Volume 1, Issue 1, June 2023| pp. 17-28
https://doi.org/10.63208/xxxxx-xxxx

Check for updates

E- ISSN: xxxx-xxxx

Sustainable Finance, ESG, and Innovation in Promoting Sustainable Economic Growth

Widi Pramudya Rahmadani[1] ✉, and Yoga Tama[1]

Universitas Negeri Yogyakarta, Yogyakarta, Indonesia[1]

ABSTRACT

This study aims to examine the relationship between sustainable finance, Environmental, Social, and Governance (ESG), innovation, and sustainable economic growth through a Systematic Literature Review (SLR) approach. The review was conducted on various scientific literature published over the past five years and indexed in Google Scholar. The results indicate that sustainable finance has evolved into a strategic instrument that integrates economic, social, and environmental aspects into investment and business decision-making processes. The implementation of ESG has been shown to contribute to improved governance, risk management, organizational reputation, and the creation of long-term value. Furthermore, sustainable innovation plays a crucial role in enhancing the effectiveness of ESG implementation by developing more efficient and environmentally friendly solutions. Nevertheless, this study also identified several key challenges, such as differences in ESG measurement standards, limitations in sustainability performance evaluation, and the risk of greenwashing, which can undermine the credibility of sustainability practices. Overall, sustainable finance, ESG, and innovation are mutually reinforcing elements in achieving sustainable economic growth and creating long-term value for various stakeholders.

Keywords: *ESG, Innovation, Sustainability, Sustainable Economic Growth, Sustainable Finance.*

CORRESPONDING AUTHOR:
Widi Pramudya Rahmadani
Universitas Negeri Yogyakarta, Yogyakarta, Indonesia
contact: *widiprahma89@gmail.com*

ARTICLE HISTORY
Received : January 14, 2023
Final Revised : April 13, 2023
Accepted : May 8, 2023
Published : June 30, 2023

© 2023 The Author(s)| This article is an open access article and distributed under the terms and conditions of the Creative Commons Attribution (CC BY-SA) license.

1. | INTRODUCTION

The changing global business environment in recent years has prompted organizations to not only be oriented towards achieving economic benefits, but also pay attention to the sustainability aspect in each of their operational activities. Increasing attention to environmental, social, and corporate governance issues has given birth to the concept of Environmental, Social, and Governance (ESG) as one of the main approaches in realizing sustainable economic development. ESG is no longer seen as an additional part of corporate social responsibility, but has instead evolved into a strategic element that influences the organization's business decision-making process, investment, and risk management. These developments show that sustainability has become an important factor in determining the competitiveness and sustainability of organizations in the long term (Edmans & Kacperczyk, 2022).

In line with the increasing attention to ESG, the concept of sustainable finance has also experienced significant development. Sustainable finance is a financial approach that integrates environmental, social, and governance considerations into the investment and financing decision-making process. This approach aims to create a balance between achieving economic benefits and contributing to sustainable development. According to Schoenmaker and Schramade (2018), sustainable finance plays an important role in directing the allocation of financial resources towards economic activities that are able to create long-term value while minimizing negative impacts on the environment and society. Therefore, sustainable finance is increasingly seen as a strategic instrument that is able to support economic transformation towards a more inclusive and sustainable system.

In the context of organizations, the implementation of ESG and sustainable finance is believed to be able to provide various benefits, including improving company reputation, operational efficiency, reducing risk, and increasing investor confidence. Research conducted by Gillan et al. (2021) shows that companies that integrate ESG principles in their business strategies tend to have better ability to manage risk and maintain long-term performance. The findings are supported by Flammer (2021) who explains that the implementation of sustainability practices can increase a company's access to funding sources and strengthen its competitive position in the market. Thus, ESG and sustainable finance are seen as factors that contribute to sustainable economic value creation.

In addition to financial and governance aspects, innovation is also an important element in supporting ESG implementation. Organizations that are able to develop innovation in a sustainable manner tend to have a greater capacity to adapt to changing business environments and stakeholder demands. Awan et al. (2017) explain that pressure from various stakeholders encourages organizations to develop sustainability-oriented innovations. These innovations not only improve resource use efficiency, but also help organizations create solutions that are able to deliver economic, social, and environmental benefits simultaneously. Therefore, innovation can be seen as an

important mechanism that strengthens the link between ESG implementation and sustainable economic growth.

Although various studies have addressed the relationship between ESG, sustainable finance, and organizational performance, there are still a number of research gaps that require further attention. First, the results of research on the influence of ESG on organizational performance still show mixed findings and have not produced consistent conclusions (Velte, 2022). Second, the role of innovation as a mechanism linking ESG implementation with sustainable economic growth is still relatively limited in the literature. Third, differences in ESG measurement methodologies and indicators used by various assessment agencies pose challenges in evaluating the effectiveness of ESG implementation objectively (Berg et al., 2022). In addition, growing concerns about greenwashing practices also raise questions about the extent to which ESG implementation actually contributes to sustainability goals.

Based on these conditions, this study aims to comprehensively examine the relationship between sustainable finance, ESG implementation, innovation, and sustainable economic growth through a systematic literature review approach. This research is expected to provide a deeper understanding of the contribution of sustainable finance and ESG to long-term value creation and identify various challenges that are still faced in their implementation.

2. | LITERATURE REVIEW

Sustainable Finance

Sustainable finance is a financial approach that integrates environmental, social, and governance considerations into economic and investment decision-making processes. This concept evolved in response to the growing need to balance economic goals with long-term sustainability. In contrast to conventional financial approaches that focus solely on financial gain, sustainable finance considers the impact of economic activities on society and the environment. In its development, sustainable finance has become an important part of organizational strategy because it is considered to be able to create more sustainable economic value and reduce various non-financial risks that can affect the organization's performance in the future (Schoenmaker & Schramade, 2018).

The increased attention to sustainable finance is driven by the awareness that environmental and social factors have a significant influence on economic stability and business sustainability. Organizations that integrate sustainability principles into their financial management tend to be better prepared to face regulatory changes, stakeholder pressures, and increasingly complex market dynamics. In addition, sustainable finance also plays a role in directing investment towards economic activities that support sustainable development and the achievement of broader social goals. This condition makes sustainable finance a strategic instrument that not only serves to improve

economic performance, but also strengthens the organization's contribution to global sustainability (Edmans & Kacperczyk, 2022).

Furthermore, the development of sustainable financial instruments such as green bonds and ESG-based investments suggests that sustainability has become a key consideration in modern investment decisions. Organizations that are able to effectively implement the principles of sustainable finance have a greater chance of gaining access to funding, improving reputation, and creating a sustainable competitive advantage. Therefore, sustainable finance is seen as one of the main pillars in supporting economic transformation towards a more inclusive and sustainable system (Flammer, 2021).

Environmental, Social, and Governance (ESG)

Environmental, Social, and Governance (ESG) is a framework used to assess the extent to which an organization pays attention to environmental, social, and governance aspects in carrying out its business activities. The environmental dimension includes natural resource management, emission reduction, and environmental impact mitigation efforts. The social dimension focuses on the organization's relationship with employees, customers, and society, while the governance dimension deals with transparency, accountability, and the effectiveness of decision-making within the organization. These three dimensions are interrelated and form the basis for sustainability-oriented business practices (Gillan et al., 2021).

In recent years, ESG has evolved to become one of the important indicators that investors use to evaluate the quality and long-term prospects of an organization. Companies that have good ESG performance are generally considered better able to manage non-financial risks, maintain relationships with stakeholders, and create sustainable value. Therefore, ESG not only serves as a sustainability evaluation tool, but also as an indicator that reflects the quality of management and the resilience of the organization to various business challenges. Investors' increased attention to ESG suggests that sustainability factors have become an integral part of modern investment decisions (Eccles et al., 2020).

Nonetheless, ESG implementation still faces various challenges, especially related to measurement and reporting. Differences in methodologies used by ESG rating agencies often result in different assessments of the same organization. This condition creates uncertainty in the interpretation of ESG performance and makes it difficult for investors and researchers to conduct objective evaluations. Therefore, the development of more consistent ESG measurement standards is one of the important issues in the current sustainability literature (Berg et al., 2022).

Innovation and Sustainable Economic Growth

Innovation is an important factor that allows organizations to adapt to changing business environments and create added value in a sustainable manner. In the context of sustainability, innovation is not only oriented towards increasing efficiency and productivity, but is also geared towards producing solutions that are able to provide

economic, social, and environmental benefits at the same time. Organizations that are able to develop sustainable innovation tend to have higher competitiveness because they can respond to market needs and stakeholder demands more effectively. Therefore, innovation is seen as one of the main drivers in realizing sustainable economic growth (Damanpour et al., 2018).

The relationship between innovation and sustainability is increasingly seen through the increasing application of green innovation in various economic sectors. Green innovation allows organizations to reduce resource use, improve energy efficiency, and minimize negative impacts on the environment. In addition to providing environmental benefits, sustainable innovation also contributes to improving economic performance through the creation of more efficient products and processes. Thus, innovation can be a means that strengthens the relationship between ESG implementation and the achievement of sustainable development goals (Awan et al., 2017).

In addition, various studies show that innovation has a strategic role in supporting the successful implementation of ESG. Organizations that invest in technology development and sustainable innovation tend to be better able to meet stakeholder expectations and increase their long-term value. Therefore, innovation not only serves as a supporting factor for sustainability, but also as a mechanism that can bridge the relationship between sustainable finance, ESG, and sustainable economic growth. This role makes innovation an important element that needs to be considered in future economic development strategies (Le, 2022).

3. | RESEARCH METHOD

This study uses the Systematic Literature Review (SLR) approach to identify, evaluate, and synthesize various research findings related to sustainable finance, Environmental, Social, and Governance (ESG), innovation, and sustainable economic growth. The SLR method was chosen because it is able to provide a comprehensive and systematic understanding of the development of research in a certain field through a structured literature search, selection, and analysis process. This approach allows researchers to integrate various results of previous research so that they can identify patterns, research gaps, and future research development directions.

The data collection process was carried out through searching for scientific articles indexed by Google Scholar and published in the last five years. The selection of the time range aims to obtain relevant references to the latest developments related to the implementation of ESG and sustainable finance before the year of publication of this article. The keywords used in the search process include “sustainable finance”, “ESG”, “environmental social governance”, “sustainability”, “green innovation”, “sustainable innovation”, and “sustainable economic growth”. In addition, the search process also considers these keyword combinations to obtain articles that discuss the relationship between sustainability, innovation, and economic growth more specifically.

The literature selection stage is carried out by applying several inclusion and exclusion criteria. The inclusion criteria include articles published in reputable scientific journals, available in full-text form, in English, and having direct relevance to the topic of sustainable finance, ESG, innovation, or sustainable economic growth. Meanwhile, articles that are not related to the research focus, are not fully available, or are non-scientific publications are excluded from the analysis process. After the selection process is carried out, articles that meet the criteria are then analyzed in depth to identify the main concepts, research findings, variables used, and the theoretical and practical implications produced.

Furthermore, the data obtained were analyzed using a thematic analysis approach. The analysis was carried out by grouping the results of the research into several main themes which include sustainable finance, ESG implementation, sustainable innovation, organizational performance, and sustainable economic growth. Through this process, this research seeks to produce a comprehensive synthesis of literature on the relationship between sustainable finance, ESG, innovation, and sustainable economic development. The results of the synthesis are then used to answer the research objectives as well as identify various research gaps that still require further study in future research.

4. | RESULTS

The results of the literature review show that sustainable finance has developed into one of the most widely used approaches to support sustainable economic development. This concept not only focuses on achieving financial gains, but also pays attention to the social and environmental impact of the economic activities carried out by the organization. These developments are influenced by the increasing awareness of various stakeholders on the importance of sustainability in the face of increasingly complex global challenges. Sustainable finance encourages the integration of environmental, social, and governance factors into the investment decision-making process so that the economic activities carried out are able to create long-term value for organizations and society at large (Schoenmaker & Schramade, 2018).

A literature review also shows that the increasing attention to sustainable finance is inseparable from the development of the concept of Environmental, Social, and Governance (ESG) which is currently one of the main indicators in assessing the quality and sustainability of an organization. ESG allows investors and stakeholders to evaluate an organization's performance not only based on financial aspects, but also on its contribution to the environment and society. Companies that have good ESG practices are generally considered better able to manage risk, maintain reputation, and maintain business sustainability in the long term. Therefore, ESG is increasingly being used as a basis in investment decision-making and business strategies of modern organizations (Gillan et al., 2021).

Literature findings show that ESG implementation has a positive relationship with improved organizational performance. Organizations that integrate ESG principles into

their operations tend to gain higher levels of trust from investors, customers, and the public. In addition, the implementation of ESG also contributes to increasing operational efficiency through more effective resource management and reducing various risks that have the potential to hinder organizational growth. These conditions show that ESG is not only an instrument to meet regulatory demands or social expectations, but can also be a source of sustainable competitive advantage (Velte, 2022).

However, the results of research found in the literature still show that there are differences in findings regarding the influence of ESG on organizational performance. Some studies have found a strong positive relationship between ESG and financial performance, while others show a relatively weak or insignificant influence. These differences can be influenced by industry characteristics, organizational size, market conditions, and ESG measurement methods used in the research. Thus, the relationship between ESG and organizational performance is still an ever-evolving topic and requires further research to gain a more comprehensive understanding (Friede et al., 2015).

In addition to contributing to improving organizational performance, ESG implementation also has a close relationship with long-term value creation. Organizations that consistently implement sustainability practices tend to have better ability to anticipate changes in the business environment and face various economic challenges in the future. This shows that sustainability has become an important part of modern organizational strategies that are not only oriented towards short-term profits, but also on sustainable value creation for all stakeholders. Therefore, ESG is increasingly seen as a strategic instrument that is able to support the success of organizations in the long term (Edmans & Kacperczyk, 2022).

Further literature review shows that innovation has an important role in strengthening the implementation of ESG and sustainable finance. Organizations that are able to develop innovation in a sustainable manner have a greater ability to adapt to changing market needs and sustainability demands. Innovation enables organizations to create more efficient products, services, and processes that reduce environmental impact while increasing the economic value generated. Therefore, innovation is seen as one of the factors that strengthens the relationship between ESG and sustainable economic growth (Damanpour et al., 2018).

The role of innovation in supporting sustainability is increasingly seen through the increasing application of green innovation in various economic sectors. Green innovation allows organizations to reduce energy consumption, minimize waste, and improve resource use efficiency. In addition to providing benefits for the environment, sustainable innovation is also able to increase productivity and competitiveness of organizations. The results show that organizations that invest in sustainable innovation tend to be more successful in implementing ESG principles than organizations that still rely on conventional business approaches. Thus, innovation plays an important role as

a mechanism that links sustainability practices with improved economic performance (Awan et al., 2017).

Furthermore, several studies show that the combination of ESG and innovation has a greater impact on organizational sustainability than if the two factors were applied separately. ESG implementation creates a framework that supports sustainability, while innovation provides solutions and technologies that enable sustainability goals to be achieved more effectively. This synergistic relationship contributes to improving economic, social, and environmental performance simultaneously so that it is able to create more inclusive and sustainable growth (Le, 2022).

Although the benefits of ESG and sustainable finance have been widely identified in the literature, various challenges are still found in their implementation. One of the main challenges is the differences in ESG measurement standards and methodologies used by various rating agencies. These differences cause the results of ESG assessments for the same organization to differ significantly. This condition creates uncertainty for investors and researchers in evaluating the level of organizational sustainability and the effectiveness of the ESG strategies implemented (Berg et al., 2022).

The problem of ESG measurement is also strengthened by findings that show that perceptions of ESG performance can be influenced by various subjective factors that differ between assessment institutions. As a result, the results of ESG evaluations often reflect differences in interpretations of the sustainability indicators used. The situation shows that the development of more consistent and integrated ESG standards is an important need to increase the credibility and effectiveness of ESG implementation in business and investment practices (Christensen et al., 2021).

Another challenge that is widely discussed in the literature is the emergence of greenwashing practices. Greenwashing occurs when an organization claims to implement sustainability or ESG principles without real and substantial implementation. This practice can reduce investor and public trust in the sustainability initiatives carried out by the organization. In addition, greenwashing also has the potential to hinder the effectiveness of sustainable finance because resource allocation can be directed to organizations that do not actually contribute to sustainability goals. Therefore, transparency and accountability are important factors in ensuring credible ESG implementation (Eccles et al., 2020).

The results of the study also show that sustainable finance has a significant contribution to the achievement of sustainable development goals. The integration of ESG factors in investment and financing activities can help direct capital to sectors that support resource efficiency, emission reduction, and improved social welfare. Thus, sustainable finance not only provides benefits for organizations, but also supports efforts to achieve sustainable development goals more broadly (United Nations, 2020).

The contribution of sustainable finance to sustainable economic growth is also seen through its ability to drive economic transformation towards a greener and more inclusive development model. Various sustainable financial instruments have been used

to support investment in projects that have a positive impact on the environment and society. This condition shows that sustainable finance can serve as a catalyst in accelerating the transition to a sustainability-oriented economy (OECD, 2021).

In addition, the use of sustainable financial instruments such as green bonds is increasingly showing that investors are starting to consider sustainability factors as an important part of their investment strategies. The increased interest in sustainable investing reflects a paradigm shift in the financial world that was previously more oriented towards short-term profits to long-term value creation. These changes strengthen the position of sustainable finance as one of the important elements in supporting economic stability and sustainable development in the future (Flammer, 2021).

Overall, the results of the literature review show that sustainable finance, ESG, and innovation have mutually supportive relationships in encouraging sustainable economic growth. ESG serves as a framework that directs organizations towards more responsible business practices, sustainable finance provides funding mechanisms that support sustainability, while innovation is a factor that allows the implementation of sustainability to be carried out effectively. While various benefits have been identified, challenges related to ESG measurement, implementation consistency, and greenwashing risks remain important issues that require further attention in future sustainability research and practices.

5. | DISCUSSION

The results of the literature review show that sustainable finance, ESG, and innovation have mutually supportive relationships in encouraging sustainable economic growth. These findings reinforce the view that sustainability is no longer positioned as a complementary activity within organizations, but has instead become an integral part of modern business and investment strategies. Sustainable finance acts as a mechanism that directs the allocation of financial resources towards activities that provide economic benefits while paying attention to social and environmental impacts. In this context, ESG is an instrument that helps organizations integrate sustainability principles into their decision-making processes so that they are able to create long-term value for various stakeholders (Edmans & Kacperczyk, 2022).

However, the results of the study also show that the relationship between ESG and organizational performance is still not completely consistent. Some studies have found that ESG implementation contributes to improved organizational performance, while others show more varied results. These differences indicate that the effectiveness of ESG can be influenced by various factors, such as industry characteristics, governance quality, market conditions, and measurement approaches used. These findings confirm the first research gap that states that the influence of ESG on organizational performance is still a debate in the literature and requires a more in-depth study to produce a more comprehensive understanding (Velte, 2022).

The results of the study also show that innovation has an important role in strengthening ESG implementation and the success of sustainable finance. Organizations that are able to develop sustainable innovation tend to be more effective in implementing sustainability principles and creating sustainable economic value. The findings support a second research gap that highlights the limited study of the role of innovation as a mechanism linking ESG to sustainable economic growth. Thus, innovation can be seen as a strategic factor that bridges sustainability goals with the achievement of long-term economic performance (Awan et al., 2017).

In addition, the study found that one of the main challenges in ESG implementation is the lack of a completely uniform measurement standard. Differences in methodologies and indicators used by various rating agencies mean that the results of ESG evaluations are often different for the same organization. This condition supports the third research gap which highlights the need to develop a more consistent and widely accepted ESG measurement system. Without clear standards, the effectiveness of ESG in supporting sustainable finance will be difficult to evaluate objectively (Berg et al., 2022).

On the other hand, the increasing attention to ESG also raises the risk of greenwashing which can reduce the credibility of sustainability practices. Some organizations have the potential to use ESG as a marketing tool without making substantial changes in their business activities. These findings support the fourth and fifth research gaps related to the effectiveness of sustainable finance in achieving sustainable development goals and the potential for greenwashing in ESG implementation. Therefore, greater transparency, accountability, and oversight are needed to ensure that ESG implementation truly makes a tangible contribution to economic, social, and environmental sustainability in the long term (Eccles et al., 2020; Christensen et al., 2021).

6. | CONCLUSION

This study aims to examine the relationship between sustainable finance, Environmental, Social, and Governance (ESG), innovation, and sustainable economic growth through the Systematic Literature Review approach. The results of the study show that sustainable finance has developed into a strategic instrument that is able to integrate economic, social, and environmental goals in the investment and business decision-making process. ESG implementation has proven to have an important role in improving the quality of organizational governance, strengthening stakeholder trust, and supporting long-term value creation.

The study also found that innovation is a significant factor in supporting the successful implementation of ESG and sustainable finance. Innovation enables organizations to increase efficiency, develop more sustainable solutions, and strengthen competitiveness in the face of increasingly dynamic business environments. Therefore, the relationship between ESG, sustainable finance, and innovation can be seen as an important foundation in realizing sustainable economic growth.

However, there are still various challenges that need to be considered, including differences in ESG measurement standards, limitations in sustainability performance evaluation, and risks of greenwashing practices. These challenges show the need to develop more consistent and transparent standards so that ESG implementation can provide more optimal benefits. Overall, sustainable finance, ESG, and innovation are complementary elements in supporting sustainability-oriented economic development and long-term value creation.

Acknowledgment

We gratefully acknowledge the contributions of individuals who supported the completion of this article.

Funding Information

This research did not receive any funding.

Conflict of Interest Statement

The authors declare that there is no conflict of interest.

Ethical Approval and Originality Statement

Ethical approval was obtained for this study. The manuscript represents original work and has not been previously published, nor is it under consideration by another journal.

Data Disclosure Statement

The data that support the findings of this study are available from the corresponding author upon reasonable request.

REFERENCES

Awan, U., Kraslawski, A., & Huiskonen, J. (2017). Understanding the relationship between stakeholder pressure and sustainability performance in manufacturing firms in Pakistan. *Procedia Manufacturing*, *11*, 768-777.

Berg, F., Kölbel, J. F., & Rigobon, R. (2022). Aggregate confusion: The divergence of ESG ratings. *Review of finance*, *26*(6), 1315-1344.

Christensen, D. M., Serafeim, G., & Sikochi, A. (2022). Why is corporate virtue in the eye of the beholder? The case of ESG ratings. *The Accounting Review*, *97*(1), 147-175.

Damanpour, F., Sanchez-Henriquez, F., & Chiu, H. H. (2018). Internal and external sources and the adoption of innovations in organizations. *British Journal of Management*, *29*(4), 712-730.

Eccles, R. G., Lee, L. E., & Stroehle, J. C. (2020). The social origins of ESG: An analysis of Innovest and KLD. *Organization & environment*, *33*(4), 575-596.

Edmans, A., & Kacperczyk, M. (2022). Sustainable finance. *Review of Finance*, *26*(6), 1309-1313.

Flammer, C. (2021). Corporate green bonds. *Journal of financial economics*, *142*(2), 499-516.

Friede, G., Busch, T., & Bassen, A. (2015). ESG and financial performance: aggregated evidence from more than 2000 empirical studies. *Journal of sustainable finance & investment*, *5*(4), 210-233.

Gillan, S. L., Koch, A., & Starks, L. T. (2021). Firms and social responsibility: A review of ESG and CSR research in corporate finance. *Journal of corporate finance*, *66*, 101889.

Le, T. T. (2022). How do corporate social responsibility and green innovation transform corporate green strategy into sustainable firm performance?. *Journal of Cleaner Production*, *362*, 132228.

OECD. (2021). *OECD green growth indicators 2021*. OECD Publishing. https://doi.org/10.1787/1f9c71c4-en

Schoenmaker, D., & Schramade, W. (2018). *Principles of sustainable finance*. Oxford University Press.

United Nations. (2020). *The sustainable development goals report 2020*. United Nations. https://unstats.un.org/sdgs/report/2020/

Velte, P. (2022). Archival research on integrated reporting: a systematic review of main drivers and the impact of integrated reporting on firm value. *Journal of Management and Governance*, *26*(3), 997-1061.