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Green Finance and ESG: A Foundation Dedicated to Creating a Sustainable Financial Structure

Yingjie Wang

School of Foreign Studies, Shandong University of Finance and Economics, Jinan 250002, Shandong, China.

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***Corresponding author:** Yingjie Wang, School of Foreign Studies, Shandong University of Finance and Economics, Jinan 250002, Shandong, China.

Abstract

Amidst the challenges of worldwide climate alteration and diminishing resources, green finance alongside Environmental, Social, and Governance (ESG) guidelines have progressively become principal instruments in advancing sustainable growth. The article explores the profound links between green finance and ESG, examining their crucial functions in forming a sustainable financial structure. The primary goal of green finance is to expedite the shift towards a low-carbon economy, focusing on boosting investments in environmental safeguards and funding eco-friendly initiatives. Additionally, ESG standards offer a structure for investors to assess a company's sustainability and social responsibility, guiding funds towards projects with greater sustainability. This paper, by meticulously examining practical instances, demonstrates the equilibrium between economic enhancement and ecological safeguards in companies and countries where green finance and ESG approaches are effectively put into practice. In conclusion, this research suggests a sequence of policy advice for enhanced integration of green financing and ESG, establishing a stable base for realizing sustainability objectives. Establishing a strong, enduring financial system enables various societal strata to collaboratively tackle present environmental issues, fostering uniform advancement across economic, social, and ecological elements.

Keywords

Green Finance; ESG; Sustainable Financial Structure

1. Introduction

1.1 Major Challenges Faced by Global Climate Change and Environmental Concerns

Presently, the worldwide ecological setting confronts significant difficulties. Global warming is causing swift glacier melting and escalating sea levels, resulting in more frequent extreme climatic incidents like hurricanes, intense rainfall, and worldwide droughts. Concurrently, the shortage of resources persists as a major problem, with numerous nations and areas grappling with water scarcity and energy strain. Such occurrences not only cause considerable harm to the equilibrium of natural habitats but also directly endanger the bedrock of human existence and living conditions.

1.2 Highlighting the Significance of Sustainable Development

With the swift advancement of society, there's a growing consciousness that depending entirely on conventional economic growth models is not feasible. Achieving synchronized advancements between the economies, society, and the environment is now an internationally acknowledged objective. Solely through a commitment to sustainable development tenets, harmonizing social welfare with environmental safeguarding, and fostering economic expansion, can we tackle current multifaceted challenges and establish a robust basis for upcoming generations.

1.3 Goals of the Deliberation

1.3.1 Deliberate in-depth analysis of the meanings behind green finance and ESG, including their interrelations

Engaged in a thorough investigation into the essence and extent of green finance and ESG, elucidated their meanings, and offered an in-depth examination of their interconnectedness, encompassing both theoretical and practical viewpoints. This has established a robust groundwork for additional studies into their cooperative impacts within the financial industry.

1.3.2 Investigating its impact on creating a stable financial framework

The paper explores how green finance and ESG contribute to steering the financial system towards a path of sustainability and inclusivity. This analysis also delves into the ways in which both strategies can be utilized to optimize the distribution of fiscal resources and improve risk control, thus leading to the creation of a stable and lasting financial framework.

2. A Concise Explanation of Green Finance

2.1 Fundamental Principles of Green Finance

Green finance is defined as a fiscal framework that amalgamates environmental conservation and sustainable growth principles into its financial operations and decision processes. This idea's primary goal is to employ financial instruments to steer the allocation of capital towards resource-efficient technological research and development, alongside environmental and ecological safeguards. This motivates businesses to focus on environmentally conscious and sustainable procedures in production, leading consumers toward green consumption patterns, which in turn guarantees the enduring growth of the economy and society, as well as the consistent functioning of the financial sector.

This entity's main concentration lies in various domains including environmental safeguarding, conserving energy, and promoting clean energy. This advocates for the conservation of resources and their effective use using innovative financial offerings and services, fostering the enhancement and refinement of the economic framework and the harmonious integration of economic, social, and ecological advantages.

2.2 Crucial Tools for Leading Green Finance

For the actual enactment of green finance principles, extensive engagement in diverse green finance activities is essential. Throughout this procedure, a variety of green financial service instruments have surfaced, fueling comprehensive studies in the field of green financial instruments. The present market's green financial instruments, as categorized by various tiers of financial services, are segmented into three primary types: tools for finance, tools for investment and trade, and risk management tools (Deng Wenyi, 2023).

2.2.1 Classification of financing options via eco-friendly financial tools

Green financial instruments, focusing on finance, especially in areas of green credit and bonds, play a significant role in modern green finance methods. Eco-friendly credit contributes to both the financial backing of eco-friendly initiatives and the indirect rise in pollution project costs, clearly illustrating the restrictive incentives of green finance. Recent findings suggest that, as part of its service framework, green credit markedly boosts the energy of green innovations, enhancing energy efficiency and cutting down on carbon emissions (Wang Xin & Wang Ying, 2021). Concurrently, the role of green credit is to streamline the distribution of resources among environmentally conscious and pollution-producing companies, though additional refinement and validation are required to specifically actualize its Porter effect (Lu Jing et al., 2019). Furthermore, short-term impacts such as green credit on the cost efficiency of commercial banks could be detrimental, as they influence costs (refer to Ding Ning et al., 2020). Viewed in the future, the esteem and emerging commercial prospects it fosters could notably boost the overall asset returns of commercial banks and mitigate credit hazards, thus positively elevating their competitive edge (He Lingyun et al., 2018). The national government frequently motivates financial entities in our nation to adopt a range of favored subsidy strategies. These include reducing interest rates, reducing target reserve requirement ratios, and reissuing green credit, thereby enlarging green credit's reach. This approach not only boosts the enthusiasm and backing for eco-friendly sectors but also varies from conventional regulatory practices. Such strategies are capable of circumventing adverse effects, including reduced overall social output, structural unemployment, and frictional unemployment, thus fostering balanced economic growth and environmental safeguarding (Wang Yao et al., 2019). Green bonds, focused on enterprise investment, serve as a financial instrument for eco-friendly initiatives. Latest data in development reveal that releasing green bonds can greatly enhance the eco-friendly innovation rates among issuers, due to efficient management of resources and supervisory impacts, with this impact maintaining a form of dynamic continuity (Wang Ying & Feng Jiahao, 2022).

2.2.2 Financial products focusing on sustainability and trading

The design of eco-friendly financial tools for investment and trade aims to foster greater involvement in the practical management of green finance via product innovations. With changing market demand, a sequence of green indices debuted in the stock market. The 2011 study by Wai Kong revealed that publicly disclosing the Dow Jones Sustainability World Index yielded profitable outcomes for its selected stocks swiftly. Within Germany's market, environmental concerns led to negative impacts on associated stock indices (Oberndorfer U et al., 2013). China has formed three principal index categories: the Sustainable Development Index, the Environmental Protection Industry Index, and the Green Environment Index. These indices have the potential to boost investor confidence and yield a short-term positive impact on the prices of similar stocks, yet this impact is not enduring. The importance of associated green indices primarily lies in enhancing the revelation of environmental details, directing the movement of social capital, and maintaining the equilibrium of capital market activities (Tang Chun & Wang Guojing, 2020). Within carbon emission sectors, pioneering methods in carbon funding are vital in saving energy, diminishing emissions, and enhancing business frameworks. Wang Fengrong and colleagues highlighted in their 2023 research that companies' overall eco-friendly factor productivity and superior environmental innovative developments have gained significant encouragement.

2.2.3 Eco-friendly financial tactics for managing risks

Even as environmental risk management financial tools are in the trial phase of the trial, they have shown initial stages in their scale and structure. Of all these measures, the green insurance offerings stand out as the most indicative, featuring practical efforts like environmental liability insurance, climate index insurance, and green corporate social responsibility insurance. Despite the challenges posed by inadequate capital backing, a lack of knowledge about associated hazards, and disjointed growth, both within the country and globally, a structured structure in green insurance remains elusive. Owing to variations in business norms and faults in data handling and management, numerous pertinent studies are confined to their respective phases of conducting feasibility analysis and designing plans.

3. A Concise Synopsis of ESG

3.1 Precise Explanation of ESG

The ESG system focuses intensively on three essential elements: the environment, society, and corporate governance, creating an all-encompassing system for evaluating a company's potential for long-term growth.

Environmentally, our examination centers on the ecological footprint of a corporation during its production and operational phases, examining vital metrics like carbon dioxide emission vigor, the effectiveness of recycling water resources, and adherence to waste management regulations to advance advances in energy saving, diminishing emissions, and sustainable production methods.

From a societal viewpoint, the focus is on safeguarding labor rights (like fair wages and career prospects), preserving community ties (such as through public welfare funding and job advancement), and promoting supply chain integrity (like eradicating child labor and protecting workers' rights), underscoring corporate accountability in societal matters.

In corporate governance, our main attention is on crucial elements like the internal power equilibrium, risk handling methods, and the openness of information sharing for the sake of maintaining business operational stability and integrity.

3.2 Pertaining to the Assessment Criteria and Benchmarks for ESG

Worldwide, esteemed organizations like MSCI and Sustainalytics hold an exceptional standing. MSCI’s ESG rating methodology takes a worldwide viewpoint, methodically breaking down and measuring E, S, and G subthemes across numerous evaluation metrics, thus offering an extensive evaluation of corporate ESG effectiveness. Conversely, Sustainalytics concentrates on evaluating risks by accurately measuring a company's ESG risk exposure, providing investors with a strong defense against risks. In the meantime, local bodies like the Green Finance Institute at the Central University of Finance and Economics customize evaluation criteria to suit nationwide circumstances, aiding businesses in enhancing their benchmarking benchmarks.

3.3 Present State and Prospective Path of ESG

3.3.1 Financial backers highly value the aspects of ESG

The focus of investors on ESG has surged notably in recent times, with key players like major pension and sovereign wealth funds spearheading this field, thus integrating ESG fundamentally into their investment approaches. The fundamental reasoning, for one reason, is to synchronize with the worldwide movement towards sustainable growth while circumventing possible risks from environmental and societal hazards. Seen from a different angle, with the aim of securing both economic and social advantages and investigating the prospects for sustained value enhancement in ESG firms, worldwide surveys among investors reveal that upwards of 70% are diligently analyzing the ESG outcomes of their targeted investments.

3.3.2 Improving the dissemination and clear transparency of ESG reports

Global firms are avidly composing ESG reports, covering both vast multinational corporations and local small and medium-sized businesses. They exhibit accomplishments in ESG via appendices in annual reports or independent reports. Gradually, the substance, information, and clarity of these reports have progressed. Regulating bodies have enhanced their norms by motivating companies to shift from mandatory to voluntary transparency, thereby aiding all involved parties in grasping the company's commitment to sustainability.

4. The Link Linking Eco-friendly Finance with ESG

4.1 The Reciprocal Strengthening Bond Between Them

4.1.1 The role of green finance in aiding ESG objectives

Green finance is pivotal in advancing sustainable advancements in today's financial landscape. This establishes a robust base and revitalizes businesses' ability to attain ESG objectives from various angles, serving as an indispensable 'catalyst.'

Environmentally speaking, green credit holds a pivotal position in green financial instruments. Numerous business banks effectively pinpoint and bolster organizations dedicated to cutting energy, reducing emissions, managing pollution, and ecological rejuvenation through their environmental performance metrics. Using the “Green Credit Development Report of the Chinese Banking Industry” as an illustrative case, Bank A offered specialized green credit assistance to conventional manufacturing sectors, aiding them in implementing sophisticated exhaust gas treatment methods and enhancing their manufacturing processes. The outcome was an over 30% decrease in carbon emissions per output unit, greatly lowering pollution levels and enhancing the quality of the ecological environment nearby. This is wholly in agreement with the ESG's environmental aspect directives, advising companies to lessen their ecological harm and shift to eco-friendly practices.

Green investment funds are equally esteemed as pioneers in enhancing the environment. The Preqin research report “The State of Green and Sustainable Investment 2022” indicates that worldwide green technology investment funds primarily concentrate on advanced technologies like renewable energy and environmentally friendly materials, targeting the growth and development capabilities of burgeoning and expanding businesses. As an example, Fund X has heavily invested in a burgeoning solar photovoltaic firm to enhance its advanced photovoltaic cell technology and expand production. This progression not only hastens the shift from conventional fossil fuels to renewable energies but also contributes to enhancing society's energy framework, offering solid backing for tackling climate change and meeting carbon emission cutback goals. By investing in tangible capital, the fund closely corresponds with the environmental dimensions of ESG.

Socially, green finance has a significant impact. Green bond funds are used for eco-friendly construction, improving building energy efficiency and ecological integrity, and creating various jobs during construction, which boosts local employment and social good. For instance, a European green bond-funded eco-friendly community building project attracted many local workers and improved the local employment situation. Meanwhile, green finance-backed eco-friendly agricultural initiatives ensure the secure and sustainable supply of agricultural products, protect consumer rights, strengthen the bond between businesses and society, and comply with the social aspect of ESG by safeguarding stakeholders' rights like those of workers and local people.

In the eyes of corporate management, eco-friendly finance exemplifies its unique contribution. As businesses benefit from green funding, particularly via prolonged involvement in green investment funds or continuous collaboration with eco-friendly credit, external finance entities, steered by green development requirements, motivate these companies to enhance their internal governance frameworks. Corporations enhance decision-making by fortifying environmental risk management units and improving the disclosure of information, thereby factoring in environmental considerations to promote operational openness and adherence. This is in sync with ESG corporate governance objectives - to enhance internal management and boost governance efficiency - thereby steering businesses towards a secure and eco-friendly operational route.

4.1.2 In what ways do ESG criteria impact the growth of eco-friendly financial systems

ESG benchmarks act as an exact guiding principle, thoroughly governing and deeply propelling the solid progression of the green finance sector, simultaneously altering the rationale behind financial resource distribution and market architecture.

A framework of ESG evaluation and indicators helps financial institutions choose projects and allocate funds, accurately identifying good green projects. MSCI's Ratings Methodology offers a detailed framework for analyzing environmental, social, and governance metrics and conducting quantitative analysis. This helps financial institutions avoid 'greenwashing' and ensures funds go to businesses committed to ecological growth and strong ESG performance, enhancing the effectiveness of green finance budgeting. For example, Financial Institution Y used MSCI's evaluation to select electric car projects with high ESG scores and provided green credit funding to balance investment and support top green projects.

From the perspective of product innovation, ESG standards are a major incentive for financial entities to innovate. As businesses and investors pay more attention to ESG, financial institutions are launching various innovative products to meet market needs and reduce ESG risks. Chen Yulu's "The Theory and Practice of Financial Support for Green Development" mentions that some structured financial products related to ESG indices are in use. They link financial returns to a company's ESG performance, encouraging businesses to improve their ESG strategies for better loan terms. Besides, bespoke financial services are provided for eco-friendly supply chains, offering customized financial support based on firms' ESG compliance at different supply chain stages, aiming to improve ESG efficiency in the supply chain, expand eco-friendly financial services, and diversify product choices.

Standards related to ESGs hold significant value throughout various aspects of market control and robust growth. Through standardized protocols, the similarity in corporate ESG accounts has improved, highlighting the market's strategy of 'survival of the fittest'. This motivates firms to enhance the effectiveness and caliber of their ESG initiatives, bolster transparency in information revelation, and foster a superior business climate for financial entities. Regulatory agencies have amplified their oversight and application by adhering to ESG guidelines, embracing a strict 'zero tolerance' approach towards unfounded ESG assertions, and non-adhering green finance practices. This guarantees the systematic functioning of green finance and ESG markets, paves the way for sustained sustainable growth, and hastens the accelerated expansion of green finance on a regulated path.

4.2 A Thorough Analysis of Two Cases

Taking Tesla, the internationally renowned renewable energy car maker, as an example, it shows how to integrate green finance with sustainable ESG. In the ecological aspect, Tesla has made progress in battery and power systems through continuous R&D investment. The significant reduction in EV carbon emissions and high battery recycling efficiency (over 90%) have spurred the global automotive industry's ecological transformation. Socially, Tesla offers good pay and benefits and promotes career development. It actively participates in community learning and environmental welfare activities near its plants, like promoting STEM education in Nevada. In governance, it focuses on an effective board and management framework, with high information transparency, regular ESG reports, and acceptance of international market oversight. Its excellent ESG performance has won acclaim from global rating firms and attracted investments from green funds. Major banks have provided large green credit quotas. In 2022, it got hundreds of millions in ESG-related venture investments and over ten billion in bank lending, using green financing to enhance capabilities and technology, advancing the global green transportation goal.

Top Chinese financial firms like Industrial Bank, a leader in green finance, have fully adopted green financing methods and integrated ESG principles. They've creatively introduced various eco-friendly financial products such as the "Turning Green into Gold" green loan series and the "Green Innovation for the Future" investment fund to meet diverse environmental needs. Credit guidelines have been adjusted according to strict ESG criteria, resulting in tougher credit strategies for high-pollution and low-ESG companies, while giving priority to sectors like green energy and eco-friendly manufacturing. In the past five years, the annual average growth of green loan balances has exceeded 20%. In daily operations, ESG norms have been implemented, energy-saving renovations have been carried out in offices, eco-friendly office environments have been promoted, employee training has been enhanced, and an inclusive and diverse workplace has been cultivated. With the support of sustainable financial practices, Industrial Bank has achieved dual ESG goals and unique development in this area. It has set an example in the industry, won many national and global awards for green finance and ESG, inspired domestic financial institutions to adopt sustainable practices, and greatly helped build a sustainable financial system.

5. Confronting the Obstacles in Creating a Durable Financial Framework

5.1 Present Flaws Within the Financial Framework

Traditional finance models have long excessively depended on economic metrics for success assessment, overlooking the environmental consequences and societal effects of investment endeavors. Such a method often leads to disproportionate lending to industries with high pollution and energy consumption, creating an illogical dispersal of resources. Regarding the management of risks, these models fail to adequately account for newly arising risk elements like climate change and societal viewpoints. Therefore, during unexpected ecological events or labor conflicts, they frequently seem powerless and battle to satisfy the requirements of sustainable growth.

5.2 Difficulties Facing When Implementing Green Finance and ESG Policies

5.2.1 Matters of ensuring data transparency and standardization

Gathering 'greenness' information in green finance endeavors is a significant hurdle, and there exist multiple statistical techniques to address this challenge. There's a significant variance in the data quality of ESG reports, with distinct evaluation bodies showcasing pronounced differences in their methods for interpreting and quantifying indicators. The variability in data among different companies and industries creates a challenge for investors to draw definitive conclusions. The data implies that the decision-making framework of financial bodies becomes unclear, thereby hindering the market's effective operation.

5.2.2 Investors exhibit a deficiency in both educational and awareness aspects

A portion of the investors, both small and medium scale possess a minimal grasp of green finance and ESG principles. Bound by conventional investment attitudes, they erroneously perceive ESG investment as an option that compromises profit. Furthermore, their reluctance is fueled by the intricacies of green financial products, leading to reduced interest in joining. Consequently, the green finance sector increasingly depends on substantial institutional investors for extended support, impeding the market's widespread and profound growth.

5.2.3 Major shortcomings exist in the framework of policy and regulations

Currently, the framework and rules governing green finance and ESG are divided, with certain clauses demonstrating sub-optimal performance in actual application, and the regulatory coordination systems yet to be refined. Varied interpretations of green finance and ESG standards by distinct departments could result in lapses or similarities in regulations, impairing policy enforcement efficacy and complicating the prevention of market infractions like 'greenwashing' and deceptive ESG allegations.

6. Suggestions for Advancing Eco-friendly Finance and the Development of ESGs

6.1 The Government's Assistance and Economic Stimulus Strategies

The government needs to serve as a potent force, enhancing financial support for green project subsidies, offering interest grants for green bonds, lowering taxes and charges for eco-friendly businesses, and creating guidance funds in the green industry to 'utilize' social funds for involvement. The focus should also be on green initiatives in distributing land and energy allocations, fostering the green innovation vigor of market companies. As an illustration, significant financial aid to green building initiatives by various local administrations has paved the way for many model scenarios in the field of green construction.

6.2 Enhanced Refinement in Legislation and Criteria

It's crucial for the legislators to hasten the creation of targeted green finance laws, precisely delineating participant rights, duties, and operational regulatory norms; a collaborative effort between regulatory bodies and ESG organizations has led to the formulation of evaluation metrics and disclosure criteria, instituting stringent and cohesive standards akin to accounting ones. Such measures enhance accountability for ecological 'greenwashing' via legal and civil actions, guaranteeing the robust and consistent growth of the eco-friendly finance and ESG sectors.

6.3 The Function of Financial Entities

6.3.1 Creative enhancements in financial goods and services

Upon introducing eco-friendly financial offerings, financial bodies must adapt based on market needs to satisfy varied customer segments and business settings. For instance, they have the opportunity to create environmentally friendly credit offerings tailored for personal sustainability, offer tailored insurance options for eco-friendly farming, and utilize fiscal technology to boost operational effectiveness and accuracy in managing risks. Such developments will enlarge the realm of eco-friendly financial amenities.

6.3.2 Improve risk management in ESG

The comprehensive risk management system now incorporates ESG risks, utilizing quantitative modeling to assess how climate-related risks affect assets and observing societal attitudes that may lead to reputational dangers. Guided by risk evaluations, we've refined our corporate structure and loan tactics, actively venturing into the low-carbon transition sector to avert possible ESG risk disruptions and guarantee our institution's enduring functioning.

6.4 Exploring the Connection Between Learning and Societal Involvement

6.4.1 Promote public realization and engagement

Utilizing both mainstream outlets and public science channels, the promotion of green finance and ESG expertise is comprehensive, along with the planning of green investment science lectures and practical community activities in environmental finance. All these efforts aim to heighten public consciousness about ecological preservation and accountability. They also encourage investors to engage in eco-friendly practices and investments, thus reinforcing the core structure of the green finance sector.

6.4.2 Bolstering corporate social accountability

The business has thoroughly integrated fundamental ESG principles, ranging from overarching strategic formulation to base-level execution, and has developed an extended ESG strategic agenda. Simultaneously, the company frequently releases comprehensive reports on ESG advancements, actively tolerates social supervision, and assimilates ESG into its corporate ethos. In its quest for financial gains, the business engages with society, safeguarding the environment and striving for a peaceful coexistence amongst society and nature.

7. Summary

7.1 The Pivotal Importance of Green Finance and ESG in Establishing a Lasting Financial Framework

Green financing and ESG may be viewed as the fundamental components that establish a finance system's longevity. The prior links the green industry's front and back via capital 'bond' to fuel the economy's ecological shift; the latter, originating from corporations' fundamental beliefs, reshapes the criteria for assessing corporate worth and fosters both 'internal and external development' by these businesses. Collectively, these two elements function to rectify conventional financial prejudices, refine models for allocating resources, and maintain ongoing impetus and robustness for a lasting financial framework.

7.2 Prospective Reflections on Future Research and Real-world Uses

Future studies will explore more extensively the dynamics of interactions between green financing and ESG at a microscopic scale, like how ESG elements affect corporate financial outcomes and investigating the limits of green finance innovation. During our operational activities, we anticipate synchronized improvements in worldwide policies, breakthroughs by banking bodies, and more decisive corporate measures to collaboratively address present obstacles, advance towards the 'new blue ocean' in sustainable finance, and jointly forge a new era of international ecological economic success.

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