

From financing change to changing finance

Geneva Rethinking Finance Collaborative presentation

Tom Jess – Programme Manager, Rethinking Finance Impact Hub

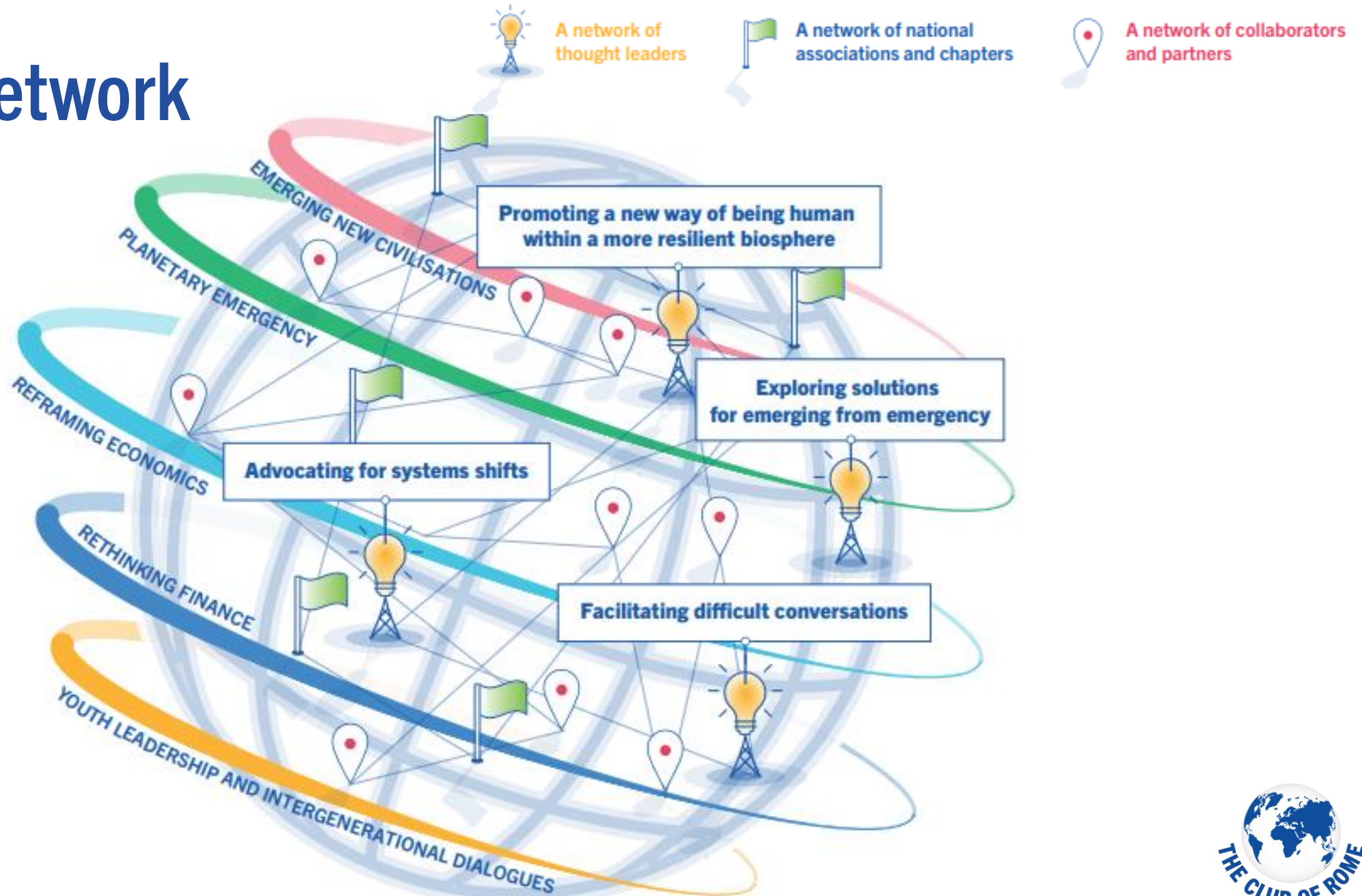
18 November 2024



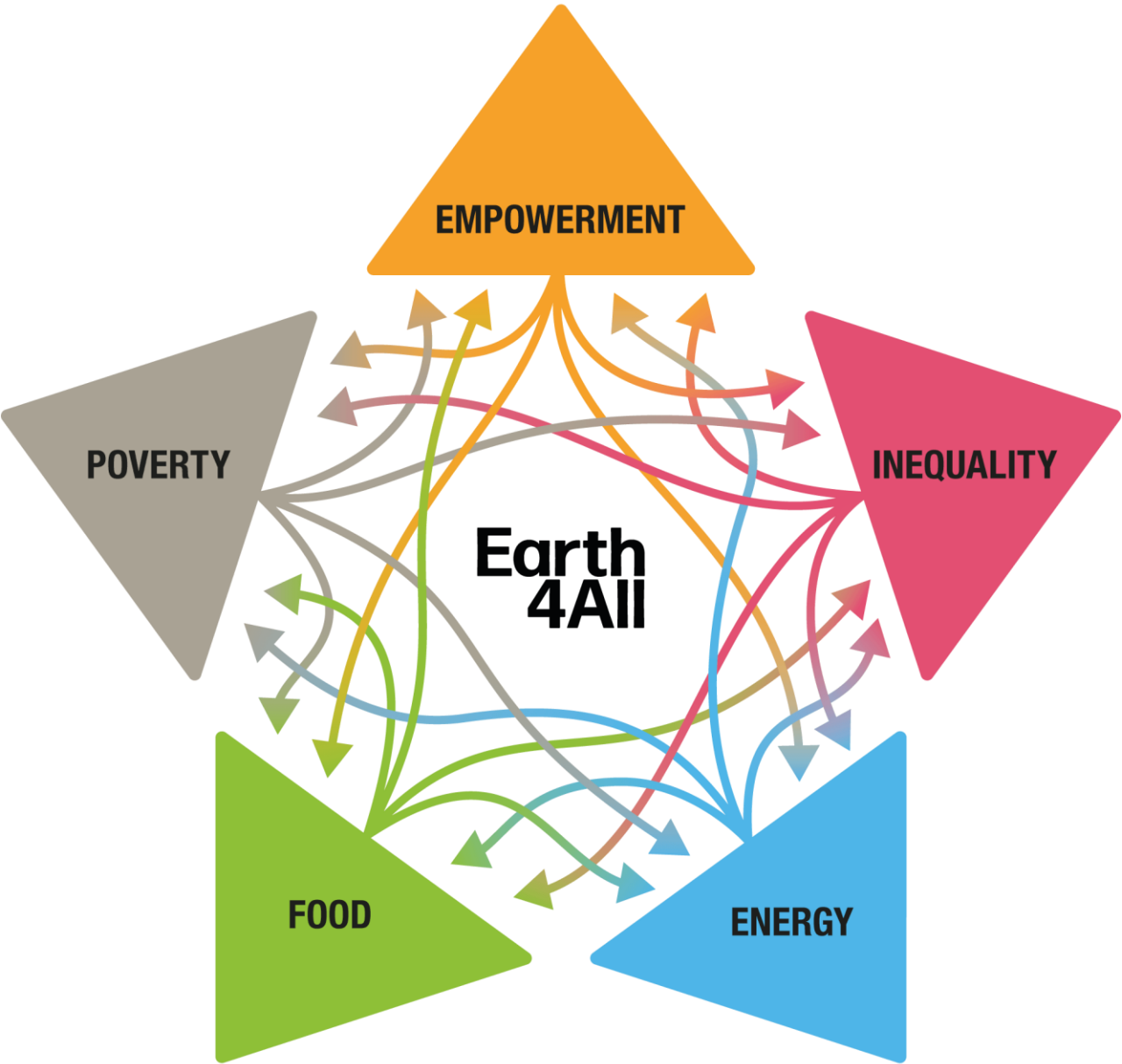
The Club of Rome

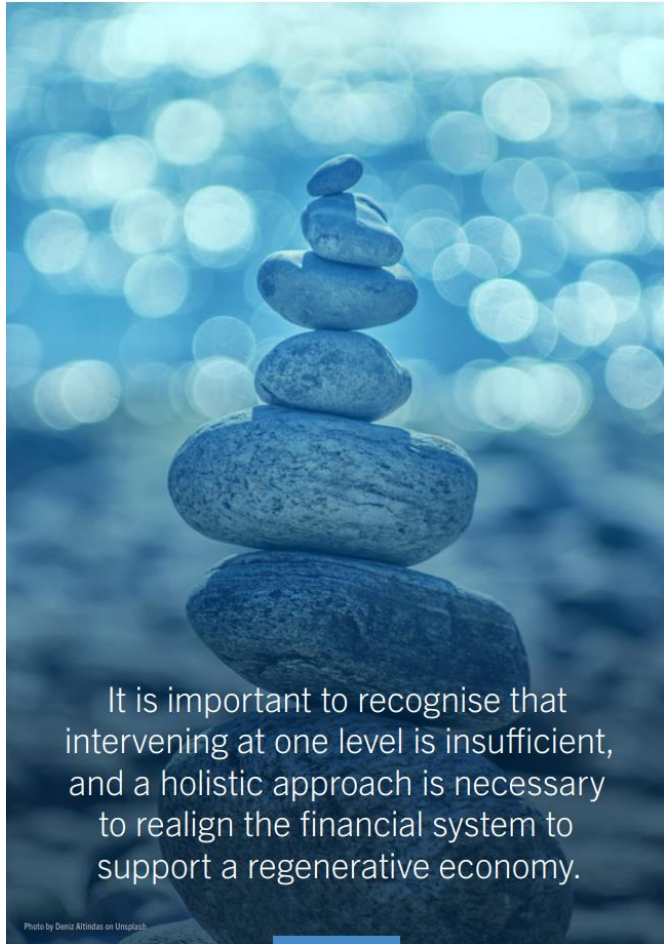


A global network



Earth4All





It is important to recognise that intervening at one level is insufficient, and a holistic approach is necessary to realign the financial system to support a regenerative economy.

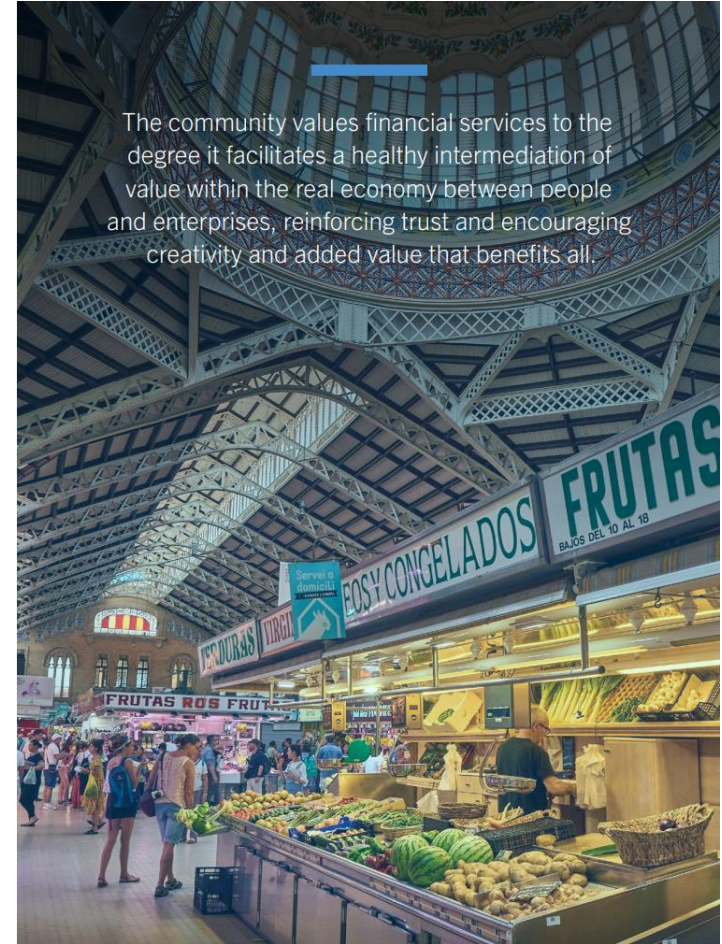
Photo by Deniz Altindas on Unsplash

THE CLUB OF ROME

November 2023

From financing change to changing finance

Tom Jess, Peter Blom and Sandrine Dixson-Declève



The community values financial services to the degree it facilitates a healthy intermediation of value within the real economy between people and enterprises, reinforcing trust and encouraging creativity and added value that benefits all.

System diagnostic – The current financial system is dependent on and therefore promotes economic growth

1. the current financial system is a major hindrance in phasing out the old economy as financialisation is increasing, and finance has become a goal in itself, strongly dependent on (addicted to) unsustainable growth.
2. a new financial paradigm is critically important in enabling a new economy that is fair and, enhances prosperity and will operate within the planetary boundaries.

Financial asset holdings in the euro area
(EUR trillion)

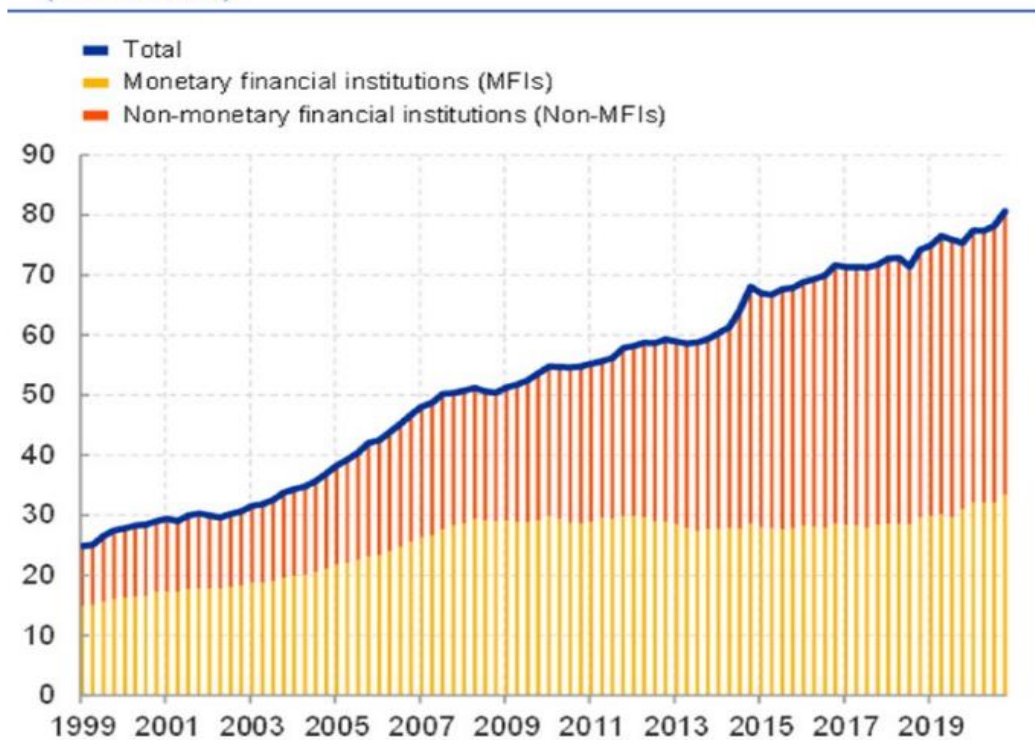
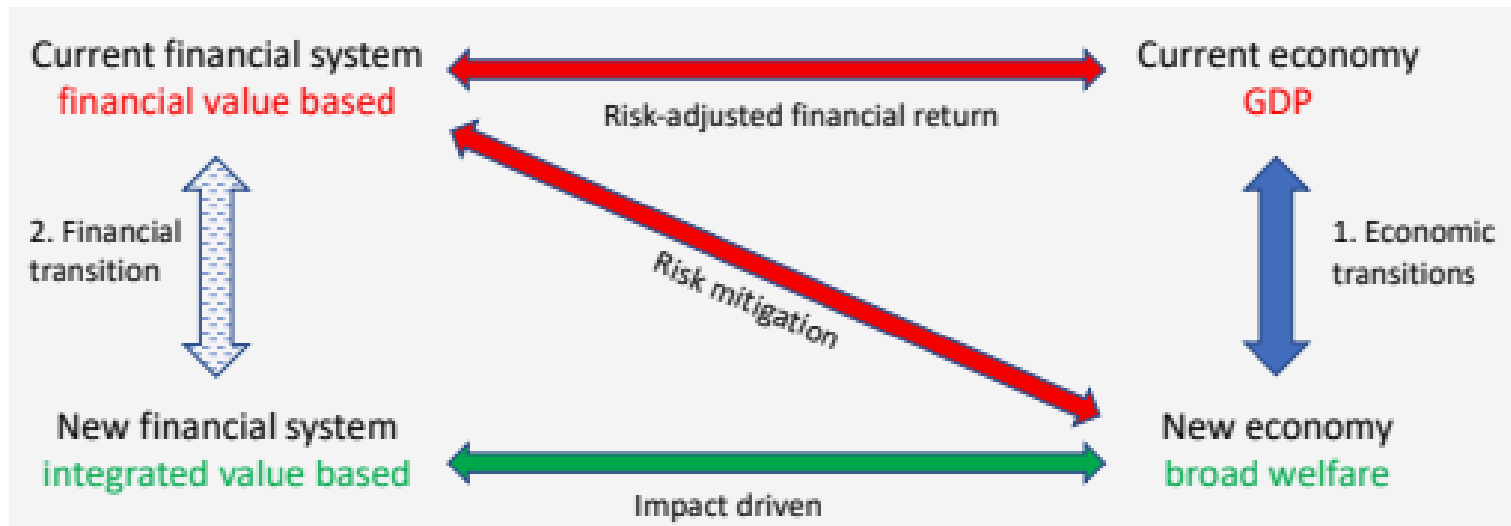


Figure 1 – Evolution of bank and non-bank finance (financial asset holdings in the euro area – EUR trillion, ECB 2021).

System diagnostic – financialisation drives unsustainable short-term growth instead of long-term value creation

- The need for economic growth at all costs has catalysed an overly financialised economic system, thus fostering an economy supporting the financial system rather than the reverse.
- This shift has contributed to lock-in to an unsustainable regime, focusing on maximising *financial* value creation instead of optimising serving people's needs.



Source: Loorbach, D., D. Schoenmaker and W. Schramade (2020), Finance in Transition: Principles for a positive finance future

Core principles for a regenerative financial system

A regenerative financial system must:

1. **Be directed by a purpose and accountable to the principle of supporting the economy in meeting the needs of people, society and the planet;**

2. **Favour integrated value over purely financial value as a whole-system goal, and in policies, practices, reporting and regulation;**

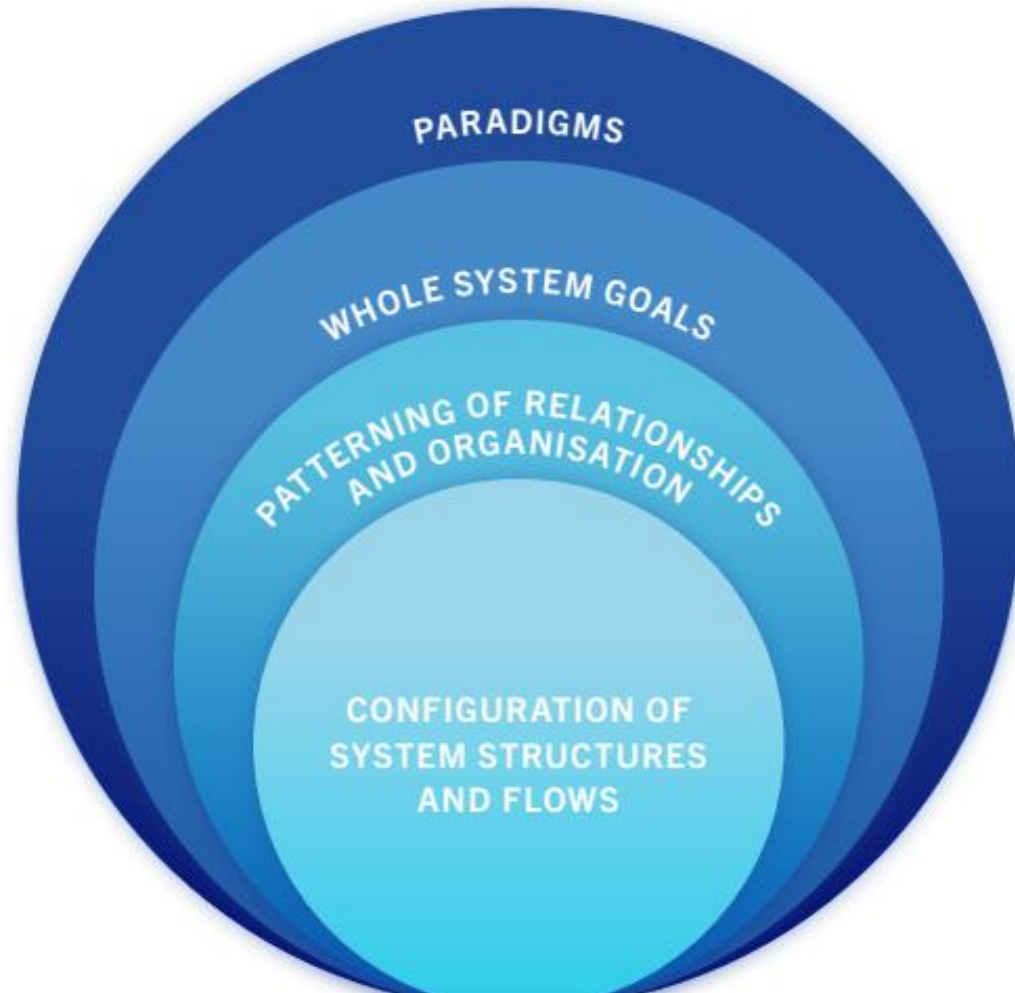
3. **Require institutions to become active agents in a coherent and collaborative strategy centred on long-term value creation, embedded in a stakeholder-oriented governance.**

Source: Club of Rome Rethinking Finance Impact Hub

Shifting from an extractive to a supportive financial system requires a different outlook and approach.



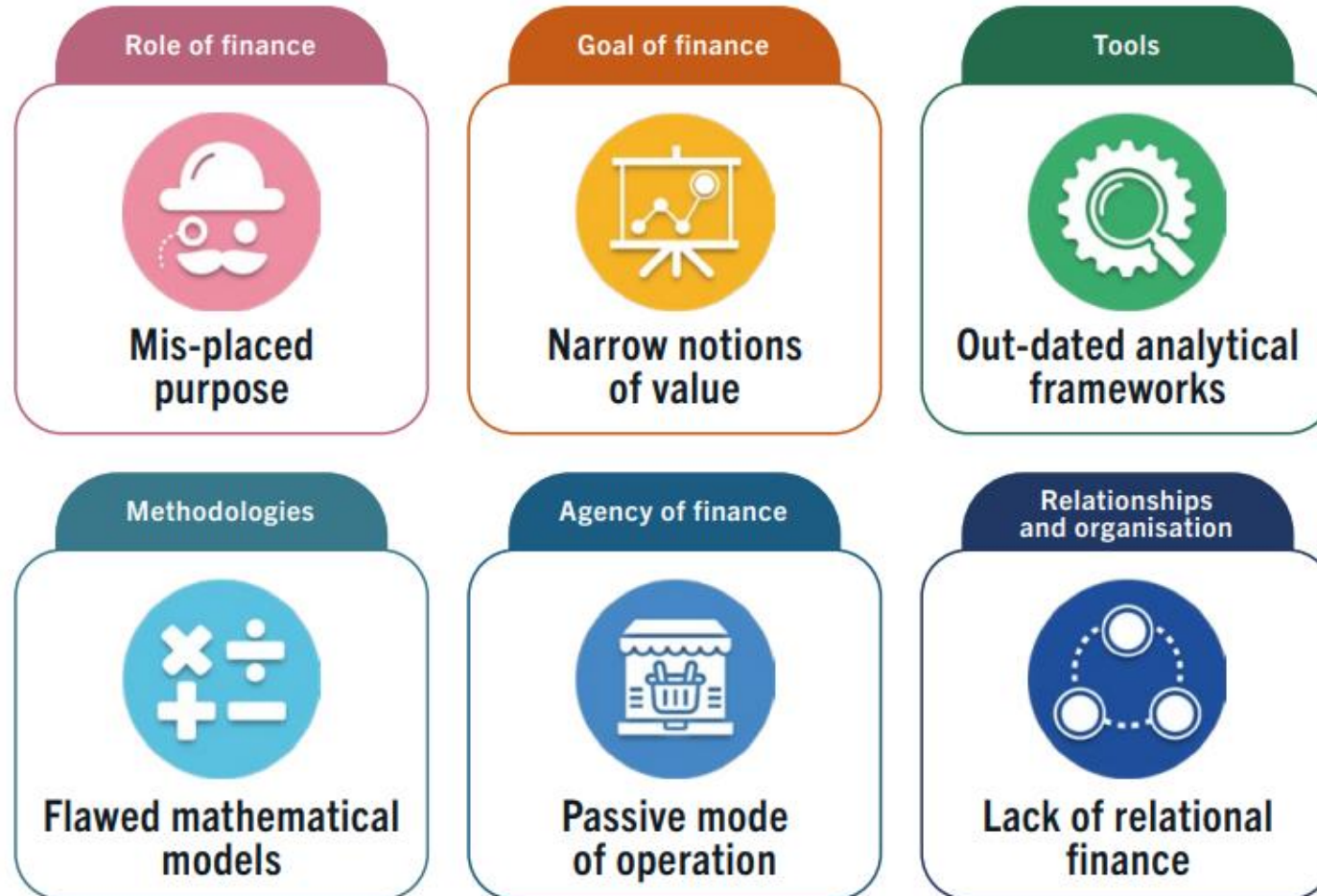
Approach to shift the financial system



For shifting to a regenerative financial system, we adopt a systems framework as a tool to help cultivate more effective and powerful areas of intervention and avoid falling into the trap of attempting to make improvements to the existing system which are fundamentally unable to change course.

Source: Nested patterns of systems, Birney 2021, adapted from Donella Meadows "Leverage points" 1999

Six main barriers to “changing finance”



Source: Club of Rome Rethinking Finance Impact Hub

1. Addressing finance's mis-placed purpose

- The financial system's purpose should be to support the economy in meeting the needs of people, society, and the planet.
- The true value of the finance sector to the community is the value of the services it provides. The community values financial services to the degree it facilitates a healthy intermediation of value within the real economy between people and enterprises, reinforcing trust and encouraging creativity and added value that benefits all.
- Question for deep-dive analysis - How to **reconnect finance** with people, local communities, and SME's in developing a diverse financial landscape?



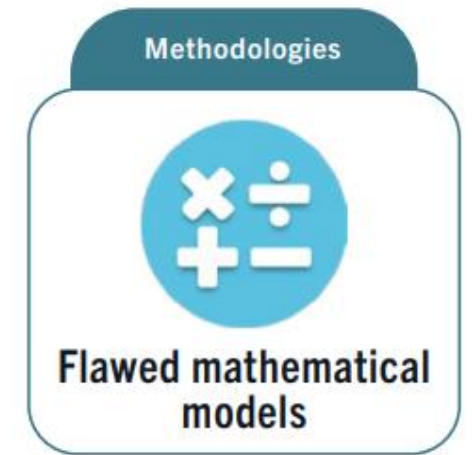
2. Broadening the notion of value

- A central paradigm of today's finance industry is that something has only 'value' if it can be measured in monetary terms and captured through transactions
- Two examples of concepts stemming from the current flawed notion of value are "shareholder value" and "risk-adjusted financial return".
- We should transition to a financial system that manages financial, social, and environmental value in an integrated way. With a goal function of the financial system as integrated value, finance becomes forward-looking and impact-driven where the strength of the financial system is used to help create value.
- Question for deep-dive analysis - How should **integrated value creation** become part of the business model and strategy of each financial institution?



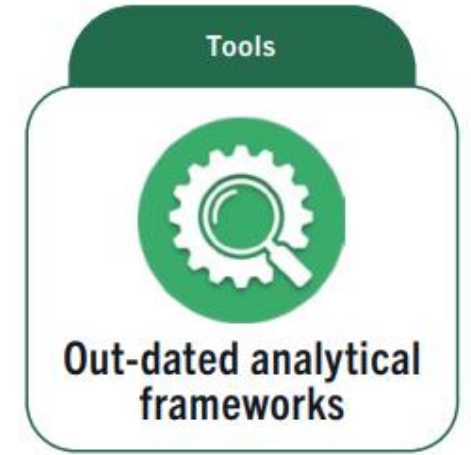
3. Advancing the use of models

- The application and use of mathematical models, which don't reflect absolute truths but a set of norms and values, compound short-termism in the financial systems and add to the disconnect between finance and the real economy.
- Two models which are greatly criticised, yet remain central to financial decision-making, are the Discounted Cash Flow (DCF) method and the models coming from Modern Portfolio Theory
- Question for deep-dive analysis - How can we learn from **advanced methodologies** of developing mathematical models, such as system dynamic modelling?



4. Updating the analytical tools

- The current financial system is dominated by outdated worldviews conceptualising issues like the green transition as a static efficiency optimisation problem rather than a “wicked problem”.
- The dominant worldviews and analytical frameworks in the financial system require a more holistic approach, utilising our understanding of systems thinking.
- We require new analysis tools – such as a ‘system positive’ lens for assessing companies and new approaches to portfolio construction designed to optimise combinatorial effects that deliver directional impact.
- Question for deep-dive analysis - What new future-orientated approaches will move financial institutions to address the complexity of the transition?



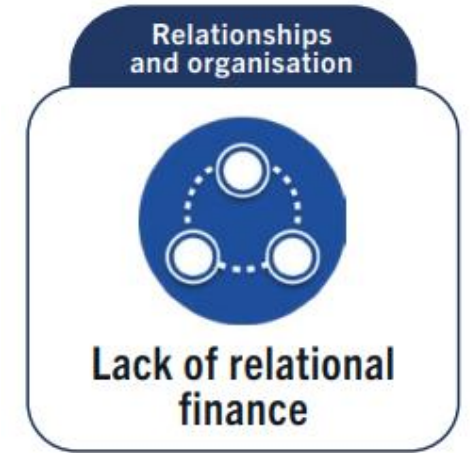
5. Activating the agency of finance

- A prevalent view is that finance and financial capital is a passive entity which follow the principles of the market and policymakers have the role to address market failures such as climate change.
- With a reactive mode of operation, financial institutions hide from their responsibility for driving the sustainability transition of a system.
- Once the reality of finance's agency and responsibility in actively shifting and shaping a system is accepted, then the role of markets, the power of public finance and the opportunity for individual financiers can be put to best use to allocate capital for long-term societal value.
- Question for deep-dive analysis -What is the appropriate governance for a financial institution to operate as an entity that **serves public and private interests?**



6. Creating stronger financial stewardship

- Practices geared away from relationships are problematic for many reasons, and the focus on trading and transactions has been a tool to further optimise financial risk-return
- Financial institutions are not utilising their influence on corporate strategy as a tool to encourage the development of environmental or social strategies or to hold companies accountable for fulfilment of these strategies
- Beyond stewardship, finance for a regenerative world means the capital expenditure decisions in the real economy, not the financial investment decisions in the financial markets.
- Question for deep-dive analysis -How can regulation and governance requirements safeguard the **role of financial institutions as stewards** to maximise overall long-term value including the value of common economic, social, and environmental assets



Questions for further analysis

1. How to **reconnect finance** with people, local communities, and SME's in developing a diverse financial landscape?
2. How should **integrated value creation** become part of the business model and strategy of each financial institution?
3. What new future-orientated approaches will move financial institutions to **address the complexity** of the transition?
4. How can we learn from **advanced methodologies** of developing mathematical models, such as system dynamic modelling?
5. What is the appropriate governance for a financial institution to operate as an entity that **serves public and private interests**?
6. How can regulation and governance requirements safeguard the **role of financial institutions as stewards** to maximise overall long-term value including the value of common economic, social, and environmental assets?

Thank you for listening



- For further details, please reach out to tjess@clubofrome.org
- <https://www.clubofrome.org/impact-hubs/rethinking-finance/>
- <https://www.clubofrome.org/publication/changing-finance/>
- <https://earth4all.life/>