Financial management: make pollution prevention pay

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The financial management of a company, including financial and accounting rules, can have a major impact on corporate performance in terms of growth and survival and of pollution and environmental impact. Environmental management can and does produce financial benefits, but these may only occur in the longer term. The pressure of meeting quarterly profit targets can jeopardize future growth and the ultimate survival of an enterprise. It can also jeopardize the future prospects of the enterprise in taking proper account of its environmental responsibilities. In summary, prevention is better than cure and early investment in clean technology can avoid later environmental problems and enhance profitable performance.

A financial manager could agree with this last statement but would certainly like to calculate the degree to which pollution prevention pays. That may not be so difficult in the case of investing in a new furnace which consumes 20 per cent less energy than the existing one. It may be rather more difficult, however, in the case of a new product that causes a complete change to the product mix.

Due to the dynamics of a business, calculating whether pollution prevention pays is not an easy task. After the strategic reorientation of an enterprise to Greener products it is normally impossible to calculate what the results would have been if the change had not taken place. Better sales figures could be attributed to the new strategy without an unequivocal cause-effect relation.

As environmental regulations are undergoing dynamic development in many countries, an investment today will have to rely on a number of assumptions concerning, for example, pollution charges and environmental taxes or emission rights which will affect cost-benefit calculations. Financing costs (interest rates, credit lines) is another factor which determines whether pollution prevention pays. As a positive development, some banks provide more attractive financing conditions for Green investments compared with others. Legal provisions may also grant shorter depreciation periods for environment-related investments.

Remembering that in private enterprise the objective of financial management is to maximize returns on capital invested, a short-term view of finance puts particular emphasis on the validity of such tools as discounted cash flow. Discounted cash flow has many valid applications, but, used nonselectively, it will always recommend minimizing expenditure in the short term, even though greater expenditure might then be necessary in the longer term. The long-term expenses will be discounted away, while the short-term expenditures will be predominant. There will always be an argument against spending money now to save money in the future on water, energy, raw materials and pollution control. The choice of discount rate is fundamental to calculations of present value of investment, and it is rare for the corporate discount rate to be the same as the social discount rate. While current and short-term returns are valued highly, society may have a longer-term perspective, valuing future returns more highly than corporations. The core of calculating returns on environmental investments is reconciling conflicting discount rates.

Controlling is perhaps the most effective function in monitoring and enforcing environmental targets in the enterprise in terms of input-output or cost-benefit indicators. The task of environmental controlling is to base its actions on a set of indicators relevant to the environment. The selections of meaningful indicators for environmental performance is a particular challenge.

Financial and accounting managers should be made aware of the external, community and economic effects of pollution and environmental degradation, and to consider the implications for national economic growth as well as for the growth of their enterprise and the specific financial implications of waste.

Data on environmental economics in general, and the internalization of environmental costs, together with information on damage costs, cost benefit analysis and the result of cost benefit studies, will show how the total benefits of a clean environment outweigh the costs of achieving that clean environment. A primary aim would be to establish a closer working relationship between financial managers and accountants, on the one hand, and project and environmental engineers within the corporation, on the other.