Mainstreaming impact investing

Strategies in Focus: Equities

One year ago, our Sustainable Investors Team was introduced to a large European fiduciary manager who had a specific request on behalf of one of their major pension fund clients. They wanted to create a bespoke global equities portfolio that would generate strong financial performance and report on the social impact of four categories: climate change, water, health and food security. Below is our answer to the increasing interest from institutional investors in impact measurement of global equities.

Measurement of social impact in the context of public equities has never been done, at least not very well. Some suggest a definition of impact in the equities space that amounts to adding the label “impact” to million metric tons of greenhouse gas emissions. Companies that reduce their greenhouse gas emissions are considered as creating positive impact, but we don’t really know by how much. Others calculate impact as a function of revenue derived from products that target renewable energy, education or sanitation, for example. Such a reductionist approach is misleading in our opinion. Just because money is invested in a social initiative (e.g. education improvement) does not automatically mean that it will deliver a measureable positive impact. This has been a frustrating lesson in the philanthropy and impact investing community.

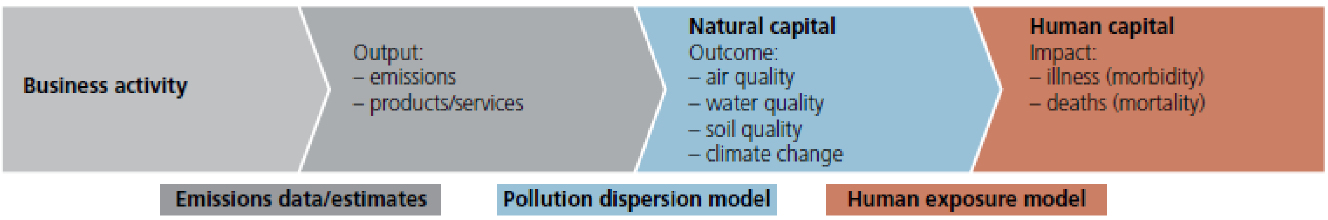
Social impact should be measured in units of human well-being

Furthermore, using revenues to capture a company’s potential social impact does not automatically represent the full range of impacts. What if a water treatment technology requires the use of a highly toxic chemical, which if released into the environment can interfere with human hormonal function, i.e. endocrine disruptors? While the debate on impact measurement is ongoing, most agree that social impact ought to be measured in units of human well-being. Public equities – as with any enterprise – that produce, store or sell stuff in a facility create an impact on human well-being: they employ people, they use energy and water, they emit pollutants to the air, water and soil (see illustration below). For the purpose of this mandate, we propose translating the activities and flows of materials, energy, water and emissions of any public equity – large or small – into a unit of human well-being.

We need to weigh the positive and negative impacts of an enterprise

We also need to weigh the positive (life-saving products) and negative (pollution) impacts of an enterprise – striving to measure net positive impact. How to do this expeditiously and based upon evidence not conjecture? It’s quite easy if you know where to look: the disciplines of public health and environmental science have been doing this work for decades, albeit in the context of regulatory standard setting. Rather than reinvent the wheel we will work with leading scholars at Harvard University and City University of New York to identify robust, credible and user-friendly metrics of social impact for climate change, water and health.

Our framework for social impact measurement



For illustrative purposes only.
Source: UBS Asset Management

This will require novel databases and leveraging scientific models of human health impact, e.g. pollution dispersion models and human exposure models (see illustration below). Food security will be next and necessitates solid models of climate change and water impact. We see growing demand among institutional and private wealth clients, who want to understand how their investment creates a measurable impact.

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