Definition and measurement dilemmas in the impact space

In September, **Tell Media Group**, in cooperation with **American Century Investments**, **Baillie Gifford** and **Vontobel Asset Management**, invited Norwegian investors to discuss impact investing. Tell Media Group founder Niklas Tell and Nordic Fund Selection Journal editor Caroline Liinanki moderated the roundtable.

By: **Niklas Tell**

As participants gathered in front of computer screens rather than face-to-face in central Oslo due to the current meeting and travel restrictions, Caroline Liinanki initiated the discussion by asking the participants how they would define impact investing and to what extent the terminology is a challenge.

HEIDI FINSKAS: "The clean definition of impact investing would be an investment with a dual objective. The financial return, of course, but also an explicit social return or a development impact effect of some kind. But I think we've seen recently that more and more investors are using that term for more traditional investments as well. So I think the term has undergone a journey from something that was more philanthropic in the past to the dual objective with both financial returns and the development impact to now, where we see investors using the impact term for all kinds of investments. But still, I would prefer the dual objective."

> "Then in practice, it gets difficult because it could include so many different types of investment strategies"
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> *– Marte Løfman, Grieg Investor*

MARTE LØFMAN: "The idea of intention is part of the Global Impact Investing Network's definition, which I think is the consensus these days. And I think it's great that we have consensus on the impact investing definition. Then in practice, it gets difficult because it could include so many different types of investment strategies. There's also the measurability. As an impact investor, you really commit yourself to measure what positive environmental or social impact you're having. I think that's part of what separates it from sustainable investing in general, which definitely could overlap, but there's not always that attention on the measurable aspects."

ISABELLE THOMPSEN: "I also think the definition has evolved over time. There was this idea that the financial return would not align with that kind of positive intention or positive impact that you wanted to derive. But, as Heidi mentioned, there's a move towards more of a generalisation of impact investing. And I think this has to do with the SDGs, which has provided a framework where most investors want to highlight what kind of contribution or alignment to the SDGs they have through their portfolios. So I think that's why the term has become more widely used. I think the measurement dimension is the part that's very difficult. Most investors are still at the stage where you can say where you're aligned and where you're not aligned and what kind of positive or negative impact your portfolio has but how to measure it is still a challenge. And I think that has to do with the availability of data."

GEORG SKARE LUND: "I very much agree to what has already been said. And just to follow up on what Isabelle just mentioned, I think measurability is a key criteria for real impact investing. I think you said, Marte, that intentionality is important but that's just a wish, right? It's not impacting investing if you don't achieve anything. I think when it comes to measurement, there's a philosophical challenge in what to measure. If it's something that's already available in the market in a sufficient quanta, you can't really call it impact investing. So I think we need an additional criteria for impact investing: additionality. That means that you're providing something in addition to what's already there and something that is a necessity. If you just buy into renewable energy plants that are already out there, are you really influencing the world in a positive way? I'm not so sure if you do. You could measure how much clean energy you produce but what if that capacity was already in place before you bought it? You could argue that by buying this power plant, you provide more capital and the company's cost of capital will decrease and it could perhaps make further investments because the cost of capital is low or profitability has increased. But where should you draw the line and what is really additionality? I think that's hard to say. And I think most managers would have an incentive to exaggerate their impact a little bit. So it would be beneficial for the industry with a standard criteria and guidelines for how to measure impact."

PASCAL DUDLE: "Impact investing has undergone an evolution. As mentioned before, it started with projects targeting vulnerable people in emerging or frontier markets, which to me is the highest level of impact you can achieve. But this model of impact investing can be applied to other segments in a transition phase. And we have enormous challenges that need to be addressed, either on the environmental or the social side. And impact investing, as it's more objective driven and solution oriented, can be an important tool to achieve that change in a more scaleable manner. When it comes to measurability, I didn't quite agree with the argument around renewables. Today, a large part of the energy or electricity generation is still based on fossil fuels, so we have to allocate a lot of additional money into that segment to get to a clean energy world within a reasonable

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Head of impact investing at the institutional investor consultancy Grieg Investor. She has worked at the firm since 2016. Prior to that, she worked with an emerging market private equity manager in London and at Norfund, which invests in developing countries on behalf of the Norwegian government

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Vice president for corporate responsibility at the pension company KLP for the past five years. She joined KLP in 2008 as an advisor for responsible investments.

timeframe. Instead of only measuring the carbon footprint, we've adopted the concept of measuring the potential avoided emissions, which helps to identify companies offering products and services that have significant potential to contribute to reduced greenhouse gas emissions. And that's basically showing the path towards zero emissions."

NIKLAS TELL: ROSIE, WHERE DO YOU DRAW THE LINE? WHEN IS SUSTAINABILITY OR ESG INTEGRATION TURNING INTO IMPACT INVESTING?

ROSIE RANKIN: "The way we think about it is that you can have a full ESG integration but not be an impact investor. But it would be impossible to be an impact investor without ESG integration."

PATRICIA RIBEIRO: "I agree. I think ESG integration and impact investing are different. ESG is the minimum that we must do. Impact investing is an extension and it goes beyond what we do on ESG. A company can check the boxes when it comes to ESG integration but may not create the impact that we're looking for when it comes to the measurability. That's why we felt we needed to create a separate portfolio where we are able to measure the impact each business is having on society. And as mentioned before, I think the SDGs have been helpful in guiding investors in how to look at the world and how to apply impact investing."

MARTE LØFMAN: "The minimum standard is that managers should integrate ESG 100 per cent. But when looking at venture and private equity managers, I often see that they're not really there. They may have a very clear impact objective but not best in class when it comes to ESG integration. I think that's partly explained by the impact investing industry being young and a lot of these emerging managers being first time players. One reason is that ESG has to look a bit different in the venture space, given the early stage of the companies. Even though it may seem counterintuitive, I think the impact investing industry still has a job to do when it comes to ESG integration."

CAROLINE LIINANKI: ISN'T THAT A BIT SURPRISING? YOU WOULD THINK THAT ESG INTEGRATION WOULD BE A PREREQUISITE IN ORDER TO TAKE THAT FURTHER INTO IMPACT.

MARTE LØFMAN: "Yes, but a lot of impact funds don't come from a traditional asset manager, where the first step naturally would be ESG integration. Many come from a different sphere where the impact focus may be the first point of focus and then ESG comes later."

PASCAL DUDLE: "Yes, the ESG framework is more to evaluate a company's risks and practices. It's strong view on internal processes and structures make it much more static, even to a certain extent backward looking. The impact model itself is much more forward looking with a clear objective – you're looking at what the company is providing in terms of change to an industry and that's a totally different approach in my view."

NIKLAS TELL: SO WHAT ABOUT IMPACT IN THE LISTED SPACE? IS THE BIGGEST IMPACT YOU CAN DO THERE ACTIVE OWNERSHIP, SO YOU SHOULDN'T BE INVESTING IN THE BEST IN CLASS, FOR EXAMPLE IN TESLA?

ROSIE RANKIN: "First and foremost, we will invest in a company because of the impact it has through its products and services. But I also think we can have an impact as investors in terms of the active stewardship. It's that point of additionality: what difference does it make to this company that we're investing? Tesla is a large position in our portfolio and we're very confident of the positive impact its having through its products and services. But we've been very active in engaging around improvements in its governance structure, on its record on health and safety and in understanding things like sourcing of cobalt for the batteries. So we've invested primarily for the really exciting potential that they're changing an industry but we can play a role as investors in being supportive and challenging."

> "I think the net impact is also something that needs to be considered"
>
> *– Isabelle Juillard Thompsen, Gjensidigestiftelsen*

CAROLINE LIINANKI: I SUPPOSE YOU COULD FIND SOME KIND OF IMPACT ASPECT IN ALMOST ANY INVESTMENT. WHERE DO YOU DRAW THE LINE?

ROSIE RANKIN: "The very first question we ask ourselves is what societal challenge this company is tackling. And that's our primary filter, because if it's not tackling a challenge – if it's not improving the status quo through its products and services – then it's never going to merit a place within the portfolio. And that actually filters out a lot of companies. There's an argument that there's a huge range of businesses that are making positive contributions to the world, but which companies are really solving a societal challenge? What companies are really contributing to having a systemic impact?"

ISABELLE THOMPSEN: "I think the net impact is also something that needs to be considered. Because even though a product or service could be beneficial and have a positive impact, it might also have a negative impact in the way it's produced. So I think that the net effect should be considered as well and that's where I think ESG integration is very important, because you need to be aware of the risks and opportunities. But the additionality that we were discussing earlier is easier to measure in the private space. That's usually entrepreneurship, creation of new technologies and new services within the marketplace where there are no similar products or services. But in the public space, it's very hard to measure additionality. Even if you produce a product that seems to be beneficial, how do you know that there are not already plenty of products or services addressing that need? I think that distinction is not always that easy in the public space."

PASCAL DUDLE: "Change takes time. We basically look at what investor impact can be achieved over time. So we engage with companies to understand their long-term strategy and how they want to contribute to that change we're looking for. We're focusing on segments that represent a significant portion of total emissions, for example transport, buildings or energy generation, and are then looking at technologies that can offer some solutions to decarbonise or reduce material consumption."

ROSIE RANKIN: "I think it's very interesting that you use the phrase 'over time', Pascal, because our belief is that you have to be long term as an investor, but even more so in impact investing. You really must have that multi-year time horizon. You're looking for those innovative disruptors but you're not looking for that over the next year or two. You're looking for it over the next decade and that's what makes impact investing exciting. But it also creates challenges in measuring that change."

NIKLAS TELL: HOW DO YOU HANDLE THE MEASUREMENT PART OF IMPACT?

PATRICIA RIBEIRO: "Measurement is obviously a challenge. For emerging markets, it's probably the biggest challenge because many companies don't have sustainability reports. They're still learning about this space. Often, we find that they have the information but never thought of publishing it in a report, so engagement is very important. Measurability is difficult but it's not impossible. It just takes time and effort and it requires an understanding of the business to position the questions in a way that makes sense."

GEORG SKARE LUND: "As a relatively small investor in a large company, it will take time to create significant change in a business plan or in business conduct. I don't really think that kind of engagement activity should qualify a fund for being labelled an impact fund. In your asset management activities, it's part of your ESG job and it's part of your impact in the long term. But because of the time horizon and the problem with measurability, I don't think a fund that only engages with management really deserves the impact label. When it comes to measurability, I agree that we have to be patient. But I think we should also emphasise the importance of materiality. It has to be a significant part of the of the company's business."

PATRICIA RIBEIRO: "To clarify, engagement is not the only way but I think engagement is one more way of addressing measurability. Also, when we look at companies, we're not only looking at them today. We need to see that the impact is there for the longer term and that it continues to improve over time. Engagement helps us to understand where the business is going in the future but the impact must be there and must be measurable and quantifiable."

HEIDI FINSKAS: "If we look at the dedicated impact investment portfolio, we're definitely looking for impact here and now from the start of the of the investment. The sectors that we're focusing on in this portfolio are banks and financial institutions in developing countries, as well as renewable energy in developing countries. And again, talking about additionality, it's about a new capacity being built. When it comes to engagement, it's definitely key for any investor to have an impact but I would separate those two discussions. You have a much longer-term perspective for engagement.

ROUNDTABLE – IMPACT INVESTING

GEORG SKARE LUND
Storebrand Asset Management
Head of manager selection at Storebrand Asset Management. He joined the company as a management trainee in 1996 and was involved in starting up the unit-linked business of Storebrand. He has held different positions relating to long-term saving and worked in the manager selection unit since it was established.

ISABELLE JUILLARD THOMPSEN
Gjensidigestiftelsen
Portfolio manager at Gjensidigestiftelsen, responsible for equity and sustainable investments for the investment portfolio. Prior to joining the foundation in 2017, she was a senior analyst at Norges Bank Investment Management for more than four years. She has also worked with alternative investments at Storebrand.

Also, measurability is really the core of the impact discussion and I think it's so important that we as individual institutions, but also as the sector as a whole, really take that seriously. At the end of the day, this is about trust and credibility and then we need to refrain from greenwashing. It's very challenging. We all know that. One thing is the lack of data and the second is the lack of definitions and that's why it's so exciting now to see what's happening on the EU level with the taxonomy. I really think that will lead to change and that this decade represents a milestone."

GEORG SKARE LUND: "Something that perhaps the various fund managers could comment on would be some of the borderline cases of impact investing. This comes back to the definition and what to include. Some managers say that investing in companies in the tech space or social media platforms, like Alphabet, Facebook, Google or Microsoft, provides something new to the digital economy, access to internet and so forth. But there are also negative effects of these companies. Would your funds be eligible for investments in those companies? Would that fit your definition of impact investing? I'm struggling a bit in measuring the positive impact of these companies."

PASCAL DUDLE: "We don't hold these mega caps in our portfolio. However, you would find specific software companies in our portfolio because we think software can play an important role in many applications. In the building segment, technologies like heat-pumps, ventilation systems or insulation can help to lower energy consumption. But ultimately, it can only reach its full potential if this is included in a smart building application, using software that also steers the building. For us, software companies and even semiconductor companies can be part of our investments. But you wouldn't find the likes of Alphabet."

PATRICIA RIBEIRO: "From the companies you mentioned, Alibaba is the one in my universe. We would look at what exposure the company has to the lower income part of the population and what plans they have for the future. But you need to be able to see, quantify and measure the impact part of the business."

CAROLINE LIINANKI: THERE ARE A LOT OF DIFFERENT TYPES OF IMPACT THAT YOU CAN AIM TO ACHIEVE. WHAT HAS BEEN YOUR THINKING WHEN IT COMES TO DECIDING WHAT TYPE OF IMPACT YOU WOULD LIKE TO HAVE?

ISABELLE THOMPSEN: "For us, it has been a journey and we've had to prioritise because we're a small investor. We basically have impact in our DNA through our work in the local society here in Norway and we decided to align the impact of the investment portfolio with the work of the foundation as a whole. For example, health and well-being is one area that the foundation is working with, so we've decided to prioritise that. Safety and future generations are other areas, so climate is obviously a big topic for us. We also focus on nutrition and sustainable agriculture. I think we've been able to demonstrate that we're aligned in terms of intention with those goals but we've been struggling to measure the impact, primarily on the public side."

MARTE LØFMAN: "For us, it really depends on what type of impact our clients are interested in. Some of our clients have very specific goals. We have one client that's very ambitious within the health and education space, so we've done several searches there. Other clients are more open. They're happy to contribute to the SDGs in general. We've had cases where clients have wanted to create an impact in an area that's not really investable. One of our clients is really interested in freedom of speech and freedom of the media. I've found one product but it's not a huge universe out there, so it would be difficult to build a diversified portfolio."

> "I also think there's an elephant in the room, which we're not addressing, and that's the trade-off between impact and financial return"
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> *– Georg Skare Lund, Storebrand Asset Management*

NIKLAS TELL: WHAT ARE SOME OF THE SPECIFIC CHALLENGES WHEN IT COMES TO FINDING GOOD IMPACT MANAGERS?

MARTE LØFMAN: "One of the key challenges for us has been the lack of managers with a track record. There are so many first time fund managers in this space. They might have great intentions, drive and want to make a difference but no real track record to show. We prefer managers that have a fund or two behind them so that we can feel more comfortable with their ability to work as a team and create return for investors. Another challenge on a broader level is liquidity. I think a lot of our clients that are putting money into the sustainable investing space would be interested in having more impact investments in their portfolios. But many don't have a private equity allocation or the ability to lock up money for the required time period."

HEIDI FINSKAS: "I agree about the challenges. At KLP, we've chosen to establish our own platforms and start new partnerships and collaborations – and that's about finding the right partners. It's also about reasonable management fees and above all, having structures with scalability and structures that fit us as an institutional investor."

ISABELLE THOMPSEN: "I think I would echo what Marte said. I think the lack of track record is definitely one area and then maybe the true intentionality. It has become very popular to launch this type of product, so you need to understand which products have a genuine intention to really make a difference and which products that are launched because of market trends. I think there's still a lot of greenwashing and I think that's where the standardisation of reporting and the EU taxonomy will help investors."

GEORG SKARE LUND: "I think a lot of the essential obstacles when it comes to finding good impact strategies have been mentioned. One additional issue relates to the dual objective we started talking about: making a positive contribution to the world and making financial returns. Managers therefore need two sets of capabilities. You need the more ESG-oriented softer skills to see the qualitative effects of the investment and then you need the more traditional investment skills. I think the teams are typically composed of just one of those skill sets and not a combination."

CAROLINE LIINANKI: CONSIDERING THAT THERE ARE A LOT OF NEW MANAGERS IN THIS SPACE, DOES THAT MEAN THAT YOU MAY HAVE TO COMPROMISE ON THE TRACK RECORD? AND DO YOU NEED TO PAY HIGHER FEES FOR IMPACT STRATEGIES AS THEY WOULD BE MORE COSTLY TO RUN COMPARED TO TRADITIONAL STRATEGIES?

GEORG SKARE LUND: "Yes, track record is a problem. They're shorter but it also depends on what kind of track record you're looking for. Is it the track record for that specific strategy or is it the track record for the management team? I think we could use the latter as a substitute to see the team's capabilities in acting as a fund manager. When it comes to fees, I think that we, in general, would expect them to be a little bit higher. However, when the track record is short, we often get a better deal by being supportive of the fund in the early phase. Perhaps that's a positive flip-side of a short track record – it gives you more negotiating power."

ROSIE RANKIN: "I agree that you need both skill sets within a team. You need the investment experience and you need the impact analysts. That's critical. That can feed into fees, because it's a resource-intensive activity but it

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American Century Investments
Senior portfolio manager at American Century Investments, managing the firm's emerging markets, emerging markets sustainable impact and emerging market small cap strategies. She joined the company in 2006 from Citigroup AM.

ROSIE RANKIN
Baillie Gifford
Director for the positive change strategy at Baillie Gifford. Prior to joining the asset manager in 2013, she worked at Martin Currie Investment Management, Aberdeen Asset Management and Edinburgh Fund Managers.

PASCAL DUDLE
Vontobel Asset Management
Head of listed impact investing at Vontobel, where he manages portfolios featuring clean technologies and social themes. He joined the company in 2007 from Swiss Re, where he was focusing on alternative energy, energy efficiency and sustainable forestry.

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>
> *– Heidi Finskas, KLP*

depends on how you think about fees. If we truly believe that this is a way to solve some of the world's most critical challenges, you need to be able to attract capital to the area. Philosophically, you therefore want to make these strategies accessible and available at a reasonable cost. So we felt it was philosophically inappropriate to set a high fee."

GEORG SKARE LUND: "I also think there's an elephant in the room, which we're not addressing, and that's the trade-off between impact and financial return. In some cases, I think the impact is sacrificed in order to generate returns. I think that's the main explanation for why some might be squeezing the boundaries a bit and invest in Amazon, Google, Facebook, Apple and Microsoft."

ROSIE RANKIN: "We only have 33 companies within our portfolio so we do set the hurdle for inclusion very high. Companies must have the ability to deliver impact and investment returns. We do have some of the big enablers within the portfolio. Amazon, for example, wouldn't merit a place in our portfolio due to factors about who the company actually is benefiting. But - and probably our most controversial holding from your perspective - we do hold Alphabet. We've also recently added Alibaba, which links into our theme of social inclusion. We really see their impact in their ability to facilitate social and financial inclusion and that's what really excites us about it. But both Alphabet and Alibaba are not without controversy and we completely recognise that."

CAROLINE LIINANKI: WE TALKED EARLIER ABOUT THE CHALLENGES AROUND POTENTIAL GREENWASHING. DO YOU THINK THAT THE EU TAXONOMY WILL HELP IN ADDRESSING THIS?

HEIDI FINSKAS: "Sustainability is such a broad theme and topic and I think the EU taxonomy, which his science based, will help with a common definition and a common standard on what's sustainable and not. It will not give us all answers and it's currently only focusing on climate but it will definitely change the whole space as investors are becoming obliged to report to the taxonomy and to what degree our portfolios are aligned. I think the taxonomy will bring us one step away from opinions and one step closer to a fact-based discussion. That's my hope, at least."

MARTE LØFMAN: "I have great hopes for the EU taxonomy. I think sustainability has been a word that has been abused for too many years and drawing some clear lines as to what economic activity can be defined as sustainable is much needed. I think it's big step forward relative to the SDGs, which have gained a lot of attention in the asset management industry. The SDGs are great in terms of giving us an idea of the big challenges out there but focusing on the SDG targets from an investment point of view doesn't always make sense. A lot of fund managers jumped on these goals and started creating products around them with varying results. The goals were not created for investors and are not always investable, especially at the target level. I hope and think the taxonomy will make more sense from an investor's perspective."