TRANSCRIPT | *The Economist* Sustainability Week interview: Analyzing environmental and social impact investments (event replay)

VAIBHAV SAHGAL: Welcome to Sustainability Week at Economist Impact. This is Vaibhav Sahgal. I'm a principal for the Americas region on the Policy and Insights practice at Economist Impact. I'm joined today by Oyin Oduya, who is the Impact Measurement and Management practice leader on the Investment Research Team at Wellington Management. Oyin, quite a lot of questions for you, but before we get started with any of that, I don't mean to oversimplify, but my baseline understanding of impact investing is that it is a general investment strategy that seeks to generate financial returns while also creating meaningful positive social and environmental impacts. But when defined in this manner, it's somewhat challenging to really differentiate between impact investing versus, say, responsible or sustainable investing. So, I really appreciate your thoughts on the matter. Could you tell us a little bit about what is impact investing, what are its key benefits, and is it really different from responsible or sustainable investing?

OYIN ODUYA: Yes, absolutely, and in terms of level-setting, I think you've done a good, broad explanation of what impact investing is, investing for market-rate returns alongside measurable social and environmental impact. I think the key thing that I would add is kind of a focus on products and services. So really when you're thinking about a strategy being an impact strategy, you want to think about how the company's products and services relate to certain

predefined impact-related themes, whether those be environmental or social in nature. If I think about other areas of the responsible investing spectrum, and I agree with you, there are many different flavors; if you compare it, for example, with ESG investing, the difference there is that when you think about ESG, it's more about how a company does business. So ESG can apply to any company, because it relates to how a company, for example, derives its power supply, is it mostly from renewable sources? How a company treats its employees, does it give them access to training and educational opportunities? How is a company governed? Is its board diverse? Is its board independent? That can apply to any company that you may be analyzing to put into your portfolio. When you think about impact investing, it's a smaller subset of companies, because their products and services have to be aligned with the impact outcomes, not just how they do business. And then the other couple of things I would add that distinguish impact investing from other forms of impact investing is the intentionality, when you're analyzing a company for an impact portfolio you have to think, before you put it in the portfolio, how does this align with certain impact outcomes. You have to have another layer of diligence that's done before the fact, not after. And the last thing I would highlight is maybe the concept of additionality, which is really important in impact investing, whether thinking about the additionality of yourself as an investor, or additionality of the company, you need to see how is this company, how is this strategy, driving outcomes that otherwise may not have happened? So in a

nutshell, those are kind of the key things which I'd say differentiate impact investing from the wider sustainable or responsible investing universe.

VAIBHAV SAHGAL: That's crystal clear, and actually really helpful for me, and I imagine our listeners too. But just to request a little bit of additional context here, could you tell us more about Wellington Management's approach to impact investing, and I think a few examples around how this differs by investment type or asset class would be helpful, too.

OYIN ODUYA: Sure. So, at Wellington we have a very high bar for our impact investing strategies. We have developed impact themes which align very well with the UN SDGs. I mean, this is not an exclusive list, but just to give you an example, we look at the theme of human empowerment which covers things like education and financial inclusion; life essentials, which covers things like affordable housing, health care; and then there's an environmental theme which covers things like alternative energy and resource stewardship. And so, for a company to enter into our impact universe, and therefore be eligible for any of our impact portfolios, we have to be able to identify, firstly, materiality. So the company has to have over 50% of its revenues aligned with one of those impact themes. Secondly, additionality. So the company has to be doing something different from business-as-usual to drive impact. And this normally relates to cost or innovation or serving an underserved population, for example. And then, lastly, we have to think about materiality, and this is where my team comes in, the impact measurement and management practice. We need to think about an impact KPI that we can track over the life of the

investment, the track that the company is actually delivering on the impact that we expect. In terms of thinking about different approaches and different asset classes, impact investing, the kind of most discussed differences -- public versus private markets, and we have impact strategies in Wellington, in both sides of that spectrum -- I think the key debate point often comes down to additionality. In public market impact investing, you often see more additionality through engagement, so through our discussions with companies around issues we think could drive impact, and working with management to kind of deliver more impact. On the private side, additionality is more kind of hands-on because you're close to the company, whether you have a board seat, [inaudible] board seat, it may more be about trying to influence the direction of the company to drive more impact. But in both areas, additionality is very possible.

VAIBHAV SAHGAL: Thanks, Oyin. So, definitely, going by your description, that is a very high bar for potential investments. And kind of linking this to a bigger picture problem, there's no question that there is a sizable gap in the availability of financing for sustainable development. There's a lot of stats about this from various, say, development agencies. But interestingly, I recently came across this stat which said up to 38% of global investment in critical infrastructure, for example, is not spent because of bottlenecks, a lack of innovation, market failures, and issues like that. So, does this stat resonate? Has your team at Wellington observed kind of a lack of worthy impact investment opportunities as well?

OYIN ODUYA: I would say no, to be frank, we have quite a wide range of opportunities on the public and private side, but we also have quite a wide range of impact themes. As I mentioned, we're looking at climate solutions, we're also looking at affordable housing, we're also looking at health care, so across all of those themes, there are a wealth of opportunities. What I would say is quite important in impact investing, is that I think impact investing is most powerful when the impact rationale for investing in the company is very much aligned with their profit motives, because there's no greater motivation I think for a company to kind of push towards an impact thesis or an impact outcome, if it's also going to make them money. And so I think that that's maybe where you see a situation where you have less of the bottleneck problem, because you have the profit motive working in the same direction as the impact motive, then it's easier to get things done. I think, for example, about the area of financial inclusion, which, particularly in emerging markets, is a huge opportunity for the private sector to do good. People and businesses not having access to bank accounts, to savings, to insurance, it's a huge, I think, [stunting] area for growth, and a huge area where banks can get involved to try and give access to financial services to these underserved populations. Now, the World Bank estimates that I think globally, one-third of adults don't have access to financial services, that's 1.7 billion people. That is a huge opportunity for banks globally to tap into. So if the profit motive is there, but there's also an impact incentive at the same time, I think that's what helps you

to get things done and to avoid things getting stuck in a bottleneck-type situation.

VAIBHAV SAHGAL: Very helpful, Oyin. You know, the view from some part of the mainstream investor circuit -- the more kind of traditional, old-school investors, usually more conservative as well -- is that impact investments are harder to scale, and therefore, particularly challenging in terms of creating attractive returns. Sometimes they're associated with higher risks and are typically tougher to exit. Do you agree with these pain points? And in your experience, what would you say are some of the key challenges associated with impact investing?

OYIN ODUYA: I wouldn't agree with the premise that if you're investing for impact, you necessarily have to give something up on returns, and -- listening to your point about kind of more conservative, traditional investors -- I think, you know, the seas are changing. If you look at the attitudes of millennials, for example, who are set to inherit today as well, they have very different views to the baby boomer generation in terms of what their money can do, what they want their money to do, so I definitely think the attitudes are changing in regards to the people who are actually investing the money. In practice, I have not seen that you need to make any sort of concession on returns to drive impact, but you do need to do [your] diligence. And so what I do think, in terms of the statement you made earlier -- that you need to put more work into doing impact investing -- I do think that is true. Because you have to do exactly the same level of financial diligence as a traditional investor, and then you have to

do another layer of impact diligence on top of that. Now, does that mean the industry can't scale? I don't believe so. At Wellington, I'm running the Impact Measurement and Management practice. My team is busy, but there are lots of people who are interested in doing the work that we're doing and supporting the investors to make sure that we're doing impact investing with integrity and scaling with integrity, so I think that it is possible we just have to put in the work.

VAIBHAV SAHGAL: That's helpful guidance, but I guess now moving to what I think is the most important part of this discussion, which is really the measurement of impact itself. So, as you would know better than anyone, there appears to be kind of a lack of consensus around impact measurement -- different agencies, different investors, are measuring impact quite differently. They have different definitions, different thresholds, things like that. So digging a little deeper into this, I'm curious whether impact investment as a discipline, so to say, actually relies on a consistent reference framework. And kind of building on that, is there any explicit relationship between impact investing and the UN Sustainable Development Goals framework?

OYIN ODUYA: Yes, I guess taking the last part of your question first, absolutely. Over 90% of impact investors align with the UN SDGs to some point. So definitely, it's a very useful third-party framework. 193 countries have got together and said, these are the most important, worldwide problems that we need to solve, but as you mentioned before, there's a $US2.5 trillion annual funding gap, so we need to get the private sector to help to solve these

problems, and therefore through impact investing, we need to get capital to the companies who are part of the solution. So I think it is very much connected to the UN SDGs and can help to push capital towards solutions, and ways to get there. In terms of impact measurement, there are some challenges in impact measurement, but I think it's important that we continue to persist in this discipline; accurately measuring impact is really key in terms of allowing the industry to grow and scale with integrity. And I do take your point that there are many different frameworks out there; many managers use their own proprietary framework which, on the one hand, you can understand, because I do think it's very important that the impact measurement and management process is really well-integrated with how the investors think about investing, how they do investing. It can't be the case that impact diligence is done on one side, and financial diligence is done on another. It has to be integrated. That very fact means that you have several different frameworks which are floating around, and I think definitely for people who are the ultimate end-investors, it is quite difficult to be able to compare impact from one fund to the other, from one asset class to the other. But what, you know, we at Wellington, really focus on doing is trying to be part of the solution here, and there are a few industry frameworks that people are coalescing around, whether at the IRIS+ system of metrics, supported by the Global Impact Investing Network, or the Impact Management Project Framework, the Five Dimensions of Impact. These are frameworks that we use within our impact-investing strategies at Wellington, and we want to make sure to, again, try and champion these frameworks that

people are coalescing around to make it easier, and to make standardization kind of come quicker. But it's definitely a journey and we're still on that path.

VAIBHAV SAHGAL: So, to understand impact measurement a little better, could you tell us a little bit more about -- at what points in the process is impact investment actually crucial? You mentioned due diligence earlier, but I imagine that even after an investment has been made, there's a certain degree of monitoring and evaluation, so could you unpack that a little bit for us?

OYIN ODUYA: No, absolutely. And I would say, you know, at Wellington, the impact measurement part of the process for our impact fund is incorporated through every stage of the investment cycle, so, right at the beginning of diligence, when we're executing deals in the monitoring stage, and also when we're thinking about exit. So it is kind of a through-line when we're thinking about the investing process. In terms of monitoring and evaluation, I think you bring up a really interesting point, because with all the concerns about impact washing and greenwashing, the market has got to a point where people understand they have to collect impact KPIs, they have to demonstrate some sort of impact diligence. Where I think we're going to is the stage where you say, okay, you've gathered all this data, what are you doing with it? How are you benchmarking your portfolio versus itself, versus peers, versus companies you didn't invest in, versus companies you could invest in? How are you using the impact data to create these benchmarks, and essentially use that information to maximize the effectiveness of every dollar that we invest for impacts? That's a really crucial point of impact measurement is the

management part of it, once you've got the data in, how do you analyze it? And I do think that this process can be additive to the investment process. I guess, if you think about it from a big picture point of view, all other things being equal, more information should allow you to make a better decision. So again, if you're doing your standard financial diligence, you're layering impact diligence on top of that, but also you're kind of monitoring impact data over the life of the investment alongside your standard data on revenues and net income and cash flow, it should tell you some interesting and useful information about the companies that you may otherwise not have thought of. So again, I think that to incorporate the impact throughout the entire process is a really valuable exercise.

VAIBHAV SAHGAL: Thank you so much, Oyin. That brings us to the end of this discussion. I really appreciate your time, and I hope that our listeners find this as enlightening as I did.

OYIN ODUYA: Pleasure, thank you very much.

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