

Transcript | *Responsible Investor* webinar, Impact in emerging markets: The role of grassroots research and IMM Practice

Ben Payton:

Hello everyone, and welcome to this *Responsible Investor* webinar, hosted in partnership with Wellington Management, on “Impact in emerging markets: the role of grassroots research and impact measurement & management practice.” My name is Ben Payton, I am the special projects editor at *Responsible Investor*, and I’m delighted to be moderating this webinar. Now I’d like to introduce today’s panelists. Joining me today, we’re very pleased to welcome Oyin Oduya, a practice leader for impact measurement and management at Wellington Management. Oyin’s work helps to inform Wellington’s investment process through delivering impact measurement and management, specifically through working on frameworks that are used to analyze the social and environmental consequences of Wellington’s [00:02:00] investments.

And we’re very happy as well to be joined by Liliana Castillo Dearth, who’s an equity portfolio manager at Wellington. Liliana manages Wellington’s equity assets in emerging markets, drawing on research from Wellington Management’s global industry analysts. In today’s session, we’re going to be talking about impact investing in emerging markets. And it’s worth bearing in mind that emerging markets, depending on [00:02:30] how exactly we define those, cover the vast majority of the world’s population, and a very large and growing share of global GDP. There are obviously huge differences between the emerging market economies, but broadly speaking, the world’s most pressing development challenges are concentrated in those countries. And governments that don’t necessarily have the resources to meet the huge social and environmental needs. So the private sector really does have a massive role to

play. [00:03:00] In fact, the UN estimates that between \$US5 and \$US7 trillion in private capital is needed to meet the SDGs (Sustainable Development Goals) by 2030. And clearly much of that will need to be deployed in emerging markets. So this really is a huge opportunity for impact investors. After all, impact investing is all about identifying innovative companies whose core products and services address major social and environmental challenges. But historically, [00:03:30] for various reasons, we have a paradox, because less than a third of impact capital is allocated to funds that focus on emerging markets, according to the International Finance Corporation.

Today we're going to be talking about the opportunities for impact investors in emerging markets to make a difference at the grassroots level, and we'll also be hearing about the role of impact measurement and management, which clearly has a very important part to play in reassuring investors [00:04:00] that their money is being well spent on achieving real impacts. So, without further ado, let's go to our two panelists, and, if we can start with you, Liliana, can you tell us how you define impact investing, and what attracted you to working in emerging markets investing?

Liliana Castillo Dearth:

Absolutely. Well first of all, thank you, Ben, it's great to see you, and thank you for the opportunity to be part of this webinar today. Impact investing strategies target a company's financial returns [00:04:30] alongside measurable positive social or environmental impact. So for a company to fit into our impact portfolios, we have to have a clearly defined rationale on how the products and services are helping solve social or environmental problems. Now you asked me about what attracted me to emerging markets investing. [00:05:00] I've been an investor in emerging markets for over 20 years. I grew up in Venezuela, so emerging

markets are home for me. And as I look back, I think this personal experience shaped my thinking about markets and the way I look at investment opportunities. It taught me how important it is that economic growth can be sustained over the longer term.

Venezuela is a great example of the economic boom and bust [00:05:30] and the political instability that unfortunately often occurs across emerging markets. So when I was growing up, Venezuela was a prosperous country with immense potential. Today, it's a country relatively poor, despite its rich natural resources, and in the midst of a deep economic and humanitarian crisis. So this is why I passionately believe that it is important to look beyond [00:06:00] near-term excitement, whether you are looking at a company, or at the prospects of a country, you have to take a longer-term view. And you look at opportunities from a sustainability angle, focusing on risks and governance. So putting it all together, impact investing in emerging markets is a unique, differentiated return opportunity. And emerging markets in particular provide [00:06:30] very compelling opportunities for investors to do well, and also do good, in areas of the world where it is needed the most.

Ben Payton:

Great, thank you Liliana. And Oyin, as an impact measurement & management professional, can you tell us how you define impact and maybe talk about how you address social and environmental challenges as you go about impact investing?

Oyin Oduya:

Sure, I'm happy to. [00:07:00] I think when we think about defining impact investing, one of the first things we have to do is distinguish it from ESG. There is a continuum of sustainable investing, and people can often get confused about the different types. And so when you're

thinking about ESG, that refers to environmental, social, and governance risks and opportunities; you're thinking more about the operations of a company, how they treat their employees, what is their carbon footprint, how independent is their board? It's really about how [00:07:30] the company is run.

But when you think about impact, it's about products and services, it's about what they do, and how those products and services can have environmental and social consequences, mostly on the people who are consuming them. So definitely getting that distinction is really important. And then defining a clear threshold for what counts, and what doesn't. At Wellington, we use revenue materiality, so for a company to count as impact, it has to have at least 50% of its revenues aligned with some impact themes that we've predefined, such as health, education, alternative energy. [00:08:00] We have an additionality constraint and a materiality constraint, which I'm sure we'll get onto talking about later on in this session.

But I think when you focus on the question of how do we ensure that we are actually targeting environmental and social challenges, I think firstly, talking about emerging markets already means that you're in a good spot. As you mentioned in your introduction, emerging markets is where some of the world's most acute environmental, social challenges are. So, if you look at our impact [00:08:30] themes, which I already said cover affordable housing, health, education, etc., there are huge gaps in emerging markets. In south sub-Saharan Africa, for example, around 300 million people live over two hours away from the nearest hospital. In India, you have around one physician per 1,000 people, versus six in the UK. Globally, you have around a third of the people who don't have access to clean and safe drinking water, and many of these people are in emerging markets. So when we think about solving

environmental and social challenges, [00:09:00] looking in emerging markets is definitely a good place to be.

And then, to kind of zero in on our process, we really try to address these challenges through impact investing, through doing research. We need to make a financial return, but also ensure that the products and services we're focusing on are aligned with other environmental and social outcomes. This may be as simple as looking at companies in the solar industry, because we know that can help to decarbonize our energy supply, or it can be more [00:09:30] complicated, like doing research into the link between access to insurance and savings products and increased rates of economic stability and opportunity.

And the last thing I'll mention is just industry standards. There are a number of industry standards evolving that are very useful guides for investors attempting to invest for impact that can be applied across asset classes. One that we rely heavily on is the impact management project Five Dimensions of Impact, which gives you a really holistic view of a company, not just what are they doing, who are they impacting, how much difference [00:10:00] are they making, but also the risk that the intended impact that you thought was going to happen may not materialize. And so doing research well, but also holistically looking at impact, helps you to increase the probability that you're having a real-world contribution to solving environmental and social challenges.

Ben Payton:

Thank you. And then going back to you, Liliana, how would you say that impact investing translates to emerging markets? Could you highlight some opportunities for us there?

[00:10:30]

Liliana Castillo Dearth:

Absolutely. So impact investing looks for companies that are providing solutions to unmet needs. And in emerging markets in aggregate, I think these markets face a larger number of unmet needs than, for example, developed markets. I find that in general, investment opportunities are at an early stage, also compared to developed markets. But the universe is expanding rapidly. [00:11:00] From my point of view, there are three powerful forces driving a growing opportunity for impact companies in emerging markets. First, the mindset of emerging consumers is changing. As people have more access to information, they also aspire to a better quality of life and environmental improvements.

At the same time, public policy is evolving. [00:11:30] Although at different stages across different countries, there is a greater focus on economic development and the sustainability of growth. In my view, this will likely provide a strong and lasting tailwind for impact companies across emerging markets. As I look at my career, over the last 20 years, I would say that while great advances have been made in recent decades, [00:12:00] there are still plenty of daunting social and environmental challenges that remain. And investors, businesses, government, we all play a key role in addressing issues such as hunger, illiteracy, gender inequality, climate change, and access to better health care.

Ben Payton:

Great, okay. And then, [00:12:30] one of the most important frameworks for the whole world here are, of course, the Sustainable Development Goals. So Liliana, could you tell us a bit more about how they fit into your work, and help to define and guide what you do?

Liliana Castillo Dearth:

Absolutely. So for each company now in our impact portfolios, we can tag the goals and targets we believe they align with. As an example, an Indonesian financial institution that focuses on providing access of microloans and financial services to disadvantaged women across Indonesia. The loans that this company provides enable these women to start new businesses and generate income for their families. The services of these companies, for example, are supporting SDG number 5, [00:13:30] which relates to gender equality, or SDG goal number 8, related to decent work and economic growth. Now, not all companies can be tagged to an underlying target, because the targets do not capture all the impact categories that we consider critical. For example, bridging the digital divide. Without exception, however, the companies we invest in [00:14:00] offer what we consider to be much needed solutions to the major challenges identified in the SDGs.

Oyin Oduya:

I think it's interesting, Liliana, that you bring up the kind of financial inclusion as a theme which is important for us but isn't actually an SDG. And you find that with a lot of impact investing funds, financial inclusion is actually an enabler of six or seven SDGs, but isn't an SDG in itself. And it highlights the idea that the SDGs [00:14:30] were really developed for countries, not for companies and private sector actors. There are a lot of policy issues in there which are hard to access through the financial markets. But I think, overall, you see that private capital has to move in the same direction the SDGs are trying to pull us. As you mentioned at the beginning, there's a big funding gap, about two and a half trillion dollars a year, right up to 2030, to meet the Sustainable Development Goals. So there is a real crucial

role for the private sector to play, and impact investing can really help to drive capital [00:15:00] towards where it's most needed.

Ben Payton:

Thanks Oyin. One of the things that is interesting about Wellington is your focus on grassroots research. It would be very interesting to hear your perspective on the role of grassroots research and how it influences impact solutions. So maybe, Liliana, you could start by telling us about that?

Liliana Castillo Dearth:

Yes, thank you Ben. Grassroots research helps us understand needs from [00:15:30] the ground up. And also helps us identify high-quality innovative businesses that are providing products or services that ultimately are filling an unmet social or environmental need. I'll give you an example from a recent trip. I recently visited India for the first time since 2018. And this was a great opportunity to reconnect with many small-business owners, and to understand how they were [00:16:00] emerging from the recent COVID-19 pandemic.

Going back to the previous trip in 2018, I visited several vendors in a bazaar about 90 minutes outside Jaipur. I met with a 30-year-old textile vendor. He told me that in previous years, he had taken out a loan for the first time. His friend who owns the stall across from him told him about a small vendor lending [00:16:30] program at a small regional bank in the area. So he contacted the bank, and at that point, the representative came to his shop and looked at his books and cash flows to assess his ability to pay. He originally didn't have any credit history. So with the use of technology, the representative was able to process the loan at the shop,

and the vendor received a small initial loan that allowed him to expand inventory and revenues. [00:17:00]

Look forward four years later, March 2022. As I talked to him, he tells me he had already paid the initial loan, he now also has a savings account with this bank, where he's starting to save for him and his family, and as business is starting to go back to the pre-pandemic levels, he's hoping that he will get a new loan to add a second floor to his business. [00:17:30]

Technology adoption has also accelerated significantly in India since COVID. As an example, today there are 830 million digital users in India. And approximately 150 million of them started using technology during the pandemic. So while many customers are still paying cash, there are many small vendors that have started to use QR codes for digital transactions. [00:18:00] Through our conversations with this textile vendor and others, it was clear how financial inclusion can impact the quality of an individual's life, and how digitalization and technology have created efficient ways to access remote underserved customers who otherwise struggle to have access to high-quality financial services.

Now it is also clear how [00:18:30] innovative companies can also enjoy long run rates of growth. As a result of the problems they address in the areas of the world where it is needed the most.

Ben Payton:

Great, thanks Liliana. And Oyin, did you have anything to add on that point?

Oyin Oduya:

Yes, I would just bring in some of my previous experience, I spent a large time of my career researching emerging market investments, and I also, like Liliana, appreciate the value of [00:19:00] the ground research. I think often what you can see on your computer screen sitting, you know, in London, or New York, or wherever you're investing from, can be very different from the reality on the ground, particularly in emerging markets. So strategies, products, assumptions that are appropriate for developed markets often can't be transplanted to companies that are at a very different stage of development. And this also applies to impact investing. If you think about certain industries like for-profit education [00:19:30] or private health care, in developed markets this can actually serve to widen inequality very significantly. But in emerging markets, where there is such limited public service provision, these can actually be very impactful.

One example that I've looked at in the past is pharmaceuticals. This is an industry — if you think about pharmacies and chain pharmacies, for example, in developed markets — that could be considered relatively neutral when you think about impact. That may be true in developed markets, but in emerging markets, there's a big problem when it comes to counterfeit drugs, [00:20:00] and the incidence of seeing fake drugs for things like pain, antimalarial drugs, antibiotics, is actually much higher in emerging markets than you can see in the West. And so being able to invest in trusted, high-quality providers of drugs and medical products can have a huge impact in emerging markets, and kind of wider societal consequences for levels of health. And so, these are the sorts of issues that come into focus really clearly when you are on the ground, speaking to people who actually experience these problems, and who value solutions, and I think it's really [00:20:30] important to take that and use it as a core part of your research.

Ben Payton:

Yes, definitely, that's very important and very interesting to reflect on. So I think one of the other interesting things here is how the two of you work together as an investor and as an IMM professional. It would be interesting to hear some examples there and how those have shaped your views. Maybe if we could start with you, Liliana, on that? [00:21:00]

Liliana Castillo Dearth:

Yes, thanks. Our process starts and ends with impact. And working closely with the impact metrics team is critical to make sure that we follow the highest level of industry standards in our impact process. So, for example, we engage with Oyin and her team in debating impact cases across industries. And that brings an important perspective, for example, with impact companies in developed markets, [00:21:30] we can take those experiences into our analysis in an emerging market company. We also work together to identify relevant KPIs, key performance indicators, that we can measure over time. Oyin and I were on a recent trip to Indonesia, and during this grassroots research trip, it was very important for us to gather feedback [00:22:00] from end consumers to have a direct, firsthand understanding of underlying needs, but also it was very important to bring our engagements with management teams to a higher level where, in a way, fundamentals, understanding of needs, and impact metrics all come together, ultimately helping improve the integrity of our final investment decisions. [00:22:30]

Ben Payton:

Great, and Oyin, do you have any thoughts to add on to that?

Oyin Oduya:

I think I'll probably just add onto the experience of working with Liliana and her team and attending the trip that we took to Indonesia a few months ago. I think it really underlines the importance of going beyond the metric. For example, we spoke about financial inclusion earlier, and for many of our names which fit into the financial inclusion theme, we measure the number of microfinance borrowers, which is a good proxy for the [00:23:00] impact that we already want to have. But it was really different being on the ground and understanding the story behind these numbers.

Just outside Jakarta, we met a woman who was running a market stall, and she had borrowed some money from one of the microfinance lenders that we invest in. She started off by just US\$20, she was now borrowing the equivalent of US\$7,000; she'd increased the number of market stalls that she owned, which meant she was able to buy bulk and then get better margins when she did eventually sell her produce. Hearing her story, particularly as a single mother [00:23:30] who had a child who'd gone to university, was now a high school teacher, again really brought into focus the wider kind of impact that we're having through the products and services that we offer. So it was really great to see how impact happens in real life.

The other thing that struck me was just the importance of putting impact into context, and this particularly matters in emerging markets. Again, financial inclusion is a topic that we think about a lot, and you often hear the phrase, "banking the unbanked." But when we were [00:24:00] in Indonesia, I actually was introduced to the phrase of banking the underbanked, thinking about people who do have bank accounts that maybe are not well served by their financial system, and here we can kind of make analyses and comparisons with what you see in developed markets here, where you have people who maybe are not fully served, they have

a bank account, but they don't have access to savings, they don't have access to insurance, and we know that particularly in emerging markets, this can be a really important safety net to stop people from falling back into poverty.

And so, these are the sorts of issues that we were discussing on our trip to Indonesia, [00:24:30] and the sorts of takeaways that I brought back with me and to my team for us to research further and make sure we're really incorporating it into how we think. And so one thing that I took away from that is really trying to think about the extent to which borrowers graduate away in kind of very early, very small microlending products, to being fully included in the financial system, having the whole array of financial products available to really kind of maximize their financial health, and that was something that I took away as a specific insight from going on this [00:25:00] Indonesia trip with Liliana, listening to how she engaged with companies and the sorts of insights and conversations we had with them.

Ben Payton:

Great. And so, it's great that you're able to travel again after COVID and get those on-the-ground insights, which are so valuable. So, just a reminder to everyone watching to please remember to keep on sending in your questions for Oyin and Liliana via the Q&A function, and we'll get to those in a few minutes. But first, if we could talk a bit more about [00:25:30] some of these issues. And Oyin, from your perspective as an IMM professional, can you say a bit more about how you determine what is and is not impact within that context?

Oyin Oduya:

Sure. As I mentioned earlier, we have three key criteria. Materiality, additionality, and measurability. Materiality is all about revenues. Can we show that the revenues of the

product, of the company we're investing in, over 50% of them align with one of our [00:26:00] key impact themes, which, as I mentioned, are things like health, education, affordable housing, alternative energy, resource stewardship, etc. That's the first criterion. The second one is additionality, how is this company doing something that's different from business as usual to drive those impact outcomes? This normally relates to the company's scale, whether they are serving an underserved market, the unbanked or underbanked, for example, where they have some sort of innovation that makes that product different. And lastly, measurability, how we define an impact KPI up front, ahead of investment, [00:26:30] that we track over time to make sure that the intended impact is actually being realized.

So that's kind of just the basic that we have in order to define our impact universe. But actually we can go a step deeper, and this is where we lean on industry frameworks like the impact management project, the Five Dimensions of Impact, which think about what you're trying to do, who you're impacting, how much change is really being affected, what is your contribution as a manager, what are the enterprises that are contributors to this outcome, and what is the impact risk? And I think the [00:27:00] impact risk is a really interesting one to kind of take a pause and talk about for a second, because all companies have positive and negative impact, right? And so it's really about trying to understand what is that risk? If we're looking at someone who is, for example, in the solar industry value chain, how are they sourcing their materials? What is the risk, what are the risks in those supply chains? And do they outweigh any environmental benefit? So, really trying to take that holistic view of impact is a very important part of defining what does and doesn't count.

And then I think for me, the key issue [00:27:30] is being up front and transparent. You know, referring to my earlier point of emerging market versus developed market impact investing,

what is important is defining up front what counts for you, what your threshold is, and just being up front about this, because we are, as an industry, trying to coalesce around [calm?] ways of thinking, but there is always going to be some nuance in that, and so being up front with the investment team, with clients, with people who are measuring impact, is really important to make sure you have a strategy that has a high level of integrity. You have to [00:28:00] make sure your strategy does what it says on the tin.

Ben Payton:

Okay. But of course it's definitely a challenging area to approach measurement to management. So maybe you could explain a bit more about some of those challenges, and how those affect your approach at Wellington.

Oyin Oduya:

Sure! I think the biggest challenge is lack of data availability. You can't always capture exactly the social and environmental change that you hope to effect with your [00:28:30] investment. And this can be more difficult in emerging markets than developed markets, but I think regardless of the geography that you're investing in, you have to have a level of intentionality as an investor to say well, I'm investing to drive this impact, and so it's up to me to try and find the data points that help to show that. I'll use an example, because it's always easier to try and put it into context rather than talking in abstract terms. If we look at, for example, a generic drugs manufacturer, they enable access to lower-cost drugs, and the ultimate impact of that is broadening access [00:29:00] to health care. But that's very difficult to measure at a societal level, particularly from looking at a drugs manufacturer that has a very diverse portfolio of drugs that they manufacture. So, what we can do is focus on the company's output. What we do know is the volume of generic drugs that they

manufacture. We could also know what the price differential is between the generic price and the branded price. And so, we can actually [derive?] a KPI that tracks anticipated cost savings for the end consumer, and essentially use that as a proxy for increased access to treatment.

So [00:29:30] really, it's all about the effort that you're willing to put in as an investor to try and get that KPI if it's not easily available. Doing assumptions like that is one way. But also engaging the company is another. As Liliana mentioned, at Wellington, we really try to bring a lot of people into the room when talking to the company; we're speaking to management at the C-suite level, and Liliana as the portfolio manager is in the room. We may have an ESG analyst in the room speaking about operations, and I also may be in the room, talking about impact KPIs, and what do you measure, and why, and what can we take from your statements that can help us [00:30:00] to come up with something that can track impact? So I think really taking the time to address the data challenge is half of the battle.

I think the other challenge is the lack of standardization in the industry. You can look at a portfolio manager and you can see how they outperform the benchmark. You can see how good they are at making money. You still can't really do that with impact, you can't look at many different impact funds and say this is how good they are at creating environmental and social change, but we are moving toward a time when you can do that. And so, for example, we [00:30:30] use the IRIS+ system and metrics, which is a system that is supported by the Global Impact Investing Network, which is essentially just a long list of metrics to say if you're looking at affordable housing, why don't you measure units built? If you're looking at renewable energy, why don't you measure CO2 emissions avoided, or gigawatts or renewable energy? So, as much as possible, we try to align with these sort of industry standards to

avoid reinventing the wheel, to avoid having a plethora of different standards and metrics to enable our clients to be able to easily compare our impact [00:31:00] with the impact of other funds. And again, it's not a perfect system, but it's come a long way in the time that I've been in impact investing. And I think we will continue to move toward standardization, and that will really help to deal with these challenges in measuring impact.

Ben Payton:

Well, that does lead us on to talking about the future trends that we're going to look forward to over the next few years. Would you like to highlight any other trends, Oyin, that you see as being important in shaping the industry? [00:31:30]

Oyin Oduya:

I guess to continue on with what I was talking about, it's data. We're seeing a lot of interest in impact investing, as we have kind of a new generation of investors inheriting wealth, and coming to the market, and understanding that actually, I can put my savings and my pensions to good use to actually make a positive change in the world. And I think that difference in terms of what the upcoming generation expects from having invested money means you're going to see increasing demand, but that also means increasing scrutiny, and you're seeing that not just from clients, but from regulators. We have had [00:32:00] a lot of regulation in the EU, there's increasing regulation across the world, in the US and Asia and elsewhere, and that will mean increasing scrutiny on the quality of impact data. So I think what we're going to see in the future is more focus on that data, and as I mentioned, we're going to have to see more coalescing around standards, more standardization.

I think as we see the quality of data improved, we can turn our efforts to managing for impact, not just measuring impact. The point of what I do as an impact measurement and management [00:32:30] practice leader, a large part of it is reporting, but that's really not the crux of it. What we're hoping to do is have real-world impact, so in order to do that, we have to take this data that we're reporting, look at it, and say, what is it telling us? Do we have our theses right? Are we driving impact through these products and services, or maybe have we got it wrong, and should we redirect our capital and change course? And so really trying to focus on the management part of impact measurement and management I think is a key trend going forward.

Lastly, I'd say spotlighting the voice of end beneficiaries, and both [00:33:00] myself and Liliana have spoken a lot about grassroots research, the importance of talking to people and hearing from them what matters to them. I think that's going to be a really important part of impact investing; you can have all the data you want, but that really only tells one part of the story. Having that context as to what creates the most impact for people, and why, I think is going to be an increasing focus of impact investing going forward. We have to have [subjective?] data, we have to have thought well, we can't forget that nuance, we can't forget the importance of getting that qualitative data from the people we're trying to affect. And so I think that [00:33:30] a focus on that will be something that we'll see increase in importance in the years to come.

Ben Payton:

Great, thank you. And Liliana, would you like to highlight any points around the future trends, just before we get to the audience questions?

Liliana Castillo Dearth:

Yes, thank you, Ben. I strongly believe that impact investing will continue to grow in client investment allocations globally. Increasingly, investors want to understand the impact that their investments are having [00:34:00] on society, or the environment. They want to understand that their investments are helping improve the quality of life. And this is even more acute across emerging markets.

Ben Payton:

Let's go now to some of the questions from the audience. Remember, you can keep submitting these via the Q&A function. The first one is around how you engage with management, how do you [00:34:30] recognize statements from company management, around their impact, and then how do you engage with them to make sure that they're accountable, in terms of achieving impact? Maybe Oyin, you want to take that one first?

Oyin Oduya:

Sure, I'm happy to. In terms of discerning between statements that are made, it's not an easy task. Companies that are large enough to be listed have [00:35:00] resources to have large sustainability departments and, in one way, that's great, because we can get a lot of data from them. On the other hand, it makes it difficult to really distinguish between who is really having impact and who is just good at marketing. And so I think one of the ways you can do that is kind of going back to what I was saying about management of impact; yes, they disclose this data, but what are they doing with it? And the one important thing that we do in our impact KPIs is not just look at the absolute value, but look at the trend; how has the amount of renewable energy you've produced, [00:35:30] the number of patients you've served, and the amount of waste you've recycled, how has that changed over time? And is

that growing in line with your revenues? Of course, there are other exogenous factors that could influence KPIs, but that's the crux of a big part of our engagement with management — talking about how those impact KPIs have trended over time, and why, and their reaction to that can often tell you a lot about how serious the impact is taken throughout the company.

Also understanding who is responsible for making sure that these KPIs get met; do the CEO and CFO [00:36:00] track these KPIs, do they know where they come from? Just really understanding not just what the number is, but who cares about it in your organization, how it's used, and how it's changed over time, I think, is a great way to really understand how serious the impact is taken throughout the company.

Ben Payton:

Great. And Liliana, would you like to add to that?

Liliana Castillo Dearth:

So adding onto Oyin, in my experience, engagement with management is key. And in emerging markets, it's almost a process of [00:36:30] mutual learning. So what I find is that talking to companies, explaining to them how we define investments in the impact world, what is the data that we need to be able to measure their impact over time? I find that often they're very open to learn. It is definitely not a perfect process, but it's one that I believe [00:37:00] is improving. And this engagement is key.

Ben Payton:

Okay, thank you. And maybe following on from what you were saying about impact measurement, Oyin, it would be interesting if you could talk a bit more about the frameworks,

and how you see those evolving over the next few years, because clearly there's been a lot of changes recently. How do you think the availability of different frameworks will evolve [00:37:30] in the next few years?

Oyin Oduya:

Well, I think it's hard to speak about frameworks without talking about regulation. And of course you've seen a lot of regulation come out of the EU, and one of the biggest changes not only in impact measurement, but also sustainable investing measurement, has been the formation of the ISSB, which is now a central body that is really trying to come up with standardization on how we think about ESG data. But the way it's being set up means that you can also kind of include, I guess, stakeholder materiality, to [00:38:00] financial materiality, so it means that it can be a platform for considering impact data, as well. And so I think that regulation will really help to drive, and if you have to disclose, and everyone has to do it, it makes sense for you all to do it in the same sort of way to really try and foster comparability. So that's one comment.

The other thing I would mention is just, speaking about the monetization of impact, that is a trend that you're increasingly seeing where people try to put a monetary value on [00:38:30] cleaner air or better health care outcomes. You know, I think that is a process which is still kind of incubating, if you see what I mean. I think that it's a really great initiative, but it does rely on a lot of different assumptions, and so I'm very interested to kind of keep an eye on the monetization of impact, and trying to put a monetary value on your impact, I think it's, again, a good way to be able to compare across different asset classes, across different strategies.

But I think it's a fair comment to say not just of monetizing impact, but of impact measurement overall, [00:39:00] it's an evolving process. We haven't been doing this for that long. If you think about how long global accounting standards have been around, it's a very long time, and it took a while to get to that standard where everyone knows that if you refer to one thing in your financial statements, it means the same thing regardless of the company, or the sector, or the country. That's where we're aiming to get to for impact, but we still have quite a long way to go. So the frameworks that we mentioned in this call, the impact management project, IRIS+, even the SDGs themselves, [00:39:30] are a kind of framework which is kind of a common language that you can use to think about impact across different strategies. We're not there yet, but we are getting there, in terms of getting that consistency we need to grow the industry.

Ben Payton:

And then, another interesting question, and this is about the ability of investors to influence corporate behavior. And the person asking the question makes the point that this may be easier for an equity investor than in some other asset classes. They ask about how that can be done with fixed income investors. So Oyin, maybe you can say a few words about that?

Oyin Oduya:

Sure, I'm happy to. The [00:42:00] impact measurement and management practice at Wellington works across the firm, so both with equities and fixed income, and private and public investors. And so, within the fixed income space, what we've found is that people are still very open to engaging and talking about their impacts, outcomes realized through their products and services, but also their impact measurement. And I think one reason this is happening is because of the growth of the labeled bond market. So, companies issuing green

bonds, issuing social bonds that have specific [ring fences?] [00:42:30] around how the proceeds are going to be used in order to further environmental and social outcomes. And of course, it can be a different conversation with a fixed income or an equity manager.

But to be honest, at Wellington, again, we're all about collaboration, so often when we're speaking to a company, you might have an equity portfolio manager and a fixed income portfolio manager, and an ESG analyst, and maybe myself. And so again, at Wellington we can make that a platform-wide discussion. But I'd say for the labeled bond market in particular, it's very interesting to speak [00:43:00] to the issuer at the point at which they're thinking about issuing labeled bonds. So maybe when they're doing a roadshow, they just established a labeled bond framework, but they've yet to maybe issue the bond, that is where, as a fixed income investor, you can have a huge amount of influence to say, well actually, we like the look of these terms, perhaps these processes could be a little bit more tightly (inaudible) how you think about allocation, how you think about reporting. I think at that point in this stage of issuing labeled bond, issuers are very receptive to feedback from people, whether it be on impact, [00:43:30] ESG issues, or other feedback.

Ben Payton:

Thank you. And then another very topical question about the current geopolitical volatility and other volatility that we're seeing in markets. How is that influencing impact investing, in your view?

Liliana Castillo Dearth:

I can take that. I go back to how we started taking the long view, I think what's unique and differentiated about impact investing [00:44:00] is that we are looking to invest in companies

that are addressing unmet needs. And that have a long runway for growth on the basis of the needs that they are fulfilling in the market. So right now, obviously, there is a tremendous amount of volatility and uncertainty, and the needs are not going away. Understanding them and fulfilling them is becoming even more relevant. And if [00:44:30] anything, having the right conviction over the longer term, having the right understanding of the sustainability and the underlying needs, allows us to have the opportunity to also take advantage of current volatility to build positions that are very relevant and fundamentally attractive for the longer term.

Ben Payton:

Great. And the next one, [00:45:00] again, focusing on risks in emerging markets. And asking if you have any advice for investors on navigating those, which may be somewhat similar to the last question, but perhaps, Oyin, you could take this one?

Oyin Oduya:

I'll give a very brief answer, because Liliana is the portfolio manager; she's the expert here. I used to work as an EM credit analyst, so I come at it from that angle. [00:45:30] One of the key risks can be just around macroeconomic stability; a lot of the emerging markets are either high-quality exporters, or they rely very much on high-quality imports, so how that kind of affects your trade balances, and therefore can spill over into economic activity, that's quite an important risk. And also currency risk can be quite a large one.

Trying to answer this with my impact hat on, I would say one of the biggest risks in emerging market impact investing is that often, the products and services you're trying to [00:46:00] support are serving low-income and sometimes vulnerable consumers. So, as much as

sometimes we're looking for scale and saying well, this is a great telecom company, because it covers the entire country, and it has a very large market share. That is great, because it can reach a lot of people, but also then there's a risk of kind of abuse of market power, or privacy risk. So trying to make sure that you're balancing the benefits with the cost and the risks when you're servicing a vulnerable population, you may not have the same sort of choices we have as consumers in the West, [00:46:30] because there may be only one or two providers of the services that they need; that's one key risk.

Then the other key risk, I think, is evidence risk. So again, we use a lot of assumptions around why the specific products or services may lead to this social environmental outcome. Again, academic research and desk-based research is great, but you really need to go on the ground and understand, okay, are those assumptions correct?

And then the last one that I'll speak about is really around the just transition. So again, we focus on both environmental and social risks, but there are [00:47:00] but there are times that those things can be at loggerheads, so thinking about the benefits of being connected to the grid and being connected to power, there are huge social benefits that come with having access to electricity in your house. But of course in many emerging markets, the sources of electricity are not clean; it can be coal or gas, and so we have ways to think about that within our firm, and within impact investing in particular, we avoid fossil fuel-based [00:47:30] exposure. But I think it's an interesting discussion that you have to think about the social opportunities versus environmental risks, and, and what do you do when those things rub up against each other? So those are the things I think about from an impact point of view.

Liliana Castillo Dearth:

Well, for me it comes down to two big buckets to start from: big picture on macro, and micro. So on the macro front you need to be able to navigate and [00:48:00] develop conviction on the fiscal account of a country, on the currency and stability, and really look into the policies and the government, and have an understanding as to where they are going with the policies. How sustainable is the growth, what are the areas of risk, whether it is an exporting country or an importing country, [00:48:30] how will they be affected with commodity prices; oil prices are going up, or do they benefit from that? So have an understanding at the macro level.

At the micro level, there is nothing, I'm a fundamental investor, and there is nothing that replaces the due diligence process of doing your research. And for me it's the combination of fundamental company research, and on-the-ground, what I call grassroots research. And that allows me [00:49:00] to tie the knots of the different parts of the story. There are many times where I go to a corporate meeting, and I bring to them the perspective of the users, which I've learned from the different focus groups, and the conversation becomes very rich and sincere, because it's not about a presentation that they are giving, that is well rehearsed; it's about responding to real questions about [00:49:30] how they are addressing the needs of the customers, and how are they positioned, and how do they see that evolving? So, that's very powerful as well.

Ben Payton:

Thank you. And then, following on from one of the points you made earlier, Liliana, about the, the way that COVID has kind of spurred the adoption of technology in some countries, in India, for example. Could you maybe [00:50:00] expand a bit on the impacts that COVID has

had on impact investing, and its role in emerging markets? How has that affected appetite for this kind of strategy?

Liliana Castillo Dearth:

Yes, so if anything, COVID has brought up to even a higher relevance the importance of addressing these key structural unmet needs across emerging markets: from all angles. From government [00:50:30] policy and corporates responding appropriately with the products and services. So, for example, COVID showed the tremendous vulnerabilities that there are in the health care systems across emerging markets. And it was a very sad picture to remember the needs in India, and the inability to really attend to the thousands of patients; they didn't have the [00:51:00] capacity. Same in Indonesia, same in Latin America. So if anything, it has brought up in importance the urgency to address these needs.

And as I mentioned before, I think that we all play a role. Policy plays a role, corporates play a role, and we investors, we play a role in the way that we also look at business, scrutinize the [00:51:30] impact that they have, and support them with our investments, as well. You mentioned the technology. Technology has been a major leapfrog, in India, in other countries in Indonesia, in Brazil. And that has brought up the opportunity to address segments of the population that were tremendously [00:52:00] underserved. It also provided access to more information, and allows people to have access to educational programs that perhaps they didn't have access to before. So it is a really powerful compounding effect.

Now you need to have the infrastructure to be able to have access to that technology. So that then becomes the government level, [00:52:30] and the process of them taking seriously,

taking infrastructure to the next level, so they are better able to serve the societal needs in the industries, for example.

Ben Payton:

Great, thank you. And the next question I think this is probably one for you, Oyin, is how you can distinguish investments which are more commercially oriented from those designed more specifically with environmental and social impacts. You did touch [00:53:00] on this earlier, but perhaps you can say a bit more around that?

Oyin Oduya:

Yes, I think it's an interesting question, but I would kind of, I guess, switch up the premise, because for us, when we think about impact investing, we need to be able to achieve an attractive return alongside an environmental or social positive impact. And there's no kind of concession to say well, if it's more environmentally or socially attractive, then we can afford for the company to be less commercially orientated. There are no companies on our impact [00:53:30] portfolios that are not commercially orientated, because if you're not a commercial business with sustainable margins and good profitability, then even if you have the greatest impact, it's not going to be sustainable, and it will probably be short-lived.

And so there is a pool of capital that can support businesses that are much more focused primarily on driving environmental and social impact, but that is more suited for maybe philanthropy or government funding. What we're looking for is that alignment between commercial outcomes and social and environmental outcomes. And it's not always easy to find, that's why we spend so much time doing research, [00:54:00] because we want to ensure that by making sure the company grows by trying to maximize profits, they aren't

necessarily having impact, because you've identified that impact products and services are at its core. And there are some instances, and again this is really what we try to look for, where the impact objective and the commercial objective really can reinforce each other. And this is kind of at the core of what impact investing is, and I guess maybe it's easiest to think about an example.

If you take, say, affordable housing, [00:54:30] and you're saying well, I'm creating housing for a level of society that may not be able to afford the market rate prices, and again, in emerging markets, this is pretty important, because if you have a country where a significant amount of people are low and middle incomes, if you can create an affordable housing solution for them, you're solving a big social problem, so you're likely going to be aligned with government priorities, and you'll likely be able to reach a large percentage of the population. And so if you think about an affordable housing producer making good quality housing which [00:55:00] has a low level of turnover, that's good for the person who can afford to live there for longer than a year at a time, but it's also good for you as a company, because you have low turnover rates, you have low void periods, that means higher margins. So trying to make sure that your commercial imperative and your social impact, or environmental impact objective, go hand in hand, is really key.

I guess to use an environmental example, which is maybe a little bit simpler, you think about the huge push toward trying to decarbonize our electricity supply, that is something [00:55:30] which is front of mind for many governments around the world, whether you're in emerging markets or developed markets. If you are providing a solution, whether it be in solar or in hydro, or just in resource efficiencies, so we have to use less energy in the first place, again, you're very well aligned with these long-term structural themes, which as Liliana said,

are not going away, and that can be a very attractive commercial opportunity. So we really try and make sure that commercial imperatives and impact imperatives are aligned, and that kind of Venn diagram helps filter out what [00:56:00] belongs in our portfolio.

Ben Payton:

Liliana, did you want to add anything there?

Liliana Castillo Dearth:

Sure. I think it really goes back to how we define impact for companies. And as Oyin had said before, we've defined it on the basis of three key metrics. Materiality, additionality, and measurability. So with respect to materiality, all the companies we invest in have to have at least 50% of revenues [00:56:30] aligned to one of our 11 impact themes. So the direct alignment is very straightforward and very clear. In terms of additionality, the company should be addressing an unmet need, in an effective and differentiated way. But also, we have to be able to measure the impact by identifying KPIs that can track the progress over time.

[00:57:00] The way that these translate, for example, in our health care theme, we have investment in a company that has 60% of revenues directly aligned with providing quality health care services to underserved segments of the population at a reasonable price. So they are innovating telemedicine, and in turn driving the preventative care, which ultimately leads to better long-term health outcomes. So if I look at our resource efficiency theme, [00:57:30] we have invested in a manufacturer of solar inverters, which is helping drive the penetration of solar energy in Africa. And to give you an example, in Kenya alone, 40% of rural communities don't have access to grid electricity. So 100% of the revenues of these companies are directly aligned with helping off-grid communities have access to much

needed electricity. [00:58:00] So, the definition itself of the three aspects in which we define impact, make very clear the alignment between the business and the impact that they are having, whether it is at the social or the environmental front.

Ben Payton:

Fantastic. Thank you very much. And I'm afraid that's all we've got time for today. So thank you very much to Wellington Management for sponsoring this webinar, and of course, thank you in particular to our two brilliant [00:58:30] panelists, Oyin and Liliana. We hope you can join us again soon for the next in our series of webinars. Goodbye.

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