The evolution of Impact Investing in listed markets – and what happens next?

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A lot has changed in the last few years. Impact investing in listed equity is relatively new and, in recent years, there has been much debate about whether impact can even be achieved in secondary markets. However, two factors go a long way to settling that argument: engagement and accessibility. Investors in listed markets can and should engage deeply with companies, behaving like true stakeholders with associated expectations and time horizons. Furthermore, as impact investing grows in listed markets, individual investors have access to more products that allow them, sometimes for the first time, to make choices that both respect their values and meet their financial objectives.

The measurement challenge

However, even as the industry has begun to understand and embrace impact investing in listed markets, challenges remain. Measuring impact has been one of the biggest issues: it remains complex, particularly in the social impact space, although there has been noticeable progress on the environmental side.

Measuring impact in listed equity is inherently difficult for several reasons: an investor is one of many shareholders and cannot specify its desired outcomes at the outset with certainty that these will not conflict with other investor priorities. Also, the non-financial information disclosed by listed businesses, even those generating a positive impact, is still limited. Of the data that is disclosed, very little of it is audited and it can be calculated in different ways, making it hard to compare companies. Progress has been made here, with several cornerstone organisations such as the Cambridge Institute for Sustainability Leadership and the GIIN establishing working groups and in some cases producing a set of standard metrics, however imperfect they might be. The Impact Alliance classification system is also a useful development in enabling investors to compare products.

Regarding carbon, measurement has progressed significantly, although it has been a long journey! Initially, the main challenge was simply to get key stakeholders – governments, companies and consumers – to recognise that carbon emissions are something to worry about in the first place. This battle has only really been won in the last five years despite the overwhelming evidence.

After reaching consensus on that, we faced the more complex matter of measuring emissions to allow reduction targets. Typically, the process is as follows: a large company starts out by measuring emissions in Scope 1 (from sources owned or controlled by the company) and Scope 2 (associated with purchased energy). However, these figures alone are very unlikely to present a true picture of the company's footprint. Scope 3 emissions cover 15 different categories, from emissions related to upstream elements of a company's supply chain (e.g. purchased goods and business travel) and downstream elements (use and end-of-life treatment of sold products). Scope 3 is highly complex and even the most advanced companies may only measure one or two of these 15 categories. We are a long way from having a full view of who is responsible for what. Double counting is also an important issue here. The headline, though, is that significant progress has been made, and initiatives such as TCFD and EU regulatory changes are all helping to keep up the positive momentum.

Tackling biodiversity

As the carbon measurement debate has progressed, the industry has begun to address the related and equally critical topic of biodiversity. Much of the global economy depends on natural systems working properly, on climate stability, ocean health and soil quality. When ecosystems are damaged, the natural services they provide are degraded. This is not only worrying for environmental reasons, but it presents clear and significant business risks, potentially hampering activities and value chains and causing raw material price volatility. System disruption also creates physical risks, transition risks for businesses left behind in the drive to reduce environmental harm (e.g. oil producers), and litigation risks associated with the finance industry's exposure to sectors or companies that may face legal challenges because of their role in biodiversity loss.

Assessing these risks is a key part of our work as impact investors, and indeed for all investors. The WEF ranks biodiversity loss as one of the top five threats that humanity will face in the coming decade, and so it is very important that progress on biodiversity is faster than it was for carbon, even though it is a more complex area.

Although we have come a long way, there is still a lot to be done in the impact investing space. We believe biodiversity will take centre stage in the coming years as the industry finds a way to measure losses and gains in this area, and ultimately to assess investments for their positive or negative biodiversity impact.