BRIDGES
Fund Management

How transparency and technology can power an impact revolution

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VISIONS 20/30

The whole field of impact emerged because of a change in values – primarily among young people, who no longer wanted to buy from or work for companies that pollute or create harm. Investors began to take notice of that, because it was going to affect the profitability of the companies in which they invest.

Today, we have $40 trillion of ESG investing globally, aiming to deliver impact as well as profit.

Of course, unless we have a way to measure the impact being created, it's very difficult to distinguish between the businesses that are genuinely creating positive impact, and those that simply claim to do so. The Impact Management Project, founded by Bridges, played a key role in focusing the attention of the world on this issue, by bringing together some 2,000 organisations globally to collaborate on impact measurement and management.

But there's also the challenge of trying to capture these impacts in a way that drives financial decision-making. How do you compare litres of water saved with tonnes of carbon emissions averted, soil erosion avoided, or an improvement in the diversity of a company's workforce – and how do you relate any of these impacts to profit?

It became obvious that we needed a single measurement unit, money, in order to enable these comparisons and incorporate impacts into financial analysis and company valuation. So in 2019, Professor George Serafeim, Clara Barby (who led the IMP), and I launched the Impact Weighted Accounts Initiative (IWAI) at Harvard Business School.

The data emerging from its work provided deep insights about impact performance.

For example, if we look at the environmental impacts of 3,000 companies. we can see that 450 companies are causing more damage than profit in a year. We can also see that the worst polluters have a lower valuation on stock markets.

More attention has been focused to date on environmental impacts, but the IWAI has been able to compare in monetary terms the diversity of companies' workforces. It reveals that the likes of Amazon and Apple have billions of dollars of "diversity debit" – measured by applying the remuneration which would have been paid to excluded gender or ethnic groups had they been employed, and viewing that as the cost to their community. This is calculated by comparing the companies' employment with the demographics prevailing in their surrounding communities.

This new level of transparency (made possible by artificial intelligence, machine learning and big data) has the potential to transform our whole economic system. It will enable investors, talent and consumers to distinguish reliably between the positive and negative impacts of companies.

Over time, this will not only reduce the harm companies create but also drive resources to companies, like Tesla, that are generating solutions.to the great environmental and social challenges we face.

The role of Government

If we look back at the birth of venture capital, government played a major role.

For example, it introduced regulation, in 1978, that encouraged pension funds to invest in venture capital. This led to an immediate ten-fold increase in the size of venture capital funds.

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Regulatory and tax incentives to boost entrepreneurial activity were also introduced in the US and the UK.

Today, impact investment needs similar support. Governments need to be bold in mandating impact transparency through regulation and providing incentives.

Greater transparency will bring great benefits to government too. They will have the numbers on hand to incentivise the creation of positive impacts and to tax companies directly for the environmental and social harm they create.

One disappointment of the last 12 years has been the slowness of governments (and philanthropists) in using "impact bonds" – the first security whose return depends on the achievement of measurable social or environmental improvement. While about $500m has been raised to date through SIBs and DIBs over the last 18 months, sustainability-linked bonds and loans — which have been inspired by impact bonds — have raised $2.5 trillion.

Government needs to help simplify the process of issuing these securities in order to bring them to much greater scale. It should support the establishment of professionally-managed Outcomes Funds that set tariffs for targeted outcomes in areas like education, health, employment, homelesness, recidivism, and the environment. By doing so, it will enable these Outcomes Funds to attract investors to fund the NGOs and businesses needed to improve our society.

At a time when governments' budgets are severely constrained – following the pandemic, the war in Ukraine, and the energy crisis – there is an opportunity for them to tap the $300 trillion in the financial markets to achieve their social and environmental priorities.

A second tech revolution

The current crises will drive a period of significant innovation. They are forcing countries to become more efficient in their spending and self-sufficient. This is driving development of new sources of clean energy, including hydrogen and nuclear energy produced at smaller scale. $25bn was invested in climate-related venture capital last year alone.

Innovation driven by the change in values and technology is also bringing a transformation to every industry. We've seen it in transport with the shift to electric vehicles. But it has also started in educational models that enable students to pay for their education once they've got into a job. We're seeing it in telehealth, FinTech, agritech, and a host of other sectors where new models are emerging to combine technology and impact.

We are in a second tech revolution, one driven by technology and the creation of positive impacts. The needed catalyst now is for government to bring full transparency on corporate impacts, to enable informed decision-making by investors, consumers, talent, and companies. We have been there before, when we introduced full transparency on profit in the 1930s. It's now time to introduce it for impact. It will harness our economies to bringing solutions to the great environmental and social challenges we face.

Sir Ronald Cohen is Chairman of the Global Steering Group for Impact Investment, The Portland Trust and the Impact-Weighted Accounts Initiative at Harvard Business School. He is a co-founder director of Social Finance UK, USA, and Israel, and founding Chair of Bridges Fund Management and Big Society Capital. For nearly two decades, Sir Ronald's pioneering initiatives in driving impact investment have catalysed a number of global efforts, each focused on driving private capital to serve social and environmental good.

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