No impact without momentum

Ashby Monk

Momentum is the currency of innovation, says **Ashby Monk**, Executive and Research Director of the Stanford Global Projects Center. Without it, our journey towards a more sustainable future is likely to be long and uncomfortable.

What are your thoughts on the relative merits of 'blended finance' – and how can we bring institutional investors and the other necessary participants to the blended finance table?

Blended finance is essentially a way to move capital into new markets. What we are trying to do is to put the cobblestones down on a new path towards a more sustainable economy. And these paths don't build themselves, unfortunately. Blended finance builds these paths.

At Stanford, we've done a ton of work on sovereign development funds and how they can use their status and capital as a way to pull more capital into certain opaque or challenging markets. These vehicles exist to combine development capital and professional investment capital and, in some cases, they have been incredibly successful at paving a new road through this combination.

Take the Canadian Pension Plan, for instance. Five years ago, you would never have pictured them co-investing alongside a sovereign development fund in an emerging market. CPPIB represents the icy vein of the pension fund world, which focuses like a laser on delivering financial performance for the benefit of its stakeholders. They are incredibly disciplined.

So how did they end up co-investing with National Investment and Infrastructure Fund in India? Well, NIIF used its capital to show a credible pathway to achieving commercial returns, and now CPP is investing in India's infrastructure.

Blended finance is many things but it's really another way of saying 'innovation'. It's a means of taking on messy and unpredictable investment projects that can deliver societal and financial benefits.

We forget sometimes in the investment world that to be innovative is to inevitably experience failures. In Silicon Valley, this is obvious. To fail is to learn. But in the pension space, there's no capacity for managing this failure. If you fail, you lose your job. We need to change that mindset. And blended finance is an important step in this direction.

Dr Ashby Monk is the Executive and Research Director of the Stanford Global Projects Center. His current research agenda is focusing on the design and governance of institutional investors, helping sovereign wealth and pension funds to rethink the way they view risk. With his writing, Ashby has been actively contributing to a variety of media, including The Economist, New York Times, Wall Street Journal and National Public Radio among others, and featured on countless academic and industry publications. He obtained his Doctorate in Economic Geography at Oxford University. He also holds a Master's in International Economics from the Université de Paris I – Pantheon Sorbonne and a Bachelor's in Economics from Princeton University.

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Is it the case that many institutional investor boards often don't have the bandwidth to consider investments that are unusual or innovative?

Fiduciary duties often push these organisations into conservative, status quo frameworks, and it's then a monumental effort to push them in a new direction. The Boards don't necessarily resource the organizations to be innovative. And even when innovation happens, I'm not sure it's fully baked.

For example, while you might be doing investments with an ESG policy, do you track what it all means in terms of risk or performance? I haven't seen it.

Right now, ESG probably should fit more into a risk management function or framework at a pension fund. They should see ESG as a means of reducing the volatility associated with an environmental threat. But ESG today often sits outside core investment teams as its own function or capability. How does that help investors properly integrate these signals?

The reality is that institutional investors need to learn how to innovate. They need to build their organizations to embrace change and different ways of doing things, especially if we want to change how capitalism works. Remember, these funds literally put the capital in capitalism, so changing how they think and act will have profound consequences for the world.

How might a blended finance marketplace be created and what might be its impact?

Blended finance gets us started! It puts conservative investment organizations in innovative products and allows us to get some forward momentum. In my world, the most important predictor of a successful innovation is its momentum.

Momentum is the currency of innovation and innovators need to show that we are moving towards a goal. If we are a platform for clean energy deals, we need to show that deals are happening. If we are trying to move capital into a new place, we need to show that the capital is moving to a new place. These small successes will pull more investors behind, creating more momentum and more "wins".

To do this, we clearly need to know which resources and actors are needed for a marketplace to gain traction and momentum.

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If an entrepreneur or innovator makes a bunch of big announcements before these key elements are in place, it's the kiss of death for long-term success. You create buzz, which will attract investors, but you won't be able to deliver more positive outcomes. You spin the innovation flywheel once and it stops. As this implies, and as institutional investors need to understand, the Jim Collins fly-wheel is critical and it should be applied to all these innovative marketplaces and platforms. These need to gain the momentum needed for 'escape velocity' to occur; I'd define that moment as when blended finance is no longer required and the new product or platform has fully emerged.

Once we get momentum, we can get to scale – then we get somewhere towards tackling the SDGs. But the impact investing space is too small today. Impact that's concessionary needs to be in the service of moving the trillions, not the millions. And only once it achieves that scale will we have a chance of tackling our really big problems.

Ultimately, it's not just a capital problem, it's a market problem – markets price things, and people buy and sell those things. You need to create that, which requires really smart people to do the due diligence, originate and manage the deals, discount the cashflows and crunch the numbers. You need someone with the skills to assess all the different moving parts and who is able to put it all together.

Are governments prepared to put in the capital required to enable us to reach the scale that we are hoping for?

Nine months ago, I didn't think there was enough. Today, I could envision a Biden administration using OPEC and Treasury and Commerce, and all these different departments and agencies, to try to drive interesting outcomes through blended finance.

When we worked with the Obama administration on something called the Aligned Intermediary, we were in the phase when the President didn't control Congress. So we used philanthropic capital to try to build an asset management platform that would then work with pension funds to invest in climate infrastructure.

We wanted to show the world that pension funds still cared about clean energy infrastructure. We wanted to re-awaken the world of asset owner investors to the notion that yes, you can invest in clean and green and not lose all your money. We also wanted to use the philanthropic money to really start building pathways for institutional investors into the sector. With some $2 million or so of philanthropic capital, we facilitated over $200 million in investments. I'll be the first to say that it wasn't a perfect or ideal outcome, but it was a lot of deals that the team got done – and we shared a lot of examples of what pension funds could be investing in, from nuclear to solar development.

I wish more philanthropists would see their role as being similar to this case: build a pathway that others can follow. Too many impact investors want to go and do the nuclear deal instead of building the platform for others to do nuclear deals. Even if you're the richest person in your neighbourhood, you're tiny compared to Calpers [California Public Employees' Retirement System]. So let's use your money to create pathways that Calpers can follow.

That's what we attempted with Aligned Intermediary, and we had some great success. It's my hope that we can do the same types of things in the blended finance space, because the objective there is really to make financial markets work more effectively.

What were some of your policy recommendations for the office of the president elect on how the new Biden administration might catalyse innovation in the world of asset owner investors?

My research over 10 years has told me that we know what we need to change in these organizations to make them more resilient and sustainable. I could tell you pretty quickly the problems with most pension funds. I can even then design pathways to innovation, through technology or collaboration. But what's really hard in this context is finding that trigger or catalyst to actually leave the status quo and change.

Usually we wait for a crisis to hit, like the global financial crisis. What did it do?

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It unlocked risk-based asset allocation and a massive trend toward insourcing. Today's crisis is triggering the digitization in investment organizations.

The point of our paper for the Biden Team was to ask how we can drive the biggest investors on earth to change what they are doing 'now'. Because we do need to change, now. We need pension funds to be long-term investors and take climate change seriously, now. And in our experience, transparency is the path to doing this.

Of course, transparency can be a little bit uncomfortable. Transparency reveals the crises that are already there – and it's uncomfortable to see that there's all of these crises inside public pension plans today that nobody knows about.

But they're there. And when you bring in transparency, it obligates the boards of directors to take these things seriously and it provides an opportunity for innovation and discovering another way.

The PPF [Pension Protection Fund] in the UK recently did an assessment of its diversity, and it revealed – no big surprise – diversity was terrible. And the PPF has turned around and changed how it's investing. This is why transparency is so powerful.

How do you think asset managers can contribute on things like a carbon tax and other public policy developments – or should they just get out of the way and let governments sort it out?

The sort of R&D that I would like to see coming out of the asset management industry is how we integrate climate risk into investment risk. And yes, one of those pathways is just putting a price on carbon and saying we're going to understand the carbon in every deal we do in the portfolio.

The government can put a price on carbon, but I would like to see the fiduciary standard change. Larry Fink is out there saying that climate risk is financial risk, which means boards of directors at pension funds can no longer get away with saying, well, 'this is extra financial'. And I would like to see more asset managers doing that kind of evangelizing.

Just be real about it, don't do it as a marketing ploy. The problem is so many managers have short horizons. And so climate risk actually won't affect their portfolio. If you're managing over a three, six and nine-month portfolio, it's an outlier. You might get a crisis, but it's not going to change your portfolio diversification necessarily. If you're managing for 5, 10 and 15 years, it will fundamentally change the assets you invest in.

Do you think our obsession with measurement in financial services, and the endless labelling of ESG activities, is part of the problem?

The classic academic view would be, if you don't measure it, how do you manage it? The problem is we don't necessarily measure the right things and we're not really transparent in the way those measurements are created, so they don't necessarily enable decision-making in a way that I think we all want.

Remember, this is still the early days of the impact investment ecosystem, and really there's still pretty poor data available. Most of the ESG landscape feels more like bond ratings than objective measurements of company behaviour. There's a few great examples of companies that are delivering outcomes data that is valuable, such as NetPurpose in London. But this type of data is rare, and most of the ESG is some red, yellow or green label.

Instead of getting a per ton-type of number to indicate a particular company's carbon reduction, you get a score of 71. But what does that really mean in the context of that company, or the next company? I think we've got to label, but maybe we need to label differently in order to enable better decision making. How do you tell a story to stakeholders about 71? You can't. I want to empower more storytelling about sustainability, which is why we need real outcomes and impact data.

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About this interview

Natixis Investment Managers is designed to be diverse. We often seek outside perspectives to gain true diversity of thought. Our interpretation of ESG is informed through collaboration – with organisations like the PRI, but also with industry experts and academics from outside asset management. To that end, this interview is part of our series of insights that seek to find more nuanced perspectives on sustainable investing and to cut through the noise in ESG. We're taking a closer look at how ideas like blended finance, policy influence and shareholder engagement are becoming key instruments in enabling investors to have a meaningful impact in sustainable investment. So we've interviewed those individuals who we consider important voices and leading thinkers in this area in a bid to explore a better way forward in ESG.

Ashby Monk is not affiliated with Natixis Investment Managers and is independently responsible for the information, expressed views and opinions he provided in this article.

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Additional Notes

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