Baringa Climate Episode 4: Using capital markets to drive sustainable outcomes

Emily Farrimond, Baringa [00:00:03] Welcome to our Climate and Sustainability Trailblazers podcast with me, Emily Farrimond.

For our regular listeners, you know we've been speaking to a variety of sustainable finance industry leaders who are driving positive economic, social and environmental outcomes.

Today's no different. And I am delighted to be joined by Ian Simm, CEO and founder of IMPAX Asset Management. As one of the first and largest asset managers who focus their investment strategy on the transition, they are helping to create a more sustainable global economy. We're also joined by Simon Abrams from Baringa, who is passionate about showing how businesses can generate commercial benefit while delivering positive social and sustainable outcomes. Welcome both.

We're delighted to have you on the podcast. Ian, can I start with you and ask you to introduce yourself and tell us a little bit about your personal and professional interest in sustainability?

Ian Simm, IMPAX [00:00:37] Sure. Yes. I was in a bookstore in Cambridge, England in the late 1980s. I was just about to finish my science degree and wasn't sure what to do with myself. And I picked up the report from the Brundtland Commission, which was set up by the United Nations to look at the future of the planet and came up with a pretty sort of apocalyptic vision for how things might go wrong if we didn't change society and the economy. And this commission's report coined the phrase sustainable development. And I was sort of captivated by this idea of sustainable development. It had to be about ten years to work out what a career in sustainable development might look like. And in 1998, having spent time in management consulting in a small business that I set up in South Africa to sell solar lighting systems, and I also did a bit of environmental consulting work in that ten year period. So 1998, after all that I set up, IMPAX asset management with a strong conviction that actually the way to solve environmental problems was to deploy private sector capital.

Simon Abrams, Baringa [00:01:39] Wow. Fascinating. I mean, you've been in and around this topic for a long time and really focussed on some of the sounds like the leading-edge technologies around things like solar as well as successful.

Ian Sim, IMPAX [00:01:51] You have fun in life if you do what you're really passionate about and what you're very interested in. And I've always been fascinated by technology, by travel, by nature, and I've always been a little bit sort of entrepreneurial. So I've been able to develop a career mingling all those things together.

Emily Farrimond, Baringa [00:02:07] Sounds fantastic. And Simon, can we hear a little bit from you on the same questions?

Simon Abrams, Baringa [00:02:14] Yeah. So I got into sustainability. I started off working as an engineer in food manufacturing, and I was involved with putting in one of my early projects was putting in a vegetable processing line. And how and one of the things that we had to think about was what to do with all the waste that came out, industrial level potato peelings and carrot peelings. And one of the things which really struck me is we can't put them all into holes in the ground because we just don't have enough holes in the ground or a small island. And this whole idea of environmental kind of pollution and what we do with waste really kind of interested me. So I kind of thought about getting into this new field of environmental sort of management, which not many people were involved with and managed to sort of negotiate my way down to the Thames. Barry I was the first environmental engineer at the Thames Barrier and that's where I really came across the whole issue of climate change, because the Thames barrier was effectively London's insurance policy against sea level rise. And while I was on the Thames barrier, I did a I did a master's in environmental technology at Imperial, and that's when I kind of said, this is this is what I want to do with my career and a little bit lacking. There wasn't really a career at that stage, so I was kind of trying to figure out what my next job would be. And so I did some really interesting work working for business and community where I manage the Environment Index. Back in 2000, we were benchmarking FTSE 350 companies for the environmental performance, and I then moved to Jupiter Asset Management, where I was involved and the early days with once an investment, working with some of Ian's now colleagues, and then moved into consultancy because I wanted to kind of combine the investment side with the practical engineering of actually providing solutions and helping companies in that transition. So that's how I got into the space.

Emily Farrimond [00:04:07] Another really fascinating story. Thanks for sharing that with Simon. So Ian, back to you. You founded IMPAX in 1998, long before sustainability had the prominence it had today and a little bit like the Prince of Wales, I suspect was talking about the impact of climate change long before it felt fashionable or topical. But I'm intrigued to understand what drove you to that conclusion and why you decided to found IMPAX.

Ian Simm, IMPAX [00:04:37] I think the result of my ten years post undergraduate of of sort of trying to explore what the ideal career would look like for me, took me down a number of blind alleys. So I did some work in the public sector, did some consultancy work for the World Bank, and realised that the World Bank and many other multilateral development banks have got ultimately capital constraints. I did some work with government agencies, particularly European Commission. I realised that public policy was actually quite a long, tortuous career and I, through setting up a small business in South Africa, which ultimately didn't scale and I abandoned it, realised what it was like to sort of be in the front line of setting up a business and trying to make entrepreneurial activity work, which I really enjoyed but realised there's quite a lot of downside. By the late 1990s I was completely convinced that I wanted to spend my career in the sustainable development area. I had really latched onto this idea that the private sector was where the capital depth was to solve environmental problems. And I was fascinated by business as a way to, to take capital to address all these challenges. When I came back from South Africa, I ended up joining a small company called Impact Capital, which was a tiny corporate finance business that had been set up in 1994 to do some advisory work and sell side work in the European renewable energy space. So I spent two years there before launching IMPAX Asset Management. Initially, it was a sister company to do the buy side work. So yeah, it was it was a long, a long, tortuous process over a decade but one and that gave me a huge amount of insight into two different angles on sustainability, which I've certainly benefited from over the last couple of decades.

Emily Farrimond, Baringa [00:06:39] And clearly you've seen sustainability as a topic kind of mature over that time. What does good look like for you at IMPAX?

Ian Simm, IMPAX [00:06:49] One of the things that sets IMPAX apart, I think apart from our long track record, is the clarity in which we articulate the vision. So we see that the sustainable development will be achieved ultimately and climate change will be slowed and hopefully reversed, hopefully in time through transforming the economy and what we call the transition to a more sustainable economy we think is best seen as a set of industrial revolutions or sector transformations in which consumer demand will change, facilitated by new products, facilitated again by new technology. The governments will provide supportive long term policy framework, sectoral roadmaps, if you like, and the capital will be efficiently deployed. Now, if you can do that effectively across the whole economy, we're convinced that you can achieve a fully sustainable economy and sustainable society. The big challenge is how quickly can you do that?

Emily Farrimond, Baringa [00:07:44] Simon, anything from you around how to maximise impact in this space?

Simon Abrams [00:07:50] Yeah, I think we need to move from thinking about the process and what the inputs that people are doing to the outcomes and processes and inputs are really useful. But actually what we want to know is that we're actually addressing the main issue where we're slowing the global warming. We are sort of minimising kind of species loss. So we really want to start focussing on the outcomes and I think we need to do a better job at doing that so that the capital is flowing to where we're making the most difference. And at the moment, I don't think we've necessarily got the right metrics to do that, and we want to get the incentives right so that we are rewarding people and creating business cases for the right outcomes to be driven. And I think that's an ongoing conversation and a journey that we're still on.

Emily Farrimond, Baringa [00:08:44] Yeah. And I think you touched on the topic of metrics there, and I think that that's interesting. And brings me to my next question, which I'm hoping to cover, because from my point of view, it feels that sustainability is a discipline very much been moving almost from a BA to a BSC. So we're getting much more quantitative in terms of how we're approaching it and thinking about how to be in really interested, to hear your views as to how you see that discipline developing over time and kind of the expectations you're seeing from your stakeholders around quantification of sustainability.

Ian Simm, IMPAX [00:09:21] Yes, look, there's a number of dimensions here. I think the the starting point is what I was saying a moment ago around sectoral transformations. So the private sector's responding very rapidly to signals from policymakers and from consumers around new products and services linked to the clean economy. So, for example, electrification of the drive train for passenger vehicles, the switch to renewable power generation. And in that context, the market's working, as it has done for decades, if not centuries, that capital is being allocated to the most efficient companies with the best plans and best execution. Alongside that, financial investors, either themselves or with a nudge from regulators or other stakeholders, are asking themselves three questions. Firstly, where are the opportunities over the coming years that I can maybe deploy capital to ahead of everyone else, realising just how valuable they are so I can make a profit? Second is what's the risk in the corporate world look like from new dimensions such as physical climate risk, transition, climate risk and potentially risk from disadvantaged communities or other sort of social risks. The corporate sector is responding really well to the signals from consumers and from policymakers around new markets. And technology is really facilitating the rapid expansion of products and services around the electrification of the drive, train and passenger vehicles, but also the deployments of renewable energy.

The financial sector is looking at three topics. Firstly, opportunities. So what's going on in these in these new markets? And is there money to be made by perhaps moving early into opportunities around growth? Secondly, how's risk evolving? And there is a challenge to look at new sources of risk. So for example, physical climate risk or risk coming from reactions of disadvantaged communities, but also the risk of regulatory change. And then the third, possibly most intriguing area is around investment beliefs. So all investment managers or those managing pension funds or other primary sources of capital have obligations to their stakeholders, be they, for example, pension trustees or governments if they're running sovereign wealth funds and investment beliefs or investment sort of morals or ethics of that sort of wrapping the fiduciary duty for those investment professionals is changing. And it's intriguing to speculate that over the next couple of decades or so, we may move away from a very sort of harsh form of capitalism to more nuanced variegated forms of capitalism in which investment beliefs and the fiduciary level. So for example, pension trustee level moving away from maximising profit to ensuring that there are additional positive societal benefits around environmental or social outcomes. So the landscape is evolving in quite a sort of interesting and varied fashion. I think it's too early to call which, which scenario is going to play out, but it's certainly never been a more interesting time to be in the space.

Emily Farrimond, Baringa [00:12:52] I couldn't agree more and I think very hopeful that certainly within my career we start to see some of those changes that you outlined. Simon, I'd be interested to hear from you and of the work from the work that you're doing with your clients, what you're seeing changing and kind of what's important about quantification and measurement and sustainability.

Simon Abrams, Baringa [00:13:16] It's a really interesting question. And I think that companies like IMPAX, or others like Generation, have demonstrated that you can focus on outcomes and make really good profits over the long term. I've been really interested by the rise of impact funds in the private equity world, where investors have loved the story of of making, kind of for-profit returns while driving social outcomes. And what that's done is, is really put a new focus on outcomes in debates around some of the larger impact funds and whether they are driving sustainable outcomes. But it has changed the conversation and that has made it much more much more acceptable, much more kind of commercial to start thinking about these outcomes in the context of trying to do good in the world. And I think that the way that those funds have been able to raise significant amounts of capital with a real commitment to focus on outcomes through theories of change and through thinking about things in a in a more holistic way has been really interesting. And I think we are a lot further down the road because there's a lot of capital looking at driving those outcomes now than they were before that. So I think we've got some way to go. But I think to Ian's point about investors changing some of their investment beliefs and starting to allocate their capital in these in to these sorts of strategies, these sorts of products is really encouraging because it's really put the focus on real world changes and not just words.

Emily Farrimond, Baringa [00:14:54] And we're seeing record levels of capital flow into sustainable investments, to your point. Simon, and actually, we're seeing some rhetoric from NGOs and others around transition investments or investments into transition technologies and whether or not they feel that those are in some way greenwashing because they're not, to use your term "earlier, clean economy products and propositions". What are your thoughts on greenwashing, Ian?

Ian Simm, IMPAX: Well, IMPAX, in the rear-view mirror is in a strong position because we started out with a laser like focus on opportunities to solve environmental problems in the private sector. And back in 1999, actually, Bruce Jenkins Jones and I created one of the world's first green taxonomies in response to a request from a prospective Danish client who wanted an environmental technology fund established. And there was no sort of definition for what that meant. So we wrote down a classification system taxonomy, if you like, to map out all the sectors that we thought were relevant, and that led to a universe of stocks. And then the underpinned are listed equity work, which is a sizeable proportion of our assets under management today. So in that sense, we've not only been able to avoid any sort of charges of greenwashing because we've been right in the heart of the green space. And also secondly, we've wrestled with the definitions of the green space and realised that green is not black and white. There are trade-offs. There are points of distinction to be debated by policymakers around what should be in or out of green classification systems. And so I think with that experience of more than 20 years in the green classification space, we're as well place as any to really help this debate unfold effectively. It's very clear that that labelling is required in the investment fund space to give, particularly retail consumers, some kind of clarity around what's in their underlying portfolios. And that's where the risk of greenwashing can be countered through labels from strong reputable brands. So some of the index providers have got straight strengthened the space, particularly FTSE Russell, who we've been helping at IMPAX, in this area since 2007. So with the emergence of labels and brands, I think we can address greenwashing. I'm concerned that if regulators overstepped the mark, then we'll end up with a swamp, if you like, a huge sort of amorphous pot of spaghetti of regulations and classification systems that that conflict with each other, that's potentially going to lead to a significant cost for everybody in our industry just to comply with what regulators are saying.

Emily Farrimond, Baringa: Thanks for sharing that and fascinating to hear about your green taxonomy work and classification system and how that's been leading some of the market's thinking. Simon, I'm just interested to get your perspectives on the topic of greenwashing. Obviously, we hear a lot of rhetoric about it in the media. Is it something we need to be worried about and that our clients need to be putting taxonomies, the likes of which Ian talks about into their businesses?

Simon Abrams, Baringa: Absolutely. I think they're having a very clear focus on what your definition of a green is. So the way that sort of Ian and the IMPAX team did it, makes so much sense because they were real clarity about what they were looking at. There was a real cultural sort of alignment with that and there were controls to make sure that, that, that all investments went met those criteria. And I think that that sense of are you clear about the why? Have you got all your people lined up and do the controls support that and reinforce that, is really key. And I think what we've seen where people have got caught out is that people haven't been clear about why they're doing it, their people haven't been lined up and they've had very weak controls. It does restrict what you invest in because you're saying we're going to invest in this, we're not going to invest in that, because we believe that this is the way to transition. And I think what people are seeing is that if they can give it a bit of a green gloss without actually having the fundamental beliefs and actually working through to find the best investment and the best the best ideas, what happens is that they do it in a in a sort of not a structured or a rigorous way. And then they find that they're caught out. So I think greenwash is a real issue. But fundamentally, the people who have it right, who have the right values and that reflects the way that they recruit people, the way that they set up their business and the controls that they put in place will be a good defence against that. And, I think some of their, some of the businesses which have found themselves in that on the back end of that have missed out on one of those three areas.

Emily Farrimond, Baringa: But clearly there are lots of challenges that we're facing. And Ian, I'm interested to hear from you in in terms of your perspectives on what the markets need to do differently to support us in achieving a just transition and also drive broader positive social outcomes.

Ian Simm, IMPAX: Yeah. Look, I think this is a really important question and. On the where we're not necessarily answering in the most effective way so that the trend right now in the early 2020s is to go for more disclosure, green taxonomies and transition pathways, corporate net zero. All of which I think have the potential to either create quite a lot of confusion and cost for business red tape, if you like, or to end up with unintended consequences. For example, the deployment of huge amounts of capital into supporting the steel industry, transitioning to green steel. And what we should really be doing is shrinking very significantly the size of the steel industry and replacing it with other products, for example, based on wood. So in contrast that, I think what I'd like to see is focus on pace of change and focus on what we can do for developing countries. So the pace of change, I think, is probably the most critical question for the developed world right now. We know how to electrify the drive train. We know how to move to zero emission vehicles. But we're struggling to build the supply chains and deal with the unintended consequences. pollution, for example, a supply chain from battery manufacture. And to bring these this new industry into being quick enough to reduce the cumulative emissions of greenhouse gases from the transportation sector. The same goes for renewable energy, although with further down the ask for lobbyist cap, if you like, for that. And then we are with electrification. Green heat or decarbonising heat is a major problem. It doesn't seem as though we're getting anywhere near fast enough in the shift to an alternative to natural gas sourced fuels. We'll probably need a hydrogen economy ultimately, but it's hard to see that really taking off until the 2040’s to any sort of global scale. So pace of changes is the most important thing for the developed world. For the developing world, I think there's some more fundamental problems, particularly around the invest ability of many developing countries in a classical sense. So many countries in that part of the world lack basic, such as reliable rule of law or enforcement of property rights. They don't have basic infrastructure around roads and transportation to move things around, which really hampers development in general, but sustainable development as well. They don’t have skills base and, in many cases they're politically unstable. So if we're not going to address those topics, it's hard to see how a conventional approach to financing sustainable development there is going to work. Beyond that, I think there's the noise around disclosures and classification systems and taxonomies is potentially getting in the way. These are all areas that could be addressed relatively swiftly and then creating a sort of a clear agenda for us to focus on what's very important.

Simon Abrams, Baringa: I think the just transition needs, you know, if I if I connect my passions around sort of sustainable development with diversity and particularly ethnic diversity and hearing voices from different parts of the world. My concern is that the people trying to think this through, particularly with regards to the capital markets, are not diverse enough and therefore the solutions that are trying to be developed in terms of some of the other countries and the governance issues are not as representative and not as thoughtful as they could be if the people thinking through those solutions were properly diverse. It's still the case that most of the capital that is looking to be deployed in this way is Western and very much white Western. And I think we don't have other voices at the table to help them think through the solutions and to come up with solutions which fit with both the economies in the societies which need to undergo those changes. And I think that's something that we need to look at and see how we can get other voices in the room to help make better decisions.

Ian Simm, IMPAX: Fully agree, Simon That's an excellent point. And I'm not sure the mechanisms are in place to do that at the scale that we need. So we definitely to focus on that.

Emily Farrimond, Baringa: I guess that's really delving deeper into that trend of convening and what we need to do in this in the world of sustainability and get more voices together at the table to solve problems collectively. Ian, you touched earlier, when we were exploring some of the challenges, that your view of some of the solutions that were made to support us in driving to a much more sustainable world. Could you outline answers in a bit more detail?

Ian Simm, IMPAX: Yes. Look, I think there's a couple that are worth dwelling on. Number one is the power of long-term policy frameworks. So I think we've all been hugely energised in the UK in the transportation space since the Government indicated that from 2013 no new vehicles with internal combustion engines could be sold. And that's given nearly a decade of notice around a market change, which gives the industry time to adapt and give an incentive to those who are minded to invest, for example, in electric vehicle charging infrastructure, that there will be there'll be customers in volume in time. Similarly, European commitments to long term development of offshore wind. The Danes, the Germans, the UK and the Netherlands in particular, have helped to catalyse what's now an enormous industry and has a potential to be the dominant supplier of renewable power in north western Europe. So these long term policy frameworks potentially with subsidy, but not necessarily. So well targeted objectives coupled with investment in public goods like interconnectors to large areas for multiple wind farms – that sort of policy is hugely beneficial and an accelerating change. So second, I think there's a huge opportunity for corporations to make early bold moves in some areas. So for example, we have seen that Amazon have sent a very strong signal to the global transportation industry, particularly in shipping, that they want to see zero emissions transportation for their goods over time. And that's been a great encouragement to many of the global shipping providers, for example, Maersk, to commit to green forms of propulsion, particularly around hydrogen and ammonia, and start ordering ships that are based on technology that doesn't really exist yet, but by the 2030’s should be viable and commercial, so that ships of the late 2030’s into the 2040’s will potentially be zero emissions. So early bold moves can make the difference and sort of catalyse the speed of change that we're looking for. I think the final area, which is intriguing, is around the financial sector itself. I think there's been some very interesting work done on new forms of financial instrument, for example, carbon credits from peatland restoration in the context of nature-based solutions and ecosystem services. There's a lot more work that can be done to create financial instruments around preserving nature, linked them to regulatory targets, for example, around sort of caps on greenhouse gas emissions with offsets. And then finally, I think the scope for financial product innovation and going back to my earlier point, which Simon also touched on around investment beliefs, then I think the scope for quite significant scope for investment managers to set up products that have got more clear impact objective and almost sort of putting impact alongside of, not ahead of financial returns that won't suit the majority of the market at the moment or maybe even ever, but it will suit and be attractive to certain pockets of capital. And those pockets, I think, are going to be sizeable enough to make a real difference to the kind of catalytic investments we need, particularly in the developing world.

Emily Farrimond, Baringa: Simon, interested to hear from you about the solutions you think we need to see in the market moving forward.

Simon Abrams, Baringa: So our theory of change is that if we can decarbonise all the point sources of energy use, so whether it's whether it's vehicles, whether it's the products from the fossil fuels sector, if we can decarbonise them and find alternatives, then we are. The one thing that we have to fix is the energy for homes and for heating. And if we can move that to renewables, then we've effectively decarbonised the system. I think we are struggling to find alternative solutions to many of the products that we have that are fossil fuel based. We're struggling to find alternatives to plastic, which are as cheap as light, have the same benefits as plastic. And I think we need to do more in terms of finding these alternative solutions, which are available to those who don't have the same amounts of disposable income as others. And I think many of the solutions that we've developed so far are quite aspirational. They're quite costly and I think we need solutions which the average citizen can affordably use and deliver the same sorts of benefit. And I think we're not there yet. And there's issues of identifying the right products, trying to get them at scale so that commercially they can land to the majority of population. If we think that the average salary in the UK is 27,000, then we need solutions which people who are on 27,000 and less can use. And that way we can transition. My concern at the moment is that the solutions that we're coming up are at a price point, which are which are unaffordable – which makes the low carbon or the environmental sustainability standard products suite quite niche and quite elitist. We want to move that very quickly so that we've got broad acceptance and we need to do more work on some of those two products, more work and some of those solutions and more work and some of that marketing.

Emily Farrimond, Baringa: Thanks. And I'm afraid to say that's all we have time for today. I wanted to say a massive thank you to and Simon for being so generous with that time. It's been an absolute pleasure spending time with you both and to you in particular, learning more about the investment philosophy at IMPAX. Thank you very much.