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# Sustainable finance – an (overdue) act of re-orientation?

Dominik Varga

In general terms, impact investments are investments that bring societal benefits on top of financial yield. This topic therefore offers a great opportunity to talk to experts about the effects of investments on society. This is why Erste Asset Management also has an internal forum, where ESG topics, sustainability aspects, and climate risks are periodically discussed and internally presented.

Dr. Timo Busch; (c) Uni Hamburg

We spoke with Dr. Timo Busch, professor of sustainability research in financial investments, about his latest research in the field of impact investing. In one of his latest research contributions, Busch has developed a new typology to classify sustainable investments[1]. The central claim of the paper proposes distinguishing between impact-aligned and impact-generating investments. In addition, Busch et al. (2021) classify sustainable investments into four areas:

- **ESG screening**, which is mainly based on exclusion and serves to reduce risk
- **ESG management**, which systematically reflects ESG-relevant risks and opportunities
- **Impact-aligned investments**, which address social and environmental challenges and goals
- **Impact-generating investments,** which contribute actively to social and environmental solutions and change

In the following, please find a summary of the Q&A session after Prof. Busch's presentation.

### Q: Difference between ESG screening/management and impact investing: in your paper, you are warning that ESG investments could sometimes be erroneously suspected of generating impact and are therefore subject to the risk of "impact washing" (i.e. in analogy to "green-washing"). Since ESG is becoming more and more mainstream, would it not help to understand impact investments as part of a broad ESG approach?

TB: Looking at the definition of impact-aligned and impact-generating, I would say that this is indeed possible. For example, taking it one step further from ESG integration, by describing the investment strategy in detail, doing a benchmark analysis, or considering SDG[2] alignment. If you can then clearly document what goals you achieve with your ESG integration and manage to communicate it to your clients, you can definitely regard this as impact-aligned.

If you take it even further by deeming the investment as impact-generating, it becomes difficult to achieve this with a conventional ESG approach. The challenge lies in the measuring of the changes that are supposed to be created by impact-generating investments. To this end, you will need a different set of methods and strategies, more engagement with companies, etc.

### Q: You have described three mechanisms that are supposed to lead to the generation of impact: investors provide capital, which allows companies to generate social or environmental impact. Investors can focus on companies that have already institutionalised goals aimed at the generation of impact. And thirdly, once the investment decision has been taken, investors can encourage companies to engage in change via active ownership (i.e. the exercise of voting rights and the submission of shareholder motions on environmental and social topics). Does one of these mechanisms alone suffice for us to be able to talk about impact generation?

TB: Yes – if any one of these mechanisms is sufficiently integrated. It's the result that matters. Climate change does not care why carbon dioxide emissions are being reduced by a tonne. The important thing is the reduction as such. Any impact generation should be documented well, and it is irrelevant through what channel this change is coming, whether through the provision of capital or successful engagement with the company.

### Q: As an active shareholder who regularly exercises their voting rights at AGMs and support shareholder motions that could generate impact, could one regard traditional funds as impact-generating as well?

TB: Yes, you could indeed. The difficult thing is the measurement of the impact, i.e. how successful one's engagement strategy is.

### Q: The next question may sound a bit provocative: can there be unethical impact generation? Let's take as an example an investment that leads to a certain amount of reduced carbon emissions, but this reduction was achieved by forced labour. Doesn't that mean that impact investment on its own cannot exist without the add-on of an ESG approach?

TB: That is a good question. The idea of impact generation also brings along a different mindset. For example, you can invest in the dirtiest company – in a best-of-class approach, such a company would be at the lower end of the scale. But from the perspective of impact generation, it would be legitimate to say that one invests in such a company out of conviction in order to start an engagement process with Management, e.g. to cut emissions. There are of course controversies about certain companies or sectors should be excluded per se.

### Q: What do you think about the following statement: "By investing EUR 100, you generate such and such degree of impact." Is it possible to quantify that?

TB: Opinions are very divided on this one. On the one hand, it makes sense to sensibilise clients to the topic of impact. On the other hand, for most products currently marketed as impact funds the impact has already been realised. Another investment in this product therefore does not create any more impact. This means there is no cause-effect relationship. This is also the underlying notion of the paper: in order to generate impact, one has to look at the primary market: micro finance or venture capital, i.e. segments where impact is made possible in the first place. Whether such a statement makes sense in connection with regular equity investments is up for discussion. One way would be to focus on companies that set themselves clear and verifiable goals, e.g. as part of the science-based targets initiative.

### Q: Will there be room for other definitions of sustainable investments on the market in addition to paragraphs 8 and 9 of the EU Taxonomy[3]?

TB: Yes, because investor impact, i.e. the idea that investors are the driving force of impact generation, is not fully covered by the current EU definition, or at least not as explicitly as it should be.

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[1] Busch et al. (2021), Impact investments: a call for (re)orientation, SN Business & Economics (2021) 1:33. https://doi.org/10.1007/s43546-020-00033-6

[2] Sustainable Development Goals

[3] https://ec.europa.eu/info/business-economy-euro/banking-and-finance/sustainable-finance_de

**Legal note:**
Prognoses are no reliable indicator for future performance.




## Dominik Varga