Changing finance, financing change:
the advent of impact measurement for public equities

By Dr. Dinah A. Koehler

Introduction

When the United Nations Environment Programme Finance Initiative (UNEP FI) was launched in 1992, it had a grand vision: to bring about systemic change in finance in order to support a sustainable world. The motto was: changing finance, financing change. This, according to the original gathering of bankers and UNEP staff, required raising the banking industry's awareness of the environmental agenda. It also required the integration of sustainability considerations into all aspects of the financial sector's operations and services. A secondary objective was to foster investment in environmentally sound technologies and services.

We have come a long way since. In the past twenty years, the field of sustainable finance has changed dramatically and is increasingly being explored by the world's largest banks. Many of these banks are working on the integration of sustainability factors into investment decisions. The concept of sustainability has been further disaggregated to entail environmental, social and governance issues, each with a growing set of metrics. Today, the majority of the world's largest companies and many small- and medium-size enterprises issue annual corporate sustainability reports, which contain data that can be used by investment teams, including UBS's Sustainable and Impact Investing team of which I am a member.

The missing link: impact

But there was always something missing: evidence of change toward a more sustainable world. In truth, this is the keystone of the UNEP FI vision. If investors claimed to be investing in a more sustainable world, where was the proof? Interestingly enough, the new ideas for measurement have come from the philanthropic community and foundations which needed to measure the impact of their donations and grant-giving on society and the environment. The involvement of wealthy philanthropists from the technology sector accelerated the movement to measure the impact of grant-giving, because this is a group accustomed to measuring everything. Program evaluation and impact measurement have also risen to the top of the agenda at multilateral banks, such as the World Bank, which have realized that much development aid had not been effective.

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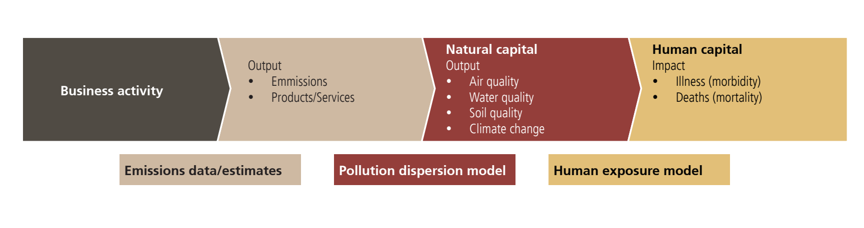

It was only a matter of time before the question of impact measurement would trickle into the discussions between asset owners and asset managers across many asset classes.

The measurement of public equities' social impact is so new that there is little to point to yet. For instance, early attempts have been made to measure corporate greenhouse gas emissions. Companies that reduce their greenhouse gas emissions are believed to be creating a positive impact on society and the environment, but we don't really know by how much.

Others calculate impact as a function of revenue derived from products that target renewable energy, education or sanitation, for example. Such a reductionist approach can be misleading. Just because money is invested in a social initiative (e.g. education improvement) does not automatically mean that it will deliver a measureable positive impact. This has been a frustrating lesson in the philanthropy and impact investing community. Furthermore, using revenues to capture a company's potential social impact does not automatically take all ramifications into account. For example, what if a water treatment technology requires the use of a highly toxic chemical, which, if released into the environment, can cause health issues for humans? The problem is obvious.

Finding answers in existing science

While the debate on impact measurement is ongoing, most agree that social impact ought to be measured in units of human well-being. How can this be done expeditiously for public equities, based upon evidence and not conjecture? We believe that a good model can be found in the disciplines of public health and environmental science where measurement has been going on for decades, albeit for regulatory standard setting.

The framework and peer-reviewed scientific models of industrial systems and activity impact on humans have been developed based upon evidence from large population studies. Armed with this knowledge, we can start to deconstruct the causal pathway from the actions of publicly traded companies to impact on human health and the environment. Public equities – as with any enterprise – that produce, store or sell commodities in a facility create an impact on human well-being: they employ people, they use energy and water, they emit pollutants to the air, water and soil (see illustration). The activities and flows of materials, energy, water and emissions of any public equity – large or small – can be translated into units of human well-being using existing science. The impact investing community has focused almost exclusively on measuring the positive impact of a company through life-saving or welfare-improving products. However, for large global equities, we cannot ignore the negative impact (pollution), which can be significant.

We believe that a better way to approach global equities' impact measurement is to balance the negative impact of a company's products and processes with the positive – striving to identify those companies that create net positive impact. Rather than reinvent the wheel, we are working with leading scholars in the fields of public health and water risks to identify robust, credible and user-friendly metrics of social impact for the dimensions of climate change, water, food security and health. This will require novel databases and leveraging scientific models of human health impact, e.g. pollution dispersion models and human exposure models (see illustration). UBS Asset Management has partnered with a large European pension fund to develop these metrics. We see growing demand among institutional and private wealth clients who want to understand how their investment creates a measurable impact.

For further information about UBS's expertise in this field please visit,
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