MSCI ESG
THOUGHT LEADERS COUNCIL

FROM MSCI ESG RESEARCH INC.

IMPACT INVESTING | JULY 2015

INTRODUCTION TO THE MSCI ESG THOUGHT LEADER COUNCIL

The goal of the MSCI ESG Research Thought Leader Council is to maintain our leading edge in research methodology by regularly seeking feedback and opinions from external experts in key industries and relevant ESG issue areas. The MSCI ESG Research Thought Leader Council consists of a series of about four panels annually, with three to seven members on each panel. We aim to assemble international experts with recognized leadership and expertise on the topic area related to the panel.

KEY TAKEAWAYS

- **There was general agreement among panelists regarding the value of looking at listed equities as potential impact investing investments.** They felt that impact investing is in its early stages and that there is a need for more discussions and debates among stakeholders to move the impact investing agenda forward.
- **Developing an impact framework to evaluate the overall impact of a company is a complex issue that requires developing a holistic approach** that would consider: both the environmental and the social impact combined; the impact a company can have through its operations as well as through its products and services; and finding the right trade-off between the positive and the negative externalities that a company can generate.
- **Assessing how a company's core business can help solve some of the biggest world challenges is a relevant approach that would need to be complemented by other assessments including product and service quality, type of customers, and companies' growth strategies and future investments.**
- Impact measurement is a key feature of impact investing but remains challenging. **Relying on a set of transparent and simple metrics might help communicate on impact and measure progress over time.**

COUNCIL MEMBERS

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KEY DISCUSSION POINTS

1. IMPACT INVESTING AND LISTED EQUITIES

   Participants acknowledged that impact investing principles can be applicable across all asset classes including listed equities. Impact investing has so far been mostly focused on private markets and panelists considered that extending the concept to other asset classes is relevant and may help the impact investing space grow further. Several panelists highlighted "intentionality" as a key principle to consider when defining impact investing and stressed the fact that all investments have impact, both negative and/or positive.

   Panelists felt that companies can have an impact through both dimensions: 1) their operations and 2) their products/services. Some panelists placed more emphasis on the products/services angle, with the view that these tend to be easier to quantify and measure yet recognized the importance of looking at the full life cycle of a product. Panelists agreed that identifying positive impact is key, but also stressed the importance of evaluating the negative externalities to fully capture the impact that a company can have on both the society and the environment.

2. IMPACT INVESTING FRAMEWORK

   The definition of the social framework based on the Millennium Development Goals that includes the following themes (education, housing, nutrition, sanitation, healthcare and finance) led to intense discussions among panelists. It was suggested to refer to the Sustainable Development Goals when defining the impact framework and to capitalize on the work done by the international community to go beyond the Millennium Development Goals and develop a more comprehensive and robust sustainability framework.

Panelists noted that generating positive impact on the social side should not be independent of assessment of environmental considerations, and that an impact investing framework should consider both aspects: the society and the environment in combination and not separately. Additionally, it was suggested to include other “access” themes such as energy/electricity and communication as well job creation.

3. **SELECTION CRITERIA**

Panelists acknowledged that assessing revenues coming from impactful activities is a useful datapoint to be provided to investors to inform their investment decision. However, participants felt that it might not be sufficient to fully capture the impact that a company might have on both the positives and the negatives. Other dimensions should be considered in the analysis including product and service quality and type of customers, but also the company’s mission statement, its growth strategy, and future developments.

Panelists felt that 50% of companies’ revenues generated from socially or environmentally impactful activities seemed reasonable but raised three caveats: 1. One should not overlook the remaining 50% of revenues. The impact will differ if the remaining 50% comes from neutrally impactful activities or from products/services that have negative environmental or social footprint. 2. A company could generate less than 50% revenues from impactful products but still have a large impact in absolute terms as low-income customers may generate lower revenue per customer. 3. From an investor perspective, a trade-off should be found between the revenue threshold and the investment universe, which needs to be large enough to remain investable.

Nestlé was used as an example in the discussion to illustrate the complexity and dilemma of assessing a company’s impact. On one hand, one could argue that Nestlé has had a significant impact on undernutrition through its fortified food product offering; however on the other hand, the company has also faced numerous controversies with regard to product quality, local community and the marketing of infant formulas.

Panelists stressed the need for transparency and clarity when assessing companies’ impacts and when deciding on whether a company would be deemed impactful. It was also suggested to look at a company’s impact from an aspirational point of view rather than from a sectorial benchmarking perspective. While the latter will compare a given company against its sector peers, the former will look at how the company is positioned to address the social and environmental challenges that the world is facing.

Assessing the geographic breakdown of revenues and in particular the proportion of revenues coming from developing countries was seen as an interesting datapoint to include in an impact analysis. Some panelists raised the point that needs are greater in the developing world and would favor an approach that focuses on/weighs more heavily companies with a higher proportion of revenues coming from developing countries. Others noted that there are social needs everywhere, including in more developed regions and that unless one is able to identify the type of customers served it would not be possible to fully measure the company’s outreach.

4. **MEASURABILITY**
   Measurability was highlighted as a key feature of impact investing. Participants recognized that impact investing is still in its early stages and that there are numerous challenges associated with measuring impact, including data availability. They suggested that we use tangible and simple metrics to report on positive impact with transparent number (e.g. number of people financed, number of people gaining access to housing etc.) as well as qualitative examples (e.g. case studies).

   It was suggested to look at IRIS (the GIIN database) as a catalogue of commonly accepted metrics. Another idea was to assess companies on the existence of an internal impact measurement framework as a way to make companies accountable for impact reporting. From a portfolio perspective it was also suggested that ideally the reporting would highlight how the portfolio compares and/or helps to achieve long term goals (i.e. the Sustainable Development Goals).

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