Roundtable

The future of sustainability

Progress towards a more sustainable global economy has been painfully slow – but could it be about to speed up? *Environmental Finance* and Irbaris asked a roundtable of finance experts to peer into their crystal balls. Mark Nicholls reports

26 September was, according to environmental group Global Witness, Earth Overshoot Day – the date on which mankind's annual consumption of natural resources outstripped the ability of the world's ecosystems to replace them. It was therefore an appropriate day to invite 10 experts from the finance sector to discuss the future of sustainability.

That future is nothing if not cloudy. The discussion, at the offices of consultancy Irbaris in central London, took place against the backdrop of the seemingly endless eurozone debt crisis and a stuttering global economy. Add to this gloom the loss of urgency in the international climate talks since the 2009 Copenhagen debacle, and sustainability experts worry about years of drift, as short-term economic and social concerns trump longer-term ecological pressures.

"There is a worrying complacency about sustainability performance"

Rory Sullivan, responsible investment expert

But every discussion of the future should begin with consideration of the past, which triggers the question, how far has the global economy come in the past 10 years in addressing sustainability?

The consensus around the table: nowhere near as far as it should have. "There is a worrying complacency about sustainability performance," said responsible investment expert Rory Sullivan. And, even among those who are engaging with questions of sustainability, "the focus of companies and investors is on process and risk management – we're perpetuating and exacerbating the problem rather than addressing it".

And there is no shortage of constituencies that can be blamed: investors failing to look beyond the short term; companies enslaved by the quarterly earnings figures demanded by stock markets; policy-makers unable to see past the next election – or to resist the lobbying of incumbent industries putting their short-term health above that of the planet; consumers insufficiently enlightened to demand sustainable products, activist pension funds or strict environmental regulations.

While companies are making progress on improving their environmental and social impacts – and, by and large, they are generally trying at least to improve the efficiency with which they use resources – there is a lack of big-picture thinking, roundtable participants agreed.

"If you look at many companies, what concerns me is that people believe they've 'done' [climate] mitigation," said David Hampton, managing partner at Irbaris. "They've got their carbon strategy, their target for 2015 and a 10% reduction – but if businesses are going to be resilient to the climate change challenge, they need to be more forward-looking and ambitious.

"Investors are saying, we accept that climate change will happen"

Catharina Saponar, CA Cheuvreux

"And now they're thinking about water, but in the same way they think about carbon … As long as they get a bit more water-efficient, they [think they] have solved the problem."

"It's compliance thinking, rather than strategic thinking," said Anita Hoffman, an executive search consultant specialising in the clean-technology sector.

"To deliver the step changes in performance that are required, many companies will need to rethink their business models; as yet, there is limited evidence of that happening," said Sullivan.

So what are the implications of this way of thinking? "Investors are saying, we accept that climate change will happen," noted Catharina Saponar, head of green tech research

Roundtable attendees

Richard Burrett, partner, Earth Capital Partners
Magnus Goodlad, head of environmental technology, Hermes GPE
David Hampton, managing partner, Irbaris
Anita Hoffman, clean-tech executive search consultant
Bim Hundal, partner, Lion's Head Global Partners
David Lyon, principal consultant, Irbaris
Catharina Saponar, head of green tech research, CA Cheuvreux
Penny Shepherd, chief executive of the UK Sustainable Finance Association (UKSIF)
Paul Simpson, chief executive officer, Carbon Disclosure Project
Rory Sullivan, responsible investment consultant

The roundtable was chaired by **Mark Nicholls**, editor of *Environmental Finance*

at equity broker CA Cheuvreux. "Mitigation strategies won't stop it, regulation is a mess, policy is a mess. Why don't we focus on adaptation … and invest in cement companies, agricultural companies? They can see the return stories, and they are easy-to-understand concepts." However, "we need both approaches".

"The corporate is a fairly simple beast – it needs something clear and understandable, otherwise it isn't going to take any action," added Saponar. "So, if it sees a world that changes every three weeks, it's not going to do anything."

It may be difficult to find many companies that are recasting their business models fundamentally towards sustainability but, argued several roundtable participants, enormous progress has nonetheless been made over the last decade.

"There isn't the track record you've got in other sectors"

Magnus Goodlad, Hermes GPE

Penny Shepherd, chief executive of the UK Sustainable Finance Association (UKSIF), argued that it is easy to forget how far we've come. "When I meet people these days, the mood music is different – the environment in which we're operating is much more open to what we're talking about." She added that, among other things, there is now a "depth of knowledge" around sustainability issues that was hitherto lacking.

However, awareness only gets you so far, said Paul Simpson, chief executive of the Carbon Disclosure Project, which has mobilised investors managing some $71 trillion in assets behind a call for more corporate disclosure of climate-related risks. "Over the last 10 years, awareness has become very high, but systemic change hasn't happened. In the investment community, I don't feel there's been a huge amount of progress … and where there has been change, it's been at the margins."

Part of the reason is the relative immaturity of proactive investment in sustainable technology compared with to more reactive approaches. "My experience is that pension funds have embraced responsible investment very strongly," said Magnus Goodlad, head of environmental technology at private equity investor Hermes GPE. "But, in terms of allocation of environmental finance to private equity funds, they haven't invested as systematically as they have in other sectors because it's a young sector … there isn't the track record you've got in other sectors."

A profound challenge for markets and investors is to solve the conundrum of 'value' versus 'price,' maintained Bim Hundal, partner at boutique merchant bank Lion's Head Global Partners. "Markets really work on price and so, if market prices do not accurately reflect social value, then the price needs to be modified through regulation. That will give the desired price signals to key market participants, most importantly to investors."

"If the climate science plays out as predicted, we're looking at a very scary outlook"

David Hampton, Irbaris

"It has to be about minimising the value component and maximising the price component," he said.

Therefore, said Sullivan, the introduction of emissions trading in Europe in 2005 is, "from an investment perspective, the single most important development in the last 10 years".

The programme, which covers over 40% of Europe's carbon dioxide emissions "legitimised a focus on ESG [environmental, social and governance] issues," said Sullivan. "It established that governments may intervene and the importance of investors properly analysing regulatory and policy risk. It showed the catalytical and critical role that forward-looking governments can play."

However, given the current political paralysis over the European debt crisis and the US deficit, there was little optimism that policy-makers are likely to forge effective policy on sustainability more broadly– in the face of growing pressures on natural resources and ecosystems. "The pressures in 10 years time will be much more intense," argued Sullivan, driven by rising populations and expectations of higher living standards across the world. Furthermore, as Saponar noted, pressure on global resource use is contributing to "mistrust and … competition. We're touching very close to the essential areas of survival".

"Environmental issues create the first predictable industrial revolution"

Paul Simpson, Carbon Disclosure Project

There was concern around the table that global governance will not be equal to the task of addressing these growing resource pressures. "Will we be living in a world that's more joined up and better governed and better managed, or will we live in a world where there's more stress and conflict, more adaptation than mitigation?" asked Richard Burrett, a partner at specialist asset manager Earth Capital Partners. His conclusion? The latter is more likely.

Simpson, however, was more optimistic. "In 10 years time we'll be in a system where there is far greater pressure to act, there will be greater pressure from politicians through regulation," with more pricing of carbon, water and biodiversity. "Ultimately, there will be large-scale financial flows towards [environmental] solutions because they will make economic sense."

"But there will also be a lot of shocks … and as a result a lot of losers," Simpson added.

So what does a resilient company or investor look like?

The increasingly compelling economics around resource scarcity could drive increasing sustainability. "We should be talking about peak oil," said Simpson. "Price will drive change; greed in the market will drive decisions" in more sustainable directions – "if the information is available and factored in over the long-term".

"Money will flow where there is a return on it," said Saponar, "and the thinking should move away from the policy perspective – policy will never deliver what is needed … A product that makes economic sense will always sell – look at energy efficiency."

Goodlad agreed. "Some large corporates have been very good at delivering [the sustainability] message to investors – if you look at GE, for example, they've significantly over-invested in that part of their business … You haven't had investors saying 'don't do it', because it's driving returns."

At the same time, the demand for robust responses to sustainability issues will only increase. In particular, as David Lyon, principal consultant at Irbaris, said, "sustainability targets are often not set with the degree of rigour they should be if they are to be meaningful drivers of important financial decisions".

So what does a proactive approach to create value from sustainability look like?

"Environmental issues create the first predictable industrial revolution," said Simpson, "but not many people are sure

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Richard Burrett, Earth Capital Partners

how to make money from it. Once they are, the money will flow."

Some hope that financial markets will increasingly reward companies that show better sustainability performance. "There is some evidence that companies that are thoughtful about sustainability are thoughtful about strategy," said Burrett. "Companies that look beyond their immediate risk register and try to understand the drivers of change in their business – it's a proxy for good management."

"What investors particularly want is for companies to be better at telling their sustainability story, and explaining how their business model will change to operate in a more sustainable world," said Shepherd.

Hundal is hopeful that 'sustainability' can be better built into the market metrics for financial assets to help guide investors. Currently this is more easily done for equity securities but he is hopeful that innovation will extend the concept to debt instruments as well. "The key is that such measures are readily accepted and the information is easy to apply. Securities of companies with better sustainability metrics should be accepted as being more attractive."

Burrett suggested that the concept of the "universal owner" – the large investor which holds a percentage of the entire market – will increasingly come into play. Such investors are unable to avoid the effects of environmental externalities which affect entire economies and societies. "If you're investing across the whole system … the health of the system will determine

"Securities of companies with better sustainability metrics should be accepted as being more attractive"

Bim Hundal, Lion's Head Global Partners

the future health of your portfolio." However, while the "intellectual" argument is understood, "I don't see any fundamental changes in asset allocation" in response, he added.

But not only will the environment for business and finance be different, so too will the actors. "Who are likely to be the disruptive innovators within the finance industry – what will happen to the boundary between the finance industry and the ICT industry?" asked Shepherd. "Are the ICT companies going to be the financial innovators of the future? Is Apple or Google going to become a serious financial service provider?"

The providers of capital are likely to change, added Sullivan. "Corporates are likely to be increasingly important providers of capital for the deployment of environmental technologies, and we need to be very aware of the role they can play in driving change."

Hampton suggests two scenarios. One, where more sustainable technologies become cost-competitive, and therefore mainstream, and another where those breakthroughs don't occur. Under the latter scenario, "short-term drivers continue to dominate, in 2020 we're sat here having a very similar conversation and, if the climate science plays out as expected, we're looking at a very scary outlook."

"It's very difficult to believe that change will come, and then we hit a point where it does very quickly"

Penny Shepherd, UKSIF

The debate, however, needs to be much broader than technological change.

"Some of the most interesting thinking going on is about social change," said Shepherd – such as around perceptions of entitlement and responsibility, and immediate consumption versus longer-term resilience.

Leadership will be critical to the investor and corporate response to the sustainability. "Certain people will have left the stage," said Shepherd, while a new generation of corporate leaders will emerge. "It's very difficult to believe that change will come, and then we hit a point where it does very quickly."

"Companies can be drivers or obstacles to the radical change that is needed," concluded Hampton. "Those companies that have a robust view of the long-term impact of sustainability are the ones that will also deliver value to their investors." **EF**