A More Enlightened Approach to SDG Investing

To solve societal challenges, we need strategies that work, that can be scaled for purpose, and—importantly—that are financially viable. Here's how to get there.

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We've been reading *Enlightenment Now: The Case for Reason, Science, Humanism, and Progress,* Steven Pinker's recent book that Bill Gates called in his blog, "my new favorite book of all time." We can see why: Pinker argues that the ideals of the Enlightenment—all centered on reason—brought the world untold progress and can help us make progress against the challenges of today. Gates agrees with Pinker's view that "there is no limit to the betterments we can attain if we continue to apply knowledge to enhance human flourishing." In other words, if we want to make further headway, we need to analyze how true progress can be made.

This is important, because big problems remain: Climate change looms, 700 million people continue to live in extreme poverty, nearly half of all deaths in children under age five are attributable to undernutrition. Pinker calls for the continuation, or even acceleration, of an enlightened approach to overcome these challenges.
Many of them, of course, are now embedded in the UN Sustainable Development Goals(SDGs), including ending poverty in all its forms everywhere, and many investors have started to reference the SDGs in their investment products. Yet as academic and investment professionals who are passionate about using finance to help solve these problems, and as fervent rationalists, we would like to call for more enlightenment in SDG investing.

SDG investing and what most people get wrong about it

SDG investing is a branch on the tree of impact investment, which aims to generate both financial and social or environmental returns. When the SDGs launched in 2015, many impact investors saw them as a handy framework for determining whether or not an investment creates a positive social or environmental impact: Invest in a pharma company? SDG No. 3: Ensure healthy lives and promote well-being for all at all ages—yes, impact investment. Invest in a cereal company? SDG No. 2: End hunger—impact again. Invest in a bank? SDG No. 1: End poverty—check.
With expectations of what impact investment can do to solve global problems already sky-high, with large investors scrambling to demonstrate their commitment to sustainability, and given the appeal and accessibility of the colorful SDG pictograms, one can see how this way of thinking would spread like wildfire. Investors around the world are sticking SDG icons on their marketing materials after conducting only the most cursory analysis of how their investments are contributing to solving problems.

This SDG mapping is, at best, a good starting point, in that it's making more people "SDG aware." At its worst, however, it's giving people the sense that there's not much to it and that if we keep this up, we will soon achieve the SDGs. To the SDG investment community, we say: Wake up and smell the coffee.

Much of what passes for SDG investing now is investing in companies and organizations that institutional investors were already investing in and that only have a tangential link to solving the problems as defined by the United Nations. Another big slice of the SDG investing pie is made up of investments in companies and activities that are, in fact, addressing one or more of the SDG challenges, but were already doing that before the investment was made. Are these investments facilitating or accelerating the activity? Usually not.

It's also important to note that often with these activities, financing isn't the real bottleneck. For example, there's plenty of money available for clean energy, but the world has not yet made the transition to windfarms and solar panels for other reasons—including the massive scale needed to fully replace coal, oil, and gas as sources of energy.

We don't begrudge investors their "SDG alignment" and its associated PR exposure, but this kind of SDG investing is not exactly the analytical and rational approach to making progress that Pinker advocates for. The best we can say about all this SDG hyperbole is that hopefully it has made financial markets ready for the heavy lifting that now needs to take place, and that will require the time and energy of the smartest people working in finance. Here's what we believe they will need to do to shift more capital toward socially beneficial activities.

Enlightened SDG investment

1. Read A/RES/70/1.

This seems like an obvious one, but most people who are passionate about SDG investment have not actually read this UN resolution, which conveys the magnitude of the global challenges ahead of us.

2. Analyze what is already happening.

With some logical thinking, googling, and reading of books like *Enlightenment Now*, you can learn—SDG by SDG—who has been making progress on these goals over the last two hundred years or so. Across all SDGs and sub-SDGs, there are already hundreds of thousands of people, organizations, and initiatives trying to solve these problems. Entrepreneurs and investors alike need to ask: What problem are we trying to solve? What needs to happen to solve the problem? Who is working to do this?

3. Think financials.

Once you have a good understanding of which initiatives are really addressing the SDGs, you can think money. How are they financed? It's important to get a sense for how much and—more importantly—what kind of money they require to make progress. The "investment" in impact investment suggests activities that require upfront funding and then generate cash flows over time. Some SDG-related activities will have this, but many more will not. (The financial sector has been in such a rush to embrace the SDGs that many people failed to notice they were not written with investors in mind.) We don't, for instance, see entrepreneurs and venture capital firms rushing into activities that support SDG No. 5.2—to eliminate all forms of violence against all women and girls in the public and private spheres.

4. Think investment.

Given the above, it is crucial to determine how investable SDG-related activities are, and this may be the hardest part. Once you've found a program that is actually trying to address SDGs, once you know how much money it needs, and once you have determined that the activity will generate cash flow, you can think about what type of investors may be interested. Some wealthy individuals, endowments, and foundations care so much about impact that they don't mind lower, or even no, return on their investments. But the deepest pockets are with the pension funds, insurance companies, and banks. And though many of them have an interest in SDGs, they are less willing to give up returns and generally avoid riskier investments. This is logical; they are investing other people's money with a specific purpose: to pay out pensions, to pay out insurance claims, to return savings to savers.

So impact entrepreneurs who want to go after the deep pockets need to ensure that their strategies demonstrably address specific SDGs, and are structured so that they can attract institutional money. Although investors talk much about their commitments to impact, we think it's safe to say that the latter criterion is by far the most important to them. Also, most SDGs describe problems in emerging economies, are addressed by small-scale programs, and don't yield much cash flow. Most institutional investors don't invest in emerging economies (too risky), in small scale projects (too much work to monitor), or in activities that have little or no cash flow (no return).

5. Think enlightened SDG investment.

This is where the "enlightened" part comes in—entrepreneurs and investors need a thoughtful and rational approach to getting institutional investors to put their money in SDG programs that actually solve problems. The field needs more investment vehicles that allow a coalition of parties to contribute. Some investors (such as governments) will give money away, others (such as insurance companies) will be happy with a low return, and still others (such as banks, pension funds) will accept more risk but demand a higher return. Some parties can underwrite the project to minimize or eliminate risks—for example, certain government agencies can provide guarantees or insurance cover, or can take the "first loss" of investments. Investments need to be structured to accommodate these different profiles.

There are good examples of this "blended finance" approach, and opportunity for many more if insurers, asset managers, pension funds, and banks put their best and brightest financial talent on these challenges. Efforts will require a proactive stance that seeks out partnerships with entrepreneurs, policymakers, and development banks. Investors also need be clear about what they want—for example, what kind of regulatory environment, infrastructure, and legal context will allow them to put their money in these investment vehicles.

Unfortunately, many of the people who have the investment expertise to work on these challenges are tied up behind their double screens and Bloomberg terminals, managing multi-billion-dollar mandates, or structuring private equity deals. They don't have anything related to SDGs in their job descriptions and are unknown, or not accessible to, the people who need their expertise. If the executives and trustees of the world's large asset owners and asset managers are serious about their commitment to the SDGs, they must tell their ESG and marketing people to hold off on the SDG stickers and the impact measurement programs, and tell their CIOs, portfolio managers, investment analysts, risk managers, and credit officers to spend time working on ways to fund the SDGs—including the 90 percent of them that have no financing today.

6. Measure impact.

Only then should the enlightened SDG investor think about how to measure the SDG impact of their invested dollars. That said, in many cases, true progress may not be attributable to individual companies or projects. So you may not be able to capture exactly what "your" SDG impact is—at least not today. Often we can measure the progress we make as a planet in solving these complex, systemic challenges—as Pinker has done—only many years after the fact, with painstaking scientific research.

Perhaps the biggest, measurable SDG impact asset owners and managers can have today is in doing what they do best: Hiring the best investment people and allowing them to apply their financial smarts to solving the world's greatest problems—and, in the meantime, make some good investments for their clients.