Goldman Sachs Exchanges

How AI, the energy transition, and the future of work are shaping impact investing

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Allison Nathan: Around the globe, more than $2 trillion dollars in assets are manage by sustainable investment equity strategies, which include ESG and impact investing. These often attempt to perform as well as, or even better, than their benchmarks, while also having a positive impact on the world. But is it actually possible to do both?

Brian Singer: Just because a company decides to invest more dollars towards sustainable goals, that's not automatically going to be appreciated by the investment community. The returns matter as well.

Allison Nathan: I'm Allison Nathan and this is Goldman Sachs Exchanges.

[MUSIC INTRO]

Today I'm sitting down with Goldman Sachs's Brian Singer, the global head of GS Sustain within Goldman Sachs Research. And Greg Shell, head of the inclusive growth strategy within Goldman Sachs Asset Management. Brian, Greg, welcome to the program.

Greg Shell: A pleasure.

Brian Singer: Thank you.

Allison Nathan: So, Brian, you've covered the natural resources sector at GS for more than two decades. For those who don't know, and Greg I'm not sure you know this, Brian and I actually started in the same GS analyst class many, many moons ago.

Brian Singer: Many moons.

Allison Nathan: And we worked closely together because I was in commodities in the first half of my career, commodities research. You were covering the oil and gas sectors. So, clearly, we had a lot of interaction, and we go way back. But you now lead the firm's research around sustainability and impact investing. So, what motivated you to shift into covering that space after covering traditional energy for so long?

Brian Singer: I loved covering energy. And I still like looking at the energy sector. The energy sector is going to play an important role in everyday life, and it's going to play an important role towards sustainable goals. The opportunity for learning and creating new lanes for sustainable investing and sustainable investors is really what attracted me to GS Sustain.

And then additionally, in some of the experiences that I had covering energy, it seemed often that there needed to be more conversations between various constituents important to energy development. Whether that was companies, investors, policymakers, other stakeholders. And so, I think really trying to put together thoughtful research on how we as a society can try to drive sufficient supply transition, affordability, reliability, and security, we think that's critical to achieving both environmental and social related sustainable goals.

Additionally, some of the frameworks that are important to energy, of looking at cyclical sectors but finding secular trends, that absolutely applies to sustainability as well. And so, we continue to have a lot of conversations about energy and the energy sector. And so, it's great being a part of both worlds.

Allison Nathan: And Greg, let me turn to you. I mentioned you run the inclusive growth strategy for Goldman Sachs Asset Management. But there are lots of styles of investing out there. So, when did you decide that sustainable and impact investing is what you wanted to focus on in your career?

Greg Shell: Yeah, thank you Allison. So, I have a unique background in the sense that I have been an investment professional for a really long time, more than 25 years now, and I'm a capitalist and I believe deeply in capitalism's ability to transform sectors and industries through innovation. It also, I think, has a proven track record at being able to deliver wealth and to left people out of poverty. I've always believed that. I still do.

At the same time, Allison, I have been really intimately familiar with all the ways that capitalism doesn't always get it quite right. And we see enormous disruptions in the economy that have delivered really uneven outcomes in the society that we live in, the likes of which are not just important to study and understand, but they've become actually self reinforcing. And that's not the way we want the economy to be run. We actually want the creative disruption that allows for equal opportunity, irrespective of their outcomes. That's actually not what we see today.

And so, there is a really significant part of my background that has been spent in the not for profit and civic world where I think you got to see the other side of the economy and deep pockets of need, intractable issues that aren't likely to get solved with the current methodologies.

And I, with respect to entering the impact investing ecosystem really used to say that this was the first time when I came to this ecosystem that the two sides of my brain have ever met each other. And so, I really have been able to marry what is real, intentional uses of private capital in all of its prerogatives to deliver solutions and innovation in pockets of the economy that vitally need it.

Allison Nathan: Well, I do want to get into that more. But before we do, I just kind of want to cut to the chase for a moment. And let me just ask the big question that I have, and I think a lot of people have, which is this idea that impact investing, to a lot of people it really feels like more of a branding or a marketing tool rather than anything real. Is there much more to it than that?

Greg Shell: Yeah, I'm happy to take that first. I'm going to follow you in there, Allison, and say that in many ways the purposeful act of using private capital to address a big challenge should be pretty intuitive. At the same time, impact investors have, at some level, been held back by any number of acronyms and branding and so on. I acknowledge that.

At the same time, I think that part of the conversation is probably best had in conferences and in the white paper crowd. When you look out the window and you observe what are the five or so most important trends where there's secular growth, big, enormous, addressable markets and real money to be made? They're going to feed back out things like technological disruption or AI. You're going to feed up decarbonization and energy transition. You're going to think about things like inequality. You're going to think about things like the future of work and the ability for much of our population, especially low and middle skilled laborers, to be able to hook onto the mainstream economy. And what you get are investment opportunities that are likely to be pretty opportune for a decade or more.

And that's what I like talking about. And if that label comes along with being thought of as one thing or another, I'm accepting of that. But I think that this is incredibly on trend for where investment capital is already going, irrespective of branding. And I think this will be, in the future, what good investing looks like to us and to everyone.

Allison Nathan: And so, all that said, I mean, when I still think about impact investing, I think about having a positive impact for the world. And, ultimately, that is a key part of the mission that you have described. But I think the key question is always, you know, does that come at some kind of compromise or sacrifice for returns from an investment perspective? You just said these trends that all investors are really trying to, I think, embrace are a key driver of impact investing. But again, is there any type of compromise from that perspective? Brian?

Brian Singer: Yeah. There should not be a compromise. There doesn't need to be a compromise. And in fact, when we look out there and we look more through the lens of public investing in opportunities, there are plenty of companies out there that have good return on capital, above average return on capital, that would meet various and advance various sustainable goals or have impact.

So, we very much prefer, and GS Sustain has long advised a concentric circles approach of let's look for companies that have good financial fundamentals. And then let's look for companies that fit the mold of a given sustainable or impact-oriented theme. And let's find who are the companies that are inside both circles.

Now, there are a lot of buzzwords within sustainable and impact investing, usually as it relates to themes. Net zero. Circular economy. Biodiversity. But when push comes to shove, we're talking about themes that we think transcend sustainable investing and, frankly, are part of normal investing or would apply to generalist investing as well.

Innovation. Efficiency. Resilience. Productivity. Those are, essentially, the same ideas that can advance these sustainable goals and, also, where we think you can find returns enhancing opportunities.

Allison Nathan: So, let's talk about those returns enhancing opportunities a little bit more. Greg, you mentioned that there are a lot of opportunities today. Give us some specific examples of what impact investors are focused on right now.

Greg Shell: Yeah, happy to. I think one of the big twin tenets that impact investors think about is the opportunity to deliver capital according to intentionality and additionality. And the idea is that it's a purposeful act to look for these opportunities, exactly as Brian has mentioned, to deliver innovation and productivity. And to really help blunt the effects that we know to be the case around many disruptive forces in the economy.

And once there, and this is where I think impact investors really do set a tone and establish a real leadership position, is that from there it's really about adding something to it. The capital is one part of the equation. But the ability to measure, for example, or to convene talent or any number of other ways that are both return enhancing, but they're also methods by which companies are supposed to be able to better and more effectively do the things that they want to do. There's actually a value-added kit. This is especially true in the private markets, Allison. But that additionality piece is really important to impact investors.

And really the theme here is that no economy can truly be truly sustainable if everybody doesn't find their way into it. So, we focus on three big industry verticals. Healthcare is one. We know for so many reasons why there's unequal access to care.

We think a lot about education and workforce development and the future of work. We live in time so crisis with respect to our public schools. Fixing that, obviously, makes our country and economy more competitive. We think a lot about how many people are either over reliant on the gig economy or are barely employable, don't have the skills to offer the economy, which as we're experiencing it, become much more about skilled labor when opportunities to participate, the kinds of growthy parts of the economy that are short the number of laborers that they need, like, it's deeply intuitive to me why that is not only a really good thing to do for the economy, but really commercial.

And the last thing is with respect to financial inclusion and allowing more people to participate in traditional products like retirement or savings or investment. But also, really delves into things like credit repair or earned wage access and removing real points of friction so that people can play the roles in the economy that they're capable of.

So, taken together, big market opportunities, really nice businesses almost all of them are service business, tech enabled, high margin, generate a lot of cash, that sounds like a pretty good investment formula to me. So, there's no reason to contemplate why doing that should make you invest at any less than a market rate of return. I actually think, Allison, that it's more true that it's the opposite. Which is, this is actually more opportune and a really nice place to be if you're focused on and have the right tools to add value to the companies you want to support.

Allison Nathan: So, just to be perfectly clear on the nuts and bolts. Your investment strategy focuses on companies, mostly private companies, aligned with those strategies you just talked about?

Greg Shell: Yeah. So, this would be mostly a buyout-oriented strategy where we'll do control deals, Allison, with some of what we do will be growth equity investing. So, all private capital. Really writing $50 to 150 million equity checks along the meridian of those key themes that I mentioned, and really working hard to try to accelerate the businesses to help them deliver more solutions, more innovation, and frankly, more scale as they go about addressing some of these big challenges that we're going after.

Allison Nathan: And so, when we put this altogether, how do we really evaluate, Brian, the success of these types of investments or, Greg, your type of fund? Is it measured just in returns like any other investment? Or is there something that captures that intangible positive that they are providing to society?

Brian Singer: Sure. So, there are probably some bottoms up ways and top-down ways where we can look at this. First, we can try to group companies into who are the companies that are adopters versus who are the companies that are enablers? The companies that are enablers are really helping with their products. Others downstream are customers or individuals to try to accomplish sustainable goals through their products.

The adopters are the ones that are trying to do it for themselves. For the enablers, it's often more easily measured through a combination of earnings and then what is the product helping to enable? So, if it's something that is helping to avoid emissions, we can try to measure what that is. But that there's at least a revenue stream. And that can translate to an earnings stream or a return on capital stream.

For those that are more of the adopters, then oftentimes if it's not a business, there needs to be some other metric to look at. Is the company reducing its own emissions intensity? Is it something where they're doing something on the social side where their human capital type metrics are improving? Is there a water or other consumption efficiently improvement that is being seen at the corporate level where one can measure that impact? And I think those are ways of trying to do it on more of an individual basis.

From a top-down basis, there is a lot of capital that needs to be invested towards goals like decarbonization infrastructure, clean water. We estimate about $6 trillion annually is needed, which would be about a $2.8 trillion run rate increase from the annual run rate in 2015 to 2020.

We can try to measure based on trends in corporate, capex, and R&D, as well as estimates for what that green mix shift is, how much of that's on track? I mean, we can see that the private sector, A, is making a significant increase in those investments while, B, it doesn't actually look like we're entirely on track when we add it all up. But we can also look at where there's spare capacity. Where can the private sector actually be doing more? Where could publicly traded companies be doing more based on their free cash flow and balance sheet capacity? We actually think there's about $700 billion of spare capacity for additional green investment that public companies could be making.

But going back to the points that we were talking about earlier and that Greg was mentioning, just because a company decides to invest more dollars towards sustainable goals, that's not automatically going to be appreciated by the investment community. The returns matter as well. And so, there's, I think, a burden, both in terms of having capital and access to capital, and also demonstrating that this is something that is not only impactful in the ways you're asking, but it can also be enhancing from a return perspective.

Allison Nathan: It sounds to me like the industry is feeling its way through really understanding how to measure returns in this space. Does that seem right to you? And if that's really the case, are investors grappling with that? Or have they embraced that at this point, that uncertainty in terms of measurement?

Brian Singer: So, on our end, we have gotten a lot more questions over the last six months on the linkages to stock performance among various sustainable strategies. And I think that makes sense in the context of some of the volatility that we've seen in broader markets and some of the uncertainty from an interest rate and geopolitics perspective.

We think that it's super healthy. We think there's a move by investors to really focus on metrics that matter in terms of how to look at companies and how to measure that impact on fusing the financial fundamentals as we talked about and with sustainable metrics. And we think it'll actually end up putting sustainable investing in a better place.

Allison Nathan: And so, Greg, if we take a step back and think about these impact investments and these ESG investments and the role that they play in investors' portfolios, how do you define that role? And is it differentiated from other asset classes?

Greg Shell: Yeah, Allison, I love this question because as somebody who deeply appreciates how challenging it is to deliver premium returns to investors, it's just an important question for us all to address.

It is exactly what you would want it to be, which is a specialized investment thesis designed to produce premium returns and find its way into diversified portfolios as a source of alpha.

I think today what's interesting is that you can buy cheap beta across asset classes and then have your opportunities to carve out really interesting managers who are delivering real expertise based on the kinds of markets that they cover. There are companies that are behaving in ways that are uniquely, you know, accessible to investors who think and act and have built a fund around the ability to support companies who are doing some key things out in the economy.

When all those things come together, premium returns aren't just possible, but they actually become more probable for your ability to have built that than if you didn't.

Allison Nathan: But correct me if I'm wrong, impact investing doesn't have a long track record. When you mentioned the diversification benefits, for example, is that what we actually see, is diversification benefits coming from impact investing funds? Or do we have enough data to make the determination at this point?

Greg Shell: You know what's fascinating about your question, the length of the track record or the depth of the data set has not stopped people from drawing a whole, you know, bunch of conclusions. I think the data set is robust enough to say that following: there is no reason to believe that in sort of a priori impact investors are delivering a concessionary return. I think we know that is not what the empirical evidence teaches us.

I think it's also true that the big secular growth trends that we think matter most are well represented. And Brian covered some of them with respect to energy transition, whether it's zero economy or waste or recycling or biodiversity or food safety or food waste. These are really big, interesting markets to go after. So, there is an investment response to that. So, I think we can say those things with deep clarity.

But you're not wrong. We will need many years and funds worth of additional data to make stronger inferences than that. The idea that data is all that matters is an intriguing concept because if that were true, there'd be some different parts of sentiment and point of view around this. And the resistance that we've seen is quite separate from the data that we see. So, longer track record, more tenure needed, but encouraging results so far.

Allison Nathan: So, last question for both of you. If we sit down again in 20 years and look back on this conversation, what will have changed? Do you think impact investing will be seen as it is today, as this separate track, another way to think about how we make our investments? Or will it just be part of the process we go through, the natural process, before we make a fundamental investment? Brian, you first.

Brian Singer: I think it will still be a very important part of the overall investment process because when looking at any company in any space, it is what is the value of their product? What is the long-term value of the product? What is the impact on the near-term in terms of returns? And so, we think impact is going to continue to play a major role.

Also, there are a lot of sustainable goals that are out there. And that's going to require a lot of capital. And frankly, one of the areas I think that is more front and center right now is what are the implications if we actually have insufficient amounts of capital that are invested? The fact that we actually are not awash in green capex actually becomes more of an opportunity because if we were seeing too much, then we would be over supplied. And we're not. So, there's a little bit of a glass half empty/glass half full way of looking at this.

The investment opportunities actually remain robust because we're actually not over supplied with green capex. But that still will leave a lot of opportunity for investment down the road.

Allison Nathan: Greg, how do you think things evolve from here?

Greg Shell: What I would anticipate, Allison, is that in the future I would like to believe that the impact investors would have helped catalyze some key questions, including what is the proper role of business in society? And I think we would also be credited, I hope, with pointing out that, hey, we've lived really over the last 15 or so years, certainly since the financial crisis, in an era of stimulus. And one of the reasons why is because the real economy continues to suffer from some real points of real decay.

I think we have witnessed, really, a full breakdown of social mobility where a person's life chances can be easily predicted by the zip code that they're born in. Capitalism's not supposed to work like that. It's not supposed to be self reinforcing. And I know to a lot of people who are, maybe not as deeply steeped in some of the points of view as maybe I or other impact investors would be, but I would actually say it's us who are sounding the rallying call for the power of the private sector in its ability to deliver solutions. And it's supposed to be dynamic, right? We've not seen that in the deepest parts of the economy.

So, as a friend of mine and former colleague has said, and I like to use this, but I do attribute it to him, impact investing is where capitalists go to fix capitalism. And when I first heard that, it really rang true to me. And first, in order to deliver real solutions, you've got to have a sensibility that something's not quite right. And in some places, it's even broken. And so, that's what this is all about. It is an opportunity to deliver premium returns by seeking out big parts of the economy that really need some adjusting. And when you have that going for you, really good things are possible, both for the kinds of impact and aftereffects that you hope to have, but especially the commercial rates of return that you can drive with that as your guiding light.

Allison Nathan: Thank you so much, Greg and Brian, for a fascinating conversation. What I took from this is we need to unleash the private sector on our biggest problems. But there are returns to help make that happen to motivate that and also do something good for society along the way.

Greg Shell: That's wonderfully said.

Brian Singer: Yeah, absolutely.

Greg Shell: Thanks for having us.

Brian Singer: Thank you.

Allison Nathan: This episode of Goldman Sachs Exchanges was recorded on Tuesday, April 16th, 2024. I'm your host, Allison Nathan.

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