WORLD ECONOMIC FORUM

Sustainability will require more trust in markets, not less

It's time for a more robust impact investment marketplace.

20 Sep 2018

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This article is part of the **Sustainable Development Impact Summit**

Emerging markets, by some measures, are setting the pace for improving global sustainability. Long the laggards, poor nations are turning heads.

This year, for example, renewable energy capacity across the developing world is set to exceed that of the developed nations. Installed wind capacity in emerging markets is estimated to reach 51% of global capacity, according to the credit ratings agency Moody's; solar is expected to reach 53%. From artificial intelligence in China to water management in India, one can find emerging market leadership in several sectors. Financial inclusion, a core component of economic mobility, is advancing rapidly across Asia and Africa, which is now home to more than half the world's mobile money systems. The "leapfrog" phenomenon – wherein nations skip over legacy technology and adopt state-of-the-art systems – is not only pervasive, it is happening with blinding speed.

Still, all is not well. Entrenched poverty, rising inequality, climate change, stressed natural resources and high levels of public debt portend a long stretch of challenging times. The aggregate amount of debt in the global economy – including governments, businesses and households – has reached the astronomical sum of $247 trillion, according to estimates by the Institute for International Finance. Since 2003, debt as a share of global GDP has risen from 248% to 318%. With such a mountain of debt to shoulder, who will be able to pay for preserving or rehabilitating public goods such as freshwater?

Image: SGX

Intangible factors critical to solving world problems are sobering, too. Public confidence in large public institutions is shaky, especially in developing nations. Populist assaults on elites and institutions have proven remarkably effective in Europe and Latin America. In America, only 18% of people now trust the federal government to do what is right most of the time, and one can see the same trend in other countries.

Crushing debt and abysmally low levels of trust are unsustainable, and they show every sign of making global sustainability harder to achieve. Some legacies cannot be leapfrogged.

The way forward

We need to bring those parts of society that retain the public trust to the forefront of sustainability efforts – e.g., smaller businesses (corporate and financial), non-governmental organizations, scientists and the military. Trust in governments, institutions and the media will return over the coming decades, but today's sustainability challenges are too pressing to wait.

If public sources of capital may be increasingly depleted, we should look for more ways to mobilize private investment. Institutional investors, such as endowments, pension funds and foundations, as well as allocators of capital such as private equity funds and venture capital funds, are increasingly working to invest in sustainability. This is the gist of the growing "billions to trillions" movement in the development community. One of the biggest challenges such investors face collectively is the lack of information about the returns and volatility of "ESG" and impact investments. Such investments are often smaller and more heterogeneous than their Old Economy counterparts. This makes investing large pools of capital difficult.

A possible solution might be the launch of a more robust impact investment marketplace that includes the same high-quality research investors have come to expect. A marketplace with targeted opportunities that match the priorities and missions of sophisticated investors would not only bring new capital to the table, it would make smart business sense. As information gaps are filled, and impact investments are subject to more return-seeking rigour, projects, funds and direct investments alike will become investable for both institutions and small investors.

One need not be overly prescriptive at this early stage. Experimentation with numerous approaches will be needed. For example, a growing number of researchers are hard at work on promising ways to rate impact investments. An online clearing house to list and sort different types of impact investing opportunities might help. Development finance institutions could do more to syndicate loans that qualify as impact investments, fostering a secondary market. Over the horizon, one could envision exchange-traded funds comprised of impact investment securities. The bottom line is that it is time to begin investing in market structures as well as impact enterprises.

In addition to a sustained focus on impact and measurements, the next and most consequential leap in impact funding will arrive through advanced financial measurement and portfolio construction. A marketplace that focuses on both financial and impact measurement will take meaningful cooperation across organizations and asset classes. Cooperation of this sort could help unlock those trillions in capital now effectively sidelined in the push for sustainability.

Advanced risk management, which helps protect against catastrophic losses and setbacks in public trust, should be an increasing part of the impact investing equation. Impact investments should have access to the full array of instruments that limit and distribute risk – political risk insurance, partial credit guarantees, currency swaps, securitization of portfolio flows, etc – that conventional assets enjoy.

High levels of debt and patchy support for some public institutions may make the path ahead more challenging. But they should not be allowed to stymie momentum towards sustainability. There is enormous potential for innovation and progress with the tools we have in hand.

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