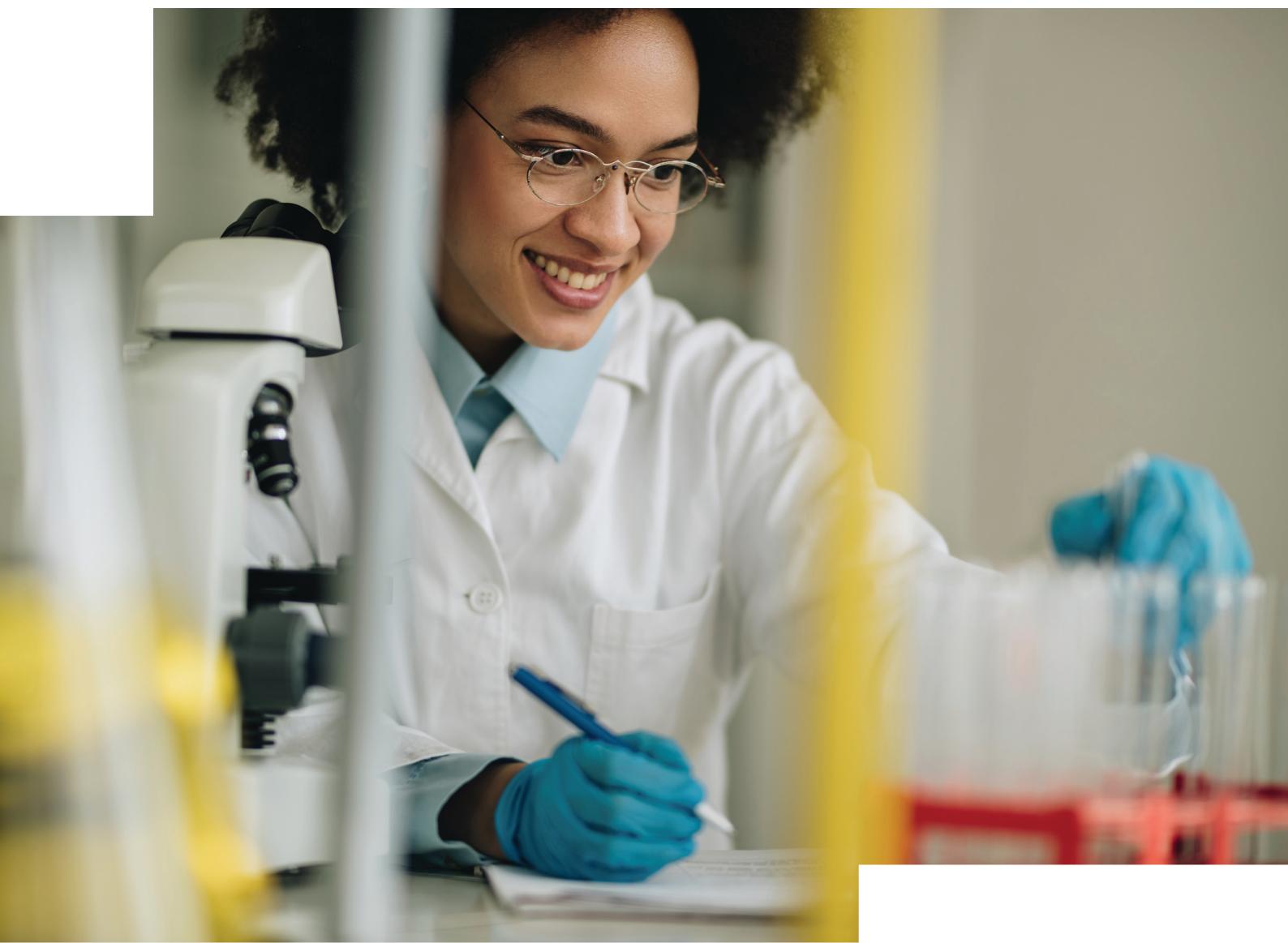


From ESG to the SDGs: The shift from process and policies to delivering positive contribution.



From ESG to the SDGs: The shift from process and policies to delivering a positive contribution.

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Foreword



We believe that business can be an essential driver of sustainable development and human prosperity. Over recent decades, the role of business has shifted from a focus on purely maximizing shareholder value to taking into account the sustainability of a company's operations, for example, whether a company is producing products in an environmentally friendly way, treating its workers well, and engaging positively with local communities. The management of environmental, social and governance (ESG) issues has moved from a niche area that sat in the compliance or CSR departments of companies to a core strategic priority embedded throughout organizations.

This shift has been backed by evidence that sustainability considerations are becoming material to companies' success, and those that manage ESG issues well are better placed to prosper financially, particularly over the long term.

More recently, we have seen a further evolution. Companies are not only focusing on the sustainability of their ESG and operational processes and policies, but are increasingly exploring the positive impact of their products on society, and the degree to which these products are directly helping achieve societal objectives. This was catalyzed in a large part by the launch of the United Nations Sustainable Development Goals (SDGs) in 2015, and the broad recognition that companies have an important role to play in delivering solutions to the world's problems.

As we see more purpose-driven companies shift from a focus on *how* they produce their products to *what* products they produce, for *whom* they are produced, and whether they are *positively contributing* to society, investors are seeking exposure to those companies that are demonstrating this transition. They want to align their portfolios with impactful companies and seek investment returns from fast-growing SDG-aligned themes, such as education technology, financial inclusion, green technology or healthcare.

While ESG data focused on processes and policies has been getting significantly more robust over the past two decades, measuring and evaluating the impact of a company's products on the world is difficult, good data is only starting to emerge. As companies, investors, customers and other stakeholders increasingly focus on the positive contribution that business can make on society, these metrics should improve, offering a clearer lens into which companies are delivering the solutions we need to achieve the SDGs.

This paper is the first in a series of reports looking at developments in the sustainable and impact investing sector. It focuses on the shift from a focus on ESG processes and policies within companies to the impact of a company's products, their contribution to solving the world's most pressing problems, how we can evaluate that impact, and how investors can gain exposure to these themes.

A handwritten signature in black ink, appearing to read "Marisa Drew".

Marisa Drew
CEO, Impact Advisory and Finance Department
Credit Suisse

“Over recent decades, the role of business has shifted from a focus on purely maximizing shareholder value to taking into account the sustainability of a company’s operations.

Credit Suisse's approach to sustainable investing

At Credit Suisse, we see sustainable investing as a spectrum that covers a variety of investment strategies and approaches. The Impact Advisory and Finance (IAF) Department aims to deliver solutions ranging from ESG strategies or exclusions and integration, through to thematic/impact-aligned and impact investing - all seeking to 'generate returns sustainably', and focused on market rate of return for the given opportunity. In this paper, we delve deeper into the thematic and impact aligned section of this spectrum.



| Traditional investments | Exclusion | ESG integration | Credit Suisse's sustainable and impact investment focus | | Philanthropy | | | | |
|---|-----------|--|---|--|--------------|--|--|--|--|
| | | | Thematic & impact aligned | Impact investing | | | | | |
| | | | | Return first | | | | | |
| Delivering competitive financial returns | | | | | | | | | |
| Mitigating environmental, social and governance (ESG) risks | | | | | | | | | |
| Pursuing environmental, social and governance (ESG) opportunities | | | | | | | | | |
| Focusing on measurable high-impact solutions | | | | | | | | | |
| <ul style="list-style-type: none"> ▪ Limited or no consideration for environmental, social or governance aspects in the investment approach | | <ul style="list-style-type: none"> ▪ Systematic avoidance of exposure to controversial business areas or unethical behaviour ▪ Norm-based exclusions ▪ Values-based exclusions ▪ Country exclusions (sanctions) ▪ Exclusions based on business conduct (UN Global Compact breaches) | | <ul style="list-style-type: none"> ▪ Consideration of financially material ESG risks and opportunities ▪ Based on industry-specific sustainability expertise ▪ Reflects the Credit Suisse house view on ESG topics ▪ ESG integration in investment processes in combination with financial analysis ▪ Approach adapted to asset class, product characteristics and investment objective | | | | | |
| <ul style="list-style-type: none"> ▪ Participation in sustainable growth themes ▪ Contribution to the Sustainable Development Goals (SDG) ▪ Alignment of investor and enterprise mission to generate impact ▪ Address societal challenges that generate competitive financial returns | | <ul style="list-style-type: none"> ▪ Impact investing fully compliant with the IFC Principles ▪ Clear and direct investor contribution to the impact of the enterprises via financing growth or active ownership ▪ May include models where the risk and return to investors may be blended i.e. catalytic capital to crowd in for profit investors | | <ul style="list-style-type: none"> ▪ Address societal challenges that do not ask to generate a financial return | | | | | |

Our commitment to the SDGs

Credit Suisse and the Sustainable Development Goals¹

SUSTAINABLE DEVELOPMENT GOALS



The 17 Sustainable Development Goals (SDGs) adopted by the United Nations in 2015 form a core element of the UN Agenda 2030 for Sustainable Development. As the SDGs are based on a participatory process, responsibility for achieving them is shared among states, the private sector, the scientific community and civil society. Credit Suisse contributes to the realization of the SDGs in various ways, including in our role as steward of clients' capital, as a global citizen, and as a principled employer.

We deliver this ambition through such activities as sustainable, impact and SDG-oriented thematic investment products and services, and through our philanthropic activities targeting education and financial inclusion. At the same time, our focus on sustainability risk management can help us to reduce potential negative impacts that certain business activities might have on the realization of the SDGs.

1. Source: UN Sustainable Development Goals

“ Our focus on sustainability risk management can help us to reduce potential negative impacts that certain business activities might have.

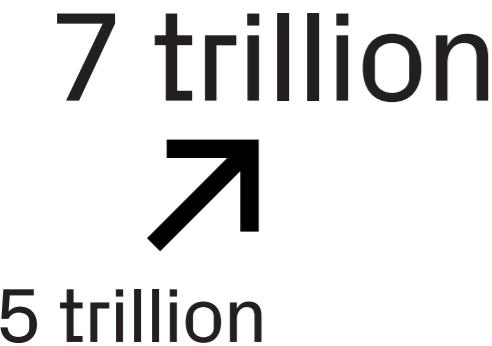


From an ESG to an SDG lens

This publication is the first in a series of reports produced by Credit Suisse exploring developments in sustainable investing. Here we focus on the shift in recent years from ESG processes of companies, to a focus on products and how they can help solve humanity's problems.

In our spectrum of sustainable investing, the focus of this paper is on the shift from ESG exclusion and integration-only approaches towards the inclusion of thematic and impact-aligned approaches with investors' portfolios.

Achieving the goals



Estimated investment required in USD per year until 2030.

The rise of ESG investing

Sustainable investing – broadly defined – has a long history, and has evolved considerably in recent decades. The movement started with exclusions, when investors simply screened out sectors that they deemed "unethical" or inconsistent with their values. Typical exclusions include companies involved in producing tobacco, controversial weapons, adult entertainment and those companies whose conduct would breach UN norms.

Then in the mid-2000s, as companies recognized the importance of corporate sustainability, the investment focus also shifted from a purely ethical screening approach towards the integration of environmental, social and governance (ESG) factors into investment processes *for the purpose of delivering superior risk-adjusted returns*.

The ESG movement was catalyzed in part by the launch of the UN Principles for Responsible Investment (UN PRI) in 2006. These strategies focus on how risk and opportunity around environmental issues, human capital, human rights, supply chain management, corporate governance and other issues can be material to the financial prospects of companies, and should therefore be taken into account in investment processes. The sustainable investing assets under management grew strongly, as mainstream asset managers jumped on board the ESG integration train.

ESG integration focused primarily on assessing the ESG policies and processes of companies in order to evaluate the companies best managing these issues, and which issues were material to the financial prospects of the company, then overweighting or underweighting the companies accordingly.

An entire ESG research industry developed, with thousands of ESG analysts collecting and analysing sustainability data connected to a company's environmental footprint, its policies and practices in how it treats its workers and how it relates to local communities. While this ESG data includes some metrics on the company's products, it has been a small percentage of the overall dataset, and it did not assess the actual impact of these products on the ground. It is fair to say that until recently, the sustainable investing industry focused on identifying and investing in companies that *produced goods and services in a responsible way*. However, it was less concerned about what was produced (with the exception of those sectors, such as weapons and tobacco, that were explicitly excluded), and the societal impact or contribution of these goods and services.

The launch of the SDGs and the focus on solutions

With the launch of the United Nations SDGs in 2015, this started to change. Endorsed by 193 countries, the SDGs address topics including poverty, hunger, health, education, climate change, gender equality, water, sanitation, energy, environment and social justice. Achieving the goals requires an estimated investment of USD 5 trillion to USD 7 trillion per year until 2030. For every year that passes, the investment needed to fulfil these goals increases, highlighting the urgency of mobilizing capital.

Since 2015, an increasing number of companies are explicitly and proactively addressing SDGs through innovative products, and reporting on these efforts. Investors too are using the SDGs as a reference point to align investments and impact goals and are working with investee companies to measure the impact of their products. This has not only added an additional layer of analysis on top of the traditional exclusion and ESG integration data sets, it has also led to the creation of a suite of additional attractive investment opportunities that are 'impact-aligned' to the SDGs.

Outotec OYJ – Enhancing sustainable use of natural resources

Every year we produce 2 billion tonnes of waste. Outotec OYJ is a provider of technologies and services for the sustainable use of natural resources, including industrial water treatment and waste to energy projects. The company is included in the Global 100 Index as the 12th most sustainable company in the world.²

The company's waste-to-energy solutions avoided around 6.2 million tonnes of CO₂ per year. This can be valued at EUR 96m according to the company who based its valuation on the CO₂ European Emission Allowances Commodity Price of 15.46 EUR/tonne of CO₂, representing more than a tenth of the company's market cap.³ The company also offers solutions to large industrial and municipal clients that can dramatically reduce water usage in industrial processes, increase renewable energy production and cut CO₂ emissions.

Outotec's products generate clear positive impact and contribute to SDGs 6 (Clean Water and Sanitation), 7 (Affordable and Clean Energy) and 13 (Climate Action). It is an example of a company that is directly contributing to solving one of our greatest environmental challenges.

For illustrative purposes only.

2. <https://www.outotec.com/company/media/news/2019/outotec-ranked-the-12th-in-the-global-100-list-of-most-sustainable-companies/>

3. https://www.outotec.com/globalassets/sustainability-report/2018/outotec_sr_2018.pdf

Evaluating a company's contribution to the SDGs

Assessing a company's contribution to the SDGs is not easy. The Impact Management Project (IMP)⁴ is a forum for building global consensus on how to measure and manage impact, and has developed a framework that helps to define and evaluate impact at the company level, considering 'What', 'Who', 'How much', 'Contribution' and 'Risk'. The IMP poses a number of questions to be considered when evaluating the impact of a company.

What

How does the company expect to generate positive outcomes for people and the planet? How relevant are the targeted SDGs in a given geography or sector and are they important priorities? In a country with water scarcity, for example, a company offering innovative solutions to save water is highly relevant to the place where it operates.

Who

Who are the stakeholders to benefit from the positive outcome? How underserved are they in relation to the product or service offered?

Beneficiary group: Is the beneficiary group underserved vis-à-vis the solution that the company is offering? "Underserved" can refer to social or demographic groups or underserved environmental challenges, ecosystems and endangered species that warrant investment by investors.

Underserved needs: How appropriate and essential are products and services to the beneficiary group? How do they provide a solution to important problems and meet SDGs? Impact-focused investors differentiate essential goods and services such as access to education, financial services, energy and healthcare and job creation, from activities likely to involve discretionary spending.

How much

What is the magnitude of the expected SDG-aligned outcomes? We explore:

Scale: This relates to the potential number of people benefiting from the product or services, or the potential scale of the environmental benefits. Can the company potentially disrupt an entire industry and make a sector-wide positive change? Is it a "lifestyle business" that may make a significant difference per dollar of revenue, but is unlikely to scale to any significant degree?

Depth: What about the beneficiary group's experience? Is it deep or marginal? Innovative and disruptive technologies can affect how supply chains operate and make a positive SDG contribution across the sector.

Duration: How long will the positive impact last? Will it endure or be short-lived? For example, the change from enhancing access to education for underserved communities could last for generations.

4. <https://impactmanagementproject.com/about/>

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The Impact Management Project is a framework that helps to define and evaluate impact at the company level.

Contribution

Do the company's efforts lead to better outcomes than would otherwise have occurred? Contribution to the SDGs and a positive impact measures the *additionality* that we can attribute to the company's activities.

There is no easy way to evaluate outcomes in "what if" scenarios, but there are indicators that can point to the value-add or additionality that a company might deliver:

▪ **Peer analysis:** Consider the competitive landscape - how many other businesses are looking to provide solutions to the same problem in the same market? The greater the number of participants in a market, the smaller contribution each new company makes in achieving an overall outcome.

▪ **Investment gap:** There may be situations where even if a company has no unique selling point, the market overall is underserved and needs more participants and capacity. The larger the investment gap, the clearer the additionality for new entrants into the market.

5. The more granular version – the "logic model" – maps out the chain of events from the original inputs to the final impact on the ground: Inputs -> Activities -> Outputs -> Outcomes -> Impact

Risk

What can go wrong, and what could be unintended negative effects of delivering the expected SDG contribution?

▪ **Risk of not meeting impact targets:** This includes normal business risks, questions around product efficacy, and the validity of a company's theory of change. Diversified businesses may also drift away from activities that contribute to global SDGs, focusing instead on businesses deemed more profitable or less risky.

▪ **ESG risks:** Identifying ESG risks ensures that portfolio companies are managing these issues and not negating a positive SDG contribution. These risks need to be identified at the outset and periodically monitored throughout the investment period and when incidents occur.

Other important factors that need to be considered when assessing a company's strategy to deliver a positive and impactful contribution to the SDGs:

▪ **Theory of change:** Companies should have a clear theory of change: the challenge the company is seeking to address, how change happens, how the transition develops and evidence to support the strategy in terms of delivering the expected contribution.⁵

▪ **Intentionality:** Intentionality is a key part of the definition of a company strategy to deliver impact developed by the Global Impact Investing Network (GIIN) in 2007. This is an important indicator of the likelihood of delivering positive change. Intentionality provides confidence to investors that management will maintain a commitment to generating change, which decreases the risk of the company drifting off its mission and ensures that the company is producing goods and services in an ethical and responsible way. Without intentionality, it will also be less likely that outcomes are tracked, monitored and reported.

▪ **Team capabilities and governance of impact:** In order to execute an impact strategy, a company needs the capabilities and team to deliver. Does the team have the right experience? Does it have the robust governance to support and enhance the corporate change goals?

How to measure and report company impact?



Companies require management and measurement systems in order to set key performance indicators (KPIs), and monitor and report on their achievement of positive contribution towards the SDGs. Most companies report sustainability metrics annually, though a minority of companies are reporting the types of impact data that allow a robust comparison of SDG outcomes from their products.

Investors need to assess the company's framework and how robust it is, and whether the SDG KPIs and associated metrics are independently verified and based on widely recognized frameworks such as IRIS+⁶ and GRI⁷. Given the SDG-focused metrics are still relatively new, it is important that investors engage with companies to encourage high quality reporting on these metrics.

6. Impact Reporting and Investment Standards (IRIS) is a widely used catalogue of impact metrics covering over 500 metrics across industries. Over 5,000 organizations are using IRIS metrics to evaluate, communicate and manage their social and environmental performance. <https://iris.thegiin.org>

7. The Global Reporting Initiative (GRI) produces sustainability and ESG reporting standards for companies. It is one of the most widely used in the world.

Investing into the SDGs

Investors are investing into the SDGs through public and private markets. As discussed in the beginning of this publication, we differentiate between *thematic and impact-aligned investing*, which is conducted primarily in public markets; and *impact investing*, a private market activity, where investors are directly financing the growth of companies. We will explore impact investing more deeply in future publications.

This section focuses on public market strategies offering exposure to companies that contribute directly to addressing the SDGs. It includes both traditional thematic funds and the newer impact-aligned funds. Both offer clients exposure to particular themes, such as water, renewable energy or healthcare. The newer breed of impact-aligned funds are more explicitly orienting their strategies towards the SDGs and placing their strategies in the context of solving the world's problems. They also typically require that the companies report explicitly on the contribution they are making to the SDGs through their products and services.



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The newer breed of impact-aligned funds are more explicitly orienting their strategies towards the SDGs.

Conclusion

The rise of SDG-aligned equity strategies

We spoke with
Christian Schmid, Director,
Credit Suisse

Q. What emerging trends are you seeing in the fund management industry regarding impact-focused funds in listed equities?

Overall, we see a big shift towards listed equity products, which consider ESG factors across the entire investment process. We also have many requests for listed equity solutions that go beyond ESG reporting to an SDG-aligned focus. From our experience, next generation investors mainly drive this trend, together with the recognition that companies that are delivering solutions to problems are well positioned to succeed financially. I think it is the fund industry's responsibility to create new products that deliver solutions to investors' changing requirements and innovative solutions offering more than just financial performance.

Q. What makes these strategies different from ESG or traditional thematic funds?

Generally speaking, SDG or impact-aligned listed equity strategies add a layer of analysis on top of ESG strategies. They also include a positive contribution to the SDGs through the products and services a company offers. Where exclusion strategies mainly exclude certain segments on values-based criteria, and ESG integration strategies look to leverage material ESG factors for better risk/return, SDG-aligned strategies specifically look for potentially impact-generating characteristics (products, services, business strategies, etc.) within companies. When comparing the traditional thematic funds to impact-focused strategies, traditional thematic funds are focused on simply giving the investor specific exposure to a certain industry or theme. Impact-focused strategies invest in companies that are explicitly delivering contribution to the SDGs through their products and services, and can fulfil the five dimensions of the IMP.

Q. What additional skills or capabilities does a fund manager need in order to run a strategy such as this?

Since impact-focused companies can be found in several different sectors and across themes, a fund manager needs a broad based background across regions, sectors and market cap buckets. On top of broad-based investment experience, the key attribute of a fund manager for impact-focused funds is an ability to consolidate several concepts into a solidly-constructed portfolio of attractive investment opportunities. This is critical to ensure investments into impact-focused companies are also profitable. More importantly, the fund manager should have immediate access to specialist knowhow, whether on the financial or impact side, and operate in a focused and supportive team environment.

Q. How easy is it to find these impact companies?

Not easy! So far, there is very little structured data available which would facilitate finding impact-aligned investments in a quantitative way. This makes discovering impact companies mainly a qualitative and time-consuming process. Unlike in traditional thematic products that usually focus on narrow sectors, the promising impact-focused companies are often hidden in a multitude of themes, sectors and geographies, and across the value-chain.

Q. What is the investment case for investing in impact companies?

Impact companies offer solutions to the world's challenges by providing new products, services, approaches or technologies. Where there is a challenge, be it environmental or social, there is a high likelihood that demand will create a market. For new markets and business opportunities to grow around specific challenges, a catalyst is required. These triggers can be changes in societal values, crises such as the Coronavirus situation, or longer-term issues, such as climate change. Companies focused on generating impact are, by necessity, working to solve problems that people want solved, and we believe this is one of the key ways to deliver strong financial returns over the long term.

The sustainable investment movement has evolved tremendously in recent decades. It has gone from simple exclusions, to ESG integration focused on companies that manage ESG issues well. More recently, it has added a lens focused on investing into companies whose products are contributing directly to addressing the SDGs.

While this latest incarnation remains in its early stages, the data required to assess companies' contribution to the SDGs is improving fast. An increasing number of companies are now making efforts to measure and report on the concrete impact their products are making on the ground, and investors are beginning to build strategies to gain exposure to these companies.

It is important to note that these strategies do not look at the impact of these companies in isolation – these companies most often are focused on a market gap resulting from an environmental or social problem that needs to be solved, and people are willing to pay to solve it. Many fast-growing sectors are also high-impact themes, such as education technology, access to finance in developing countries, sustainable food and agriculture and the new generation of low carbon technologies. These companies are not only solving problems and contributing directly to the SDGs, they are also building business models around these solutions that are amongst the fastest-growing areas in the economy.

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It is important to note that these strategies do not look at the impact of these companies in isolation.



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