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Financing the Energy Transition | Episode 4
John Goldstein, Head of the Sustainable Finance Group, Goldman Sachs

We continue our Financing the Energy Transition series by welcoming John Goldstein back into the SmarterMarkets™ studio. John is Head of the Sustainable Finance Group at Goldman Sachs. SmarterMarkets™ host David Greely sits down with John to discuss how ESG and impact investing has evolved over the past two years and where we need to be doing the hard work right now to finance the energy transition.

John Goldstein (00s):
Years ago, my big rant was around the fear, not of greenwashing, but of what I call checklist washing. People earnestly trying to solve for what they've been told they're supposed to solve for, which is there's a label, let's solve for it. And I think people trying to do a really good job of that. But I think a gravitational core of a thesis is a lot stronger way to run a business or create a financial product. And so I think the one issue I always get concerned about is: focusing too much on labels I think can get people too focused on labels versus sort of what are you doing?

Announcer (31s):
Welcome to SmarterMarkets, a weekly podcast featuring the icons and entrepreneurs of technology, commodities, and finance, ranting on the inadequacies of our systems and riffing on ideas for how to solve them. Together we examine the questions, are we facing a crisis of information or a crisis of trusts and will building smarter markets be the antidote?

David Greely (55s):
Welcome back to financing the energy transition on SmarterMarkets. I'm Dave Greely, Chief Economist at Abaxx Technologies. Our guest today is John Goldstein, Head of the Sustainable Finance Group at Goldman Sachs. We'll be catching up on how ESG and impact investing has evolved over the past two years, and where we need to be doing the hard work now to finance the energy transition. Hello, John. Welcome back to SmarterMarkets.

John Goldstein (01m 22s):
Hey Dave, thanks for having me.

David Greely (01m 24s):
So glad you're here. I mean, you were last here on SmarterMarkets, I think a little less than two years ago, but a whole lot has happened since then. So I'd like to start off today just catching up with you and getting your perspective on how that whole field of sustainable finance has evolved over the past two years and, you know, where are we now?

John Goldstein (01m 44s):
Yeah, I mean, I think, look, when we chatted last, I think we were just coming through, what I always talk about is the COVID stress test for the field, right. So to kind of go back and put this in context, you know, 2019 we saw growth, enthusiasm, excitement about the field. You know, 73 billion of equity fund flows, 2020 COVID hit and I think one of the big questions surrounding the field for a long time had been, you know, can it take a punch, right. Is this a bull market phenomenon and it did, right. Performance held in and was worded with flows, and we got 241 billion in equity fund flows in 2020. That kind of set us off to the races in 2021, right, 392 billion of equity fund flows. You got to the point where 35% to 40% of equity fund flows were into ESG or sustainability.

John Goldstein (02m 34s):
I like to say 2021 was the year of net zero everything, right, you got to the point where $60 trillion of AUM were with asset managers, with net zero asset manager commitments. You add between 10 and 15 trillion with asset owners, with net zero asset owner commitments. You had banking assets representing about 40% of global banking assets under net zero banking commitments. You had had companies, you know, all over the globe, you had countries and so big capital flows, a lot of enthusiasm, growth in markets, and now 2022 has come, right and I think it's the year when people realize the arrows don't always go up and to the right markets are

not easy things and macro matters, right, and I think against that backdrop, it's a very interesting moment for the field and I think, you know, some people, you know, it's become a very noisy time.

John Goldstein (03m 30s):
I like to call it the era of ESG hot takes and I think interestingly, these opinions aren't always consistent, right. In the sense of there are people that say ESG does too much, it starves sectors of capital and then there are folks that say it does too little just shuffling around weights of securities in a portfolio a little bit. They're the people that say that it's too politically left and there are people that say it's too politically conservative, right there are people, you know, who say that it doesn't care enough about financial returns and their people say it cares too much about financial returns and so against that backdrop, right, markets are hard, it's a complicated environment and suddenly there's all this noise. I think that's kind of where we find ourselves right now.

David Greely (04m 14s):
Yeah, and I want to get into that with you, but first, I know you've just gotten back from COP 27 and against that backdrop of like a strong year as you said, inflows, I think what, 392 billion in 2021, 40% of assets, a lot of movement on the investor side. I'm curious from COP 27, what were you seeing maybe on the government policy side, or how does coming out of COP 27 influence your outlook for where we are going forward?

John Goldstein (04m 43s):
Yeah, well, step one, I got to shake off a little bit of jet lag from 10 hours of time zone differences and my smart watch very helpfully, I was walking around one day and I think I tweeted a picture I took of it, it said, insight, you may need more sleep and that has definitely been the case this week as my body has decided, 2:00 am is a really optimal time to wake up. You know, I think a couple observations coming back from, from COP, I think, you know, it was interesting to, to show up at COP with the US having stepped up on the policy front, right. The Inflation Reduction Act has been a game changer and we've already seen, you know, capital investment flowing announcements of new commitments to manufacturing in the US. If you combine the CHIPS Act, the infrastructure bill and the IRA, we see capital kind of already in motion.

John Goldstein (05m 31s):
And I think the US having made a contribution when, for a while, I think there was a perception that US policy was lagging, European policy was leading. I mean, now you have a situation where obviously Europe is dealing, you know, with war and energy crisis and the US is forging ahead on the policy fund. So that equation has changed pretty substantially since Glasgow. I think number one, I think number two, I look, I think there is a constructive sobriety around the fact that this is hard, right. I think 2021 had tremendous optimism and one might say naiveté around the complexity of something as vast as energy transition, particularly when, you know, we're getting to the point where, and we are seeing it before Russia, Ukraine, and we certainly see it now, the supply demand imbalances have some really acute impacts on energy access, energy pricing, energy security.

John Goldstein (06m 25s):
And so I think some of that naiveté has worn off and it's put people in a, in a sober but realistic frame of mind about what it takes to make, make progress. I think number one. Number two, I think as part of that maturation process, I think people are becoming aware, and a phrase I like to use a lot is algebra as destiny and I think what I mean by that is, you know, in the absence of broad spread carbon pricing on a global basis, you know, effectively a set of interlocking voluntary commitments across sectors has almost stood in as the substitute for that and I think people are realizing, number one, that's not an optimal way to, to drive economic systems. I mean, there's a reason we've come out and talked about the importance of carbon pricing, but number two, if you're gonna do that, the algebra matters a lot.

John Goldstein (07m 09s):
I think people have come to an appreciation that a lot of the initial sets of targets and metrics and objectives have the, the unintended but very challenging consequence of effectively driving capital away from the real economy, right. If you're really measuring things like finance emissions dollars, times the emissions of an investee, it actually drives in some ways the opposite of the behavior. We need to accomplish real world decarbonization to do that, we need to put more money into the real economy, not less and I think that was one of the big topics of conversation there, is understanding that the kind of old algebra of how to do this may not serve us well relative to our goals. We need to move to new algebra that looks more forward looking metrics that allow us to invest in transition as opposed to frankly avoiding transition. I think that was point 2, point 3, I'd say, you know, and I think this has its good side and it has its challenge.

John Goldstein (08m 02s):
I think there was a lot of excitement about things that people saw as potential ways to move the needle on this and I think particularly too, I'd highlight our blended finance and carbon markets, and I think both are potentially powerful tools both are areas were active. I mean, you know, just in a couple weeks leading up to COP, we closed two blended finance transactions to a partnership we have with Asian Development Bank in Bloomberg around vehicle electrification in India and Vietnam, you know, where we help catalyze, you know, larger pools of capital to build out electric buses in both of those countries. Similarly, we've been active in carbon in a variety of ways. However, I did leave with a little bit of a nervousness that these important tools can also become panaceas, right. If there's a financing gap, if there's something that hard, if there's a challenge, you know, the answer for that missing piece of the equation for that cell that doesn't total in the spreadsheet is carbon or blended finance.

John Goldstein (08m 57s):
And so I you know, I want to be, I'm both excited and have seen the promise of that, but I also left slightly wary of the fact that they can be convenient pan. We can talk more about either of those tools on our chat and I think the last thing I left with, there's a little bit of a sifting through of where do, where is it important to start small and scale up, and where do you have to start big, right and so if you think about on the ladder things like some of the jet Ps around South Africa and coal, or what we saw at the G 20 with Indonesia and coal, where you need jurisdictional broad approaches that mobilize large sums of capital in a system wide way versus other things where if you try to start too big, they can collapse under their own weight. You need to start smaller and scale up and I didn't leave with a magic answer to that, but just with an awareness of that's gonna be a really important sorting function as we go forward. Where do we need to start small and scale up and when do you have to start at scale.

David Greely (09m 51s):
Year I'd love to go back and dig into a couple of those points with you think they're so meaty and, you know, the one really hit a point that I think is key for us in this series of trying to understand, you know, there's been a lot of money pledged, lot of optimism, lot of desire to get it to where it's gonna do good but then of course, as you said, investing's hard, it's not just about climate investing, it's, you know, all investing is hard and what I've been trying to understand is how well is that money able to flow through into meaningful investments you know, do people get the algebra to work, are you able to get it down to where it does the best and is there an empty cell that's getting filled in with blended finance or carbon. So I wanted to get your sense like when you look out with all these dollars to invest, are they getting to where they need and what are the, the big obstacles and maybe some of the solutions?

John Goldstein (10m 44s):
Yeah. I'll maybe start about with sort of an observation that I've had in the last six months and some activity I've seen picking up, which is an interesting way to kind of square this circle, right, because as you said, a lot of commitments, lot of capital raise, and whether they're in dedicated funds focused on climate or energy transition or just broad capital commitments I think particularly we see around kind of large private investors, private asset shops, and you have companies that have bold, significant ambitions that require a lot of capital, a lot of which can't just come from, you know, cash flows balance sheet or their existing borrowing capacity and so I was talking at our CFO conference the other day, and I think I said I had a two week period where about half the conversations were with large public companies.

John Goldstein (11m 28s):
It says, I have things I want to transition, or I have great sustainability businesses I could launch and I could grow. I've got the technologies, I've got the tools, but I don't have the capital. Then later that day, I'd have a call with a large private equity firm or large private asset shop that says, we have a lot of capital, a lot of ambition to put money to work in the space, but when we look at kind of the on the run private market deal flow, it's not gonna fully, it's not gonna get us there. So do you have any of your public company clients that need innovative capital solutions and so you kind of see the makings for this, you know, the chocolate meets the peanut butter and we get a Reese's Peanut butter cup here, and, and I think we're just seeing some glimmers of those types of transaction, right?

John Goldstein (12m 09s):
I think, you know, you saw publicly announced transaction around, you know, Emerson Electric spinning out their sustainability business, for example, right. I would suspect to solve those challenges you talked about how you actually realize the potential where companies have a lot of will to move forward. Investors have a lot of capital. I think you're gonna see a lot more creativity around private capital partnering with public companies, right and I think that's an elegant solution because a lot of these public companies have great people, great technologies, great tools, great ambitions, but you know, right now, especially in this economic environment,

there's not necessarily the cash to finance this. On the other hand, you have a lot of dry powder on the private asset side. So I think that for me is one area that I think is, I think tremendously interesting. I think too, that conveyor belt of capital has gotten built out in a way that's dramatically different than it was even five years ago, right?

John Goldstein (13m 01s):
You have, from the very front end of stuff, you have catalytic capital, you've got the breakthrough energies of the world, you've got folks like generation, and they're just climate fund. Then you've got, you know, venture seed, series A, series B you've got growth equity, you've got later stage capital, you've got the public markets and so I think that value chain, I think in the past people would talk about valleys of death, and I think there are a lot fewer those, right. You may have little ravines, ravines of stumbling, but not necessarily valleys of death in a way that I think is exciting because those missing pieces have started to get filled in and I think to the point about not just deploying capital, but having that capital go to the point of really scaling some businesses, some technology, some deployment and some tools.

John Goldstein (13m 48s):
And then I think at the end of the day, policy is gonna help, right. The inflation reduction act is gonna help. We need to build a lot of stuff, right, there's gonna be a tremendous amount of infrastructure built out and once again, if you have a supportive policy regime and a lot of private capital, I think that is a fairly good recipe and I think that's all those things are newer. I think it's, you know, it is easier across those spectrums ultimately to put capital to work. As you said, investing is hard, right, easier is a relative term, not an absolute term and I think that is something that people sometimes lose sight of and I sometimes will give people a little grief when they talk about the barriers. I say, you know, I like, at the end of the day, it's not barriers.

John Goldstein (14m 29s):
It's called the work, right and I think, you know, what, in what field of investing do you just go out and you find great investments, then you write a check and you just go sit back in your easy chair and watch everything go up, right. That's not really how it works. These are competitive markets and these themes, you know what's, like, at one point it was so early, the underlying demand drivers weren't robust enough for this to be a very profitable endeavor. Then the demand drivers got better and for a while the market didn't quite appreciate that. So a number of specialists had the field a little more to themselves. Now it is undiscovered no more and there's a lot of really smart investors. I mean, I get to talk to a whole lot of our clients, and I think the level of savvy sophistication and focused firepower getting trained on these thematics is, stands in remarkable contrast, honestly, even relative to two or three years ago.

David Greely (15m 20s):
That's great and I want to come back to maybe it was point 4 that you had earlier about, you know, the, the distinction that's becoming more and more important between projects that you need to start small and grow versus, you know, things where you got to I guess, do it at scale from the beginning. Because, you know, and maybe this ties into some of the challenges you've been mentioning, and whether they're small gullies or ravines, but how do these challenges vary across the financing landscape in particular by kind of the size of the investment because I think there are a lot of smaller businesses, innovative, developing new technologies that are working on smaller scale projects that still have to prove out and maybe they're looking for tens of millions of dollars as opposed to, you know, larger businesses deploying, well-established low carbon tech, you know, like wind or solar that might need hundreds of millions to billions. Is there the financing for both and is it coming from different places?

John Goldstein (16m 20s):
Yeah, I think increasingly there is financing across that spectrum because where there are good projects that individually are small, but where in aggregate there's a lot of opportunity, I think investors are figuring that out, right. Think about what happened with commercial and industrial scale solar, right. Those individual projects are small, right? They're, you know, 1, 5, 10, 20 million dollars, you know, some are smaller than that, right. Some are less than a million bucks and for a while, that was the missing middle, right. It was an area that it was too big and varied to, to work in the scale fashion of residential solar and too small for the customization and legal bills of utility scale and so it was missing. And then, you know, and, and you know, we built a business that area, other people built businesses in that area because they saw, ultimately these were bankable transactions that actually had excess spread because they were overlooked, neglected and hard to access.

John Goldstein (17m 18s):
And that gap in terms of, for example, the credit quality of an off taker where you'd be putting solar panels on the roof of a, you know, a large corporation, you know, that spread between what you could get paid to buy that company's bonds versus sell them solar. That

has slowly gone away because people saw the opportunity and they figured out how to build teams and deploy capital. I think we see that cycle happening in lots of different, different markets and different capacities. It still doesn't work if you have, you know, small transactions that even in aggregate don't get to size, but frankly, that that's okay if those are frankly the ones that don't get picked up and so, you know, there are fewer of these missing middles because a bunch of smart people with capital to put to work are finding ways to take those arbitrages, those opportunities and frankly make them go away and build profitable, robust platforms in the meanwhile.

John Goldstein (18m 09s):
Now where those gaps are harder to fill, right a couple different areas. I think one is, it is challenging in some of these areas in emerging markets, particularly where you have currency risk, right. This is a theme that came up at COP, is looking at some of these infrastructure projects and areas where there's significant currency risk. It's very expensive to hedge. I think, you know, that that's, that's a real issue wrestling with in some of these markets and I think, you know, there's some areas also just where the regulatory regime, other sorts of issues. I think there is some basic backdrops that make this harder to do in some markets than in others in the emerging markets issues a real one, because that's an area where there's tremendous opportunity, right. In some of these markets I was talking to people working in some parts of subs here in Africa where, you know, at the end of the day the economics of competing with diesel generators are great, right. The underlying economics of replacing that with solar and storage are phenomenal but, you know, there's still lots of issues you have to deal with. So I don't want to pretend that this is all easy and it all takes care of itself in some markets, some of the market backdrops, some of the macro situations make that a lot more challenging than others.

David Greely (19m 13s):
Are those markets where the blended finance plays a greater role or where does that come into play?

John Goldstein (19m 19s):
Well, I think that scenario where the development finance institutions, you know, have, have important work to do, right. The multilaterals, the DFIs, I think that's where they can play significant roles in terms of currency wraps, credit wraps, other ways to kind of stand in and leverage the fact they have very strong balance sheets and there was a lot of talk at, at cop about the role that the multilaterals can play, right. Are there ways they can, you know, take more risk, take risk differently given how important some of the emerging markets are and how easier to solve some of these issues are in developed markets and so I think there's a real focus on the significant role those entities have to play and in some ways that is the core of blended finance historically are the developed finance institutions, the multilateral banks.

David Greely (20m 03s):
Did there seem to be much enthusiasm on their part for taking that role on?

John Goldstein (20m 08s):
Look, the conversation I was in, I think there's a lot, there was a lot of interest. I know, you know, there are a lot of perspectives on multilateral reform, on risk taking, you know, what is an optimal leverage ratio for those balance sheet look like, but I think there's a lot of will to roll up sleeves and, and try to get it figured out because I think people see the, there's a real opportunity and there are real impacts on multiple levels for those economies, right. At the end of the day, there's not just a climate impact, there's a development impact, there's an energy access impact, there's an economic value, there are a whole host of, of benefits for sort of solving this, which I think put it constructively in the purviews of development banks.

David Greely (20m 45s):
And that brings us to carbon finance. I wanted to follow up on that piece. Carbon finance, the ability to sell carbon credits to help finance projects. How is that fitting into all this and how do you see it potentially growing into the future?

John Goldstein (20m 59s):
So I look, I mean, we've all seen growing interest and focus on unlocking this as a source of capital to finance, you know, both things and markets where we need capital to flow, right and whether it's, you know, it's nature based or technology based sequestration, whether it's north, south capital transfers or just whether it's to take things where the economics don't pencil without carbon you know, there's tremendous appetite to figure out how to mobilize that, number one. I think number two, there are lots of initiatives to try to take the voluntary market and help it grow with credibility and coherence and in some ways, like I say, to take the air quotes

away from the word market and turn it into a market. This is where if we were doing a video, I could do the hand gesture. Listeners will just have to imagine.

John Goldstein (21m 48s):
So I think a lot of focus on that and you see, you know, a lot of the integrity council, you see the task force on voluntary carbon markets. You see a host of initiatives, you see people building market infrastructure, you know, you have exchange in Singapore, you have, you know, verification systems and so there's a lot of will to invest in things to develop that. You have companies that have taken leadership roles in different capacities. I think about the work we've done with Apple and Conservation International on the Restore Fund. I think about other, other leaders, you know, folks like Stripe, folks like Microsoft, you know, folks like Delta people have done a lot of interesting, really innovative work out there that are important. Now, I've had my own sort of pet theory on all of this, which I will I'll unleash upon.

John Goldstein (22m 34s):
And it gets a little bit back to the algebra as destiny point, you know, talking earlier. So, so looking at this, you know, one of our most successful product launches we had on our, our data platform marque, was adding carbon and climate analytics and when you go through it though, one of the things you start to see is that carbon offsets and you know, in this flurry of target setting and measurement for asset managers and asset owners, one of the things you quickly see is offsets are currently invisible to that process. So whether a company uses offsets or doesn't, whether those offsets are high quality or not, and whether they're part of an overall business plan that's decreasing their real world emissions in a meaningful way or not, regardless of that, all of this reporting and this foot printing is done on a gross basis. And I think if you step back, one of the questions is how do we get this market to develop with credibility, coherence, and scale.

John Goldstein (23m 34s):
So one option is policy and regulation, right. I was talking to someone earlier that says, I just am not sure I see that coming. I don't know that I disagree with them on that front, but the other possibility is that it actually comes from investors, right. You can imagine that if investors said, look, if you meet the following three criteria, right. If you know, reducing your real world actual carbon emissions, if you're not using it for too much of your footprint, and if you meet a certain quality standard, I will think about a carbon footprint on a net versus a gross basis. I think that would be a phenomenal accelerant to the development, to the growth and the kind of coherence of this market, because then suddenly, you know, it goes from one of the reasons, you know, people talk about the voluntary carbon market being very fragmented, right?

John Goldstein (24m 25s):
And one of the reasons for that is, to some degree you could think about it as, as in some part, CSR driven corporate social responsibility because it's around making a consumer claim of carbon neutrality you know, there are various ways that it shows up. And because of that nature, it takes different shapes and forms for different companies because they have different priorities that they're solving for different geographies. They care about different issues that align with their businesses and so naturally it doesn't all look the same way for different companies. So if we want it to converge, we need some other force to make it converge and I think investor focus and demand is one way that that could happen. So that's my latest pet theory of how to get the market organized and I think there's a little bit of a chicken or egg because I think since some people, the idea is if we define quality standards, the market will organize around that and I think I have a little bit of the emerging hypothesis that actually if you get investors starting to have credit for it, that will drive definitions of quality standards and drive that organization.

David Greely (25m 27s):
I think there's a lot of sense to that theory. You know, whenever we talk on this show, we hear a lot of, you know, from the corporate net zero side people wanting to do the right thing, but not knowing what the right thing is and being worried that they're gonna get punished for trying to do something and then end up doing nothing sometimes is the result. So I think that's a, I like your, your pet theory

John Goldstein (25m 50s):
Well, and I think you're hitting on another issue, which I think sometimes in this field, like we, people have a hard time walking and chewing gum at the same time and what I mean by that is I think there's been a lot of skepticism over time about carbon offsets because I think the fear is that will, that suddenly remove focus away from real world decarbonization, right and I think in some ways, sometimes this either or mentality, I think can sometimes stand in the way of progress, right, which is, you know, rather than say how

do we support both the real economy transition that makes companies leaner, more resilient, more efficient and I will say a word on that in a minute. I just gave this presentation, our CFO conference really just around the, the economic drivers of all this, leave aside anything more philosophical or ideological, just the profoundly practical ways that leveraging things around sustainability and transition can increase growth, improve gross margins, operating margins and capital efficiency, and drive higher valuations through a perception of terminal value.

John Goldstein (26m 53s):
And that you've hedged carbon risk, right like they're just these core economic levers that make this good business right and we see this, I mean, I, you know, look at what's happened to companies with exposure to European energy prices over the last six months, right. Folks that have lean efficient operations that are less dependent on volatile commodity prices are feeling a lot better about their prospects heading into this winter relative to folks that haven't made that investment yet right. So, you know, this is outside of your do the right thing mindset. This is a do the profitable kind of smart thing mindset and so I think the idea is have that core focus on operational excellence and leanness, it shouldn't at all be at odds with the idea of, and take a thoughtful approach to offsets and I think that this idea that we can't walk in chew gum at the same time, we can't hold two thoughts in our heads about making our businesses efficient, effective, and resilient and thinking about offsets, you know, I think sometimes can stand a little bit in the way of progress, making progress on both of those front.

David Greely (27m 52s):
Yeah and it seems to come, seems to come from a place of we just don't trust the offsets, so we don't want to get into that at all and of course, if this is gonna work, I think we need investment into high quality carbon reduction removal projects along with the decarbonization of you know, primary emissions.

John Goldstein (28m 12s):
It's just very hard to see the math working relative to ambitious climate goals without, you know, meaningful carbon sequestration and I think I, you know, the other quip I had with somebody, you know, we were talking and I think just even the mindset of, you know, in some ways it's less of a race to zero than it's a race to 59 and I was lucky enough to get to interview John do about his excellent book Speed and Scale and he lays out a roadmap, and it's not a road to zero, it's a road to the 59 Gigatons and where they're gonna come from and how we're gonna get it and what's gonna be required and I think that for me is an important lens of we're gonna get a lot of that from becoming more efficient, more effective, but I haven't seen a lot of math that doesn't say there's also some real meaningful role for, for offsets within that.

David Greely (29m 00s):
Yeah and, you know, while your body clock is still somewhere over the Atlantic, I wanted to ask you, you know, you've talked a little bit about some of the challenges, how they differ across geographic regions with currencies and developing markets in particular but I wanted to ask you like, more broadly from a mindset perspective, do you perceive that investors and financial institutions in different parts of the world are approaching impact investing and financing the energy transition differently?

John Goldstein (29:28):
I think a little bit. Look, I mean the, facts and circumstances are fundamentally different in these different markets, right. Obviously, you know, Europe right now is going through a tremendously challenging time from an energy supplied energy security perspective. You know, I think the US has its own context as does Asia and even the different markets within Asia, you know, Japan, Korea, China, you know, all dynamics and so I think, you know, there are a few different vectors that drive these differences. So, you know, one is where people start. Right the starting point for these different markets are in quite different places. Two is the degrees of freedom they have, which is, it's a lot easier to build out scaled renewables in some markets quickly than in others. The installed base is different in some markets than in others.

John Goldstein (30m 15s):
The industrial economies in these different markets are different in some than in others. And so I think, you know, there's not a one size fits all playbook. I think number one. Number two, just the philosophies in these markets also vary a little bit, right. Which is, I think Europe even down to sort of fiduciary definitions around dual materiality have a different perspective on this you see this with the FDR, European Sustainable Finance regulations. I mean, there is a different approach in Europe than there is in the US or arguably anywhere else in the globe and I think that shapes an effect on this and I think that in some ways is the biggest fork in the road. This idea of dual materiality versus single materiality and I think the idea is for those who aren't as deeply steeped, in sustainable finance geekery, you

know, this idea of, you know, single materiality says, at the end of the day, if you're an investor or a company, you're looking at how all of these changes in the world around climate transition, inclusive growth have an impact on your business.

John Goldstein (31m 17s):
And it could be in terms of risk, it could be in terms of growth, it could be in terms of margins and that could be today, it could be in the years ahead but fundamentally, it's about analyzing how you're gonna navigate a changing world effectively from the perspective of your portfolio, your company. Europe includes that perspective, but also adds this, they, they call this kind of outside in view of, it's also about the impact of that company to that investor on the world, right. It's not just about the impact of the world on that company or that investor and that's a different mindset, right. It's a different approach and you see a lot of these things kind of cascade outside of that.

David Greely (31m 52s):
Yeah and I guess that mindset also, a question I wanted to ask you, I've been asking it of a, of, of a couple guests is, you know, there's been a pretty big proliferation of labels such as ESG impact sustainable investing in the past few years and some, you know, fairly strong feelings and opinions around each of them and I was curious, you know, from your perspective, how do you think about these, like, are they meaningfully differentiated investment styles or mostly labels or something else?

John Goldstein (32m 20s):
Can I answer yes to all of those?

David Greely (32m 23s):
Sure.

John Goldstein (32m 23s):
Sure. No, well, I'll say a couple things. I think number one, I think for me it all needs to start with a thesis of what are you doing, what are you trying to do. What's the thesis, and then you need to design whatever you're designing around that thesis and have truth, truth in advertising around what it is, what it isn't you know, I think along the way, and I think that if you're solving around a label, I think there's a certain risk in that and that it becomes, you know, it's like that, that goal seek function in Excel, right. You know, if you're solving for a label, you know, I just have seen that's where the efforts to fit to the label can really drive a lot of activity and I think I, you know, years ago my big rant was around the fear, not of green washing, but of what I called checklist washing.

John Goldstein (33m 12s):
I think people, I think its people earnestly trying to solve for what they've been told they're supposed to solve for, which is there's a label, let's solve for it and I think people trying to do a really good job of that, but I think in a gravitational core of a thesis, I think is a lot stronger way to run a business or create a financial product and so I think that, I think the one issue I always get concerned about is focusing too much on labels, I think can get people to focused on labels versus sort of what are, what are you doing. That's, I think point 1, point 2 to the point about thesis. I think there are a few different things people are trying to do, right. I think we've always talked about this difference between strategies that are focused on alignment, which are basically if people want whatever market exposure they want, but there's some stuff they just don't want to see in that portfolio.

John Goldstein (33m 59s):
That tends to be more values driven because of people's priorities. Start with faith-based screening, other sorts of things, these kind of alignment strategies. I think these integration strategies say, look, the world is changing, right which is basically along these lines of these secular themes around climate transition, inclusive growth and that has impacts across companies and across sectors and how do you thoughtfully and deeply integrate that into how you select securities and build a portfolio, right. It's hard It's like really any type of investing it's hard, but I mean, if that's the goal, that's the goal. Then if you go a little further out there are thematic strategies which basically say people want more concentrated exposure to certain themes in the economy. Those tend to be higher tracking error strategies, more concentrated, more defined strategies and you know, in equities and bonds or kind of you name it, but they're sort of tilted such that you may be less inclined to use a broad market benchmark because you're getting more concentrated risk and exposure back to kind of what's the thesis.

John Goldstein (34m 56s):
The thesis is these are interesting themes that you want to allocate capital to and that's in some ways what the offering to a potential investor would be and then I think as you get more into private markets, that's where, you know, one flavor of these thematic strategies are impact investments where, you know, the theme is one of these around sustainable transport, sustainable food and agriculture waste of materials, kind of, you, you, you name it and so, I mean, that's how I sort of tend to think about it is just what are you trying to do, how do you do it and then kind of what comes out the other end and I think, you know, the, the alphabet soup can sometimes get in the way a little bit of, of all that.

David Greely (35m 34s):
Yeah. Well, I've always appreciated the way you think about it, it and the more practical commercial approach you seem to take to investing in this space and I was curious, you know, how did you develop your approach to investing in this area and do you find your way of thinking about it more the exception or the rule at this point?

John Goldstein (35m 53s):
So to your first question, like you know, really lucky enough to get to do a lot of trial and error, to be somewhat glib about it, right. Which is, it's funny, I was just talking to someone earlier today about, you know, when Taylor and I co-founded Imprint Capital in 2007 I think what really united us is, you know, this, that was a period where there was a lot of enthusiasm and a lot of, you know, conversation, but we wanted to actually go out and try this, right and I think at that point, a lot of what had been prevalent up until that point were a lot of approaches focused on negative screening and I think, you know, there was this early effort to really say, instead of figuring out what we're not doing, why don't we figure out what we are doing.

John Goldstein (36m 33s):
And that's really where the term impact investing came from in the early days of that movement and the great work, you know, Antony Bugg-Levine at the Rockefeller Foundation and others did to really, really grow that but I think, you know, we were blessed and cursed by the fact that, you know, the largest bulk of our early clients were large US foundations who are, you know, two things at their core. One, they're very sophisticated and demanding about impact, right. That's their core business. They know it well, they value it, they prize it. It's unbelievably central and they're very rigorous. They're also very sophisticated institutional investors, very demanding, very finicky, very successful and so that really, you know, that was our DNA. That was what we were about, right. We fundamentally were about, you know, how do we bring that rigor from a research perspective into these themes, into these ideas, right.

John Goldstein (37m 22s):
Don't be reactive and just evaluate things, but let's go deep. Let's develop a thesis, let's develop a view where do we have conviction and then apply a process that looked an awful lot like a traditional investment process to it, right that's how we grew up and we were lucky enough to get to work with some great clients and some great institutions to develop it and to refine it over time and then, you know, fast forward, you know, when we joined Goldman Sachs, you know, we got a bunch of really, really smart investment colleagues to help us continue to refine and iterate and, you know, we got to teach them some things. They taught us an awful lot of things and I think we just found we had a lot in common and I think at the end of the day, at the core of it, is to think about this as investors.

John Goldstein (38m 03s):
And I think this is one of the areas where, you know, the acronym ESG has not always done the field of favor because what it often gets people into is this mental mindset that this is not investing get out your glossary and your passport. You're going to a foreign land, right. This is something different. You're gonna, you don't know how to do this, but you're gonna have to learn it. I think the reality is, you know, I think that hasn't always been constructive. I think the idea that this is every bit is susceptible to rigor, diligence, research, and care as any other type of investing is essential. I think that's honestly what we've brought and I don't think we've discovered anything new or brought in anything new. I think in some ways we've taken a very old fashioned approach to all of this, which is roll up your sleeves, do the work, do it with care, pick your head up and try to learn from both your successes and your maybe less than successes and keep on moving on and continue to find really smart people to help you get better at it.

John Goldstein (38m 57s):
So I, I think, I guess what I would say is, as this has grown and gotten much more mainstream, I don't know that it's, people are adopting our approach, but I think it's when smart investors look at growing markets that are competitive and where they want to win, I think they come to similar conclusions and similar approaches. I guess I'd be curious to, to you, what, what, what you see, but I think that's, that's how I've seen it evolve over time.

David Greely (39m 20s):
Now I'm fascinated to hear it and as you say, markets are hard, investing's hard, and as an investor you got to be ready to, you know, roll up your sleeves and do the hard work once that low hanging fruit's been picked and, you know, as we close out the conversation, I was really wanted to know where do you see some of the most important and potentially profitable areas where we need to just be rolling up our sleeves as investors and doing the hard work to get these investments done?

John Goldstein (39m 49s):
Yeah, so I had a great occasion the other the other month to, to, you know, a large sovereign client of ours you know, they presented us with our homework assignment, right. They said, you know, we want to have a real workshop around sustainable investing and I think we understand we're at a point in that market where you can't just chase TAM, right Total Addressable Market. Like we all know these are big and growing markets, you know, you could call it whatever the 150 trillion of capital's gonna move. Like we know that other people know that, right. So you can't just identify the themes and invest in them. So against the backdrop of large growing but increasingly competitive markets, how do you make money and I think it was a good exercise to step back with colleagues here and really think about it and distilled it down to four key sort of, call it patterns we've observed.

John Goldstein (40m 40s):
So number one, find the right game to play at the right point in the maturity cycle. What we mean by that is we've seen these themes generally go through a pattern and to sort of simplify it too early, too late, and just right, right. Which is early on, a lot of these themes, and we've seen this from, you know, wind to solar, to batteries, to commercial, industrial to community, solar, you kind of, you name it, right too early tends to be capital intensive, high risk and it takes a lot of time, right? It's not always a great place for private capital. Eventually stuff grows, it gets de-risked, it gets increasingly well understood and capital flows with increasing abundance and decreasing cost. Right at some point it becomes much better for the bond market than for private capital. Between those two is an interesting moment when if you're paying attention, you'll notice things have become de-risked.

John Goldstein (41m 31s):
But the rest of the market either hasn't realized how to access it or hasn't seen that, that tends to be a very interesting moment not just to invest, but to build platforms and building platforms that can originate assets at that moment, at that goldilock space because you get two benefits first of all, you can originate assets at interesting prices that the market is gonna eventually want to buy from you at much higher prices once they realize those are attractive assets. Number two, you will have built a platform that does that, that maybe worth some value, right. So that, that sort of point 1 is you invested at the right point in the maturity cycle, right. You can think about things like battery storage as, as something that now is increasingly at that moment you know, we've gone through that with solar, with, you know, with onshore wind, with offshore wind.

John Goldstein (42m 17s):
You know, we're getting to sort of new technologies, new tools as we get to a much more dynamic distributed energy system. Second point, you know, back in some of the, the internet ups and downs people would talk about, you know, not just investing in the gold miners, but investing in the picks and shovels, right and I think that's very analogous here, which is back to that earlier comment on net zero, everything, all of these corporate commitments, either because they've made commitments or it's just necessity to really drive greater efficiency and decarbonization in their business, that's gonna drive a huge volume of spend, right and I think this sort of B2B or B2B opportunity is a very significant one and sometimes if you play it right a client the other day told me, said, you know, I don't know if I can pick the winner, but I can pick that there will be a winner.

John Goldstein (43m 05s):
And right, that idea of find someone in the value chain that's gonna benefit from volume, regardless of who gets that volume, right. Find the picks and shovels, find someone that's supplying lots of different people. So you know, they're gonna supply the winners, they're gonna supply the losers, right as long as they're the one supplying. So number two is sort of picks and shovels. Number three, I steal a quote from Deborah Schwartz at the MacArthur Foundation, you know, we used many years ago, but I think it's a very relevant one, which is a lot of the best deals are made and not found right and this is go, I mean, I've talked on the last podcast here about north holt, you know, work to really help identify these advanced purchase contracts for batteries to help unlock capital so the batteries could get made, right?

John Goldstein (43m 49s):
I think we see lots of these opportunities, I think particularly in the years ahead, this idea of innovative partnerships between public companies and private capital where it's not a deal that's kind of trotting around getting marketed. It's a creative effort to really make not find those transactions is number three and number four is, you know, if you're not gonna invest in the green leaders of today, create the green leaders of tomorrow, right. The valuation gap between the folks that are understood and appreciated as leaders today and those that are not there, leaves an awful lot of room to unlock economic value and impact, right. I think, you know, we go back in our heritage, having bought the Danish oil and natural gas company, Dong Energy and turned it into Orstead you know, where the world's most important renewable power companies that unlocks a lot of value. It unlocks value. It unlocks a lot of impact, and I think that opportunity of people call it kind of great to green or transition, right. That valuation delta between folks that are the leaders of today and the folks who could be the leaders of tomorrow, there's definitely some money to be made there. So I think back to where kind of investors can focus, those are the four thematics I think are gonna be fruitful for, for years to come.

David Greely (45m09s): Thanks again to John Goldstein, Head of the Sustainable Finance Group at Goldman Sachs. We hope you enjoyed the episode. Join us next week with our guest, Adam Bornstein, Lead Innovative finance and system change at the Danish Red Cross. We hope you'll join us.

Announcer (45m 24s):
This episode has been brought to you in parts by Base Carbon. The trading of carbon credits can help companies and the world meet ambitious goals for reducing greenhouse gas emissions, but how do we judge the quality of these projects and how can we ensure that our investments are creating real value. At Base Carbon, we are focused on financing and facilitating the transition to net zero through trusted and transparent partners. It's time to focus on what's important. It's time to get serious on carbon. Learn more at Basecarbon.com. That concludes this week's episode of SmarterMarkets by Abaxx. For episode transcripts and additional episode information, including research, editorial and video content, please visit smartermarkets.media. Please help more people discover the podcast by leaving a review on Apple Podcast, Spotify, YouTube, or your favorite podcast platform. SmarterMarkets is presented for informational and entertainment purposes only. The information presented on SmarterMarkets should not be construed as investment advice, always consultant licensed investment professionals before making investment decisions. The views and opinions expressed on SmarterMarkets are those of the participants and do not necessarily reflect those of the show's hosts or producer. SmarterMarkets, its hosts, guests, employees, and producer Abaxx Technologies shall not be held liable for losses resulting from investment decisions based on informational viewpoints presented on SmarterMarkets. Thank you for listening and please join us again next week.