Don’t let the great ESG self-deception infect climate tech investing

The financial world is slowly waking up to the self-deception behind ESG ratings. Meanwhile, climate tech investors have been pouring more money into climate funds than ever before and are convinced that they are not in danger of making the same mistakes as asset allocators like Deutsche Bank’s asset allocator, DWS, which was raided by police and financial regulators earlier this year.

But we climate tech investors are in danger of falling into a similar trap, with our determination to invent and adopt meaningless impact metrics. It’s an approach that is sowing confusion and, worse, could lead to a misallocation of vital funding and resources.

I have to confess to feeling some relief that ESG ratings are now under scrutiny. Questions being asked of *major financial institutions* and concerns over *authenticity, veracity, and comparability*. *Bloomberg* states that ESG “ratings don’t measure a company’s impact on the earth and society”, but rather “gauge the opposite: the potential impact of the world on the company and its shareholders.”

Their conclusion that ESG methodologies focus more on value protection – ie reducing financial risk – than driving positive change is one we need to learn from. The cleantech sector also has much work to do to improve its methodologies and to regain its credibility.

Climate tech is not simply an arm of ESG, though. While ESG offers a set of standards as to how companies should or should not operate, climate tech companies are creating technologies and services that can directly improve our chances of reaching Net Zero. Since we make great claims of financial and environmental benefit, surely we should be measuring our impact?

An intellectual exercise in time wasting

I have been developing and applying impact metrics since I entered climate tech investing in 2007. Collecting such metrics has been a great intellectual exercise, but mostly a waste of time.

Now as climate tech gains a new generation of supporters from the venture capital world, we are seeing renewed efforts to quantify impact, often repeating the mistakes of the past. More worryingly, the practices could ultimately end up damaging the climate tech ecosystem.

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The problem is two-fold: first, it's impossible to create a universal metric for environmental impact. By trying to quantify impact, we can end up making bad investment decisions.

Second, misleading methodologies create a backdoor for greenwashing investments that sows distrust. Simply applying common sense would help to avoid such traps.

Take for example carbon accounting software that is useful to generate CO2 savings, but how much more useful is it than other offerings? That new electric motor is fantastic, but how much of the CO2 savings of that electric car do we assign to the motor, rather than the battery, or the control software, or the car sharing club that operates the car? These are all useful 'green' technologies, but there simply is no metric to quantify and compare their individual environmental benefits.

By insisting on quantifying and comparing, we create inherently faulty methodologies for calculating impact metrics.

More damaging though, is that impact metrics can lead to false positives – or the mislabelling of certain technologies as climate tech. We have already seen this year quantum technologies being labelled climate tech (because quantum computers are good at solving difficult problems), and cyber security called climate tech (because digital climate tech can only operate with secure software). Under this kind of appropriation virtual reality could even be claimed for climate tech – because people need to travel less to ‘see’ each other.

While quantum computing, cyber security, and virtual reality are attractive investment themes, they are general enablers, not more relevant to climate tech than to health care, defense, or indeed the oil and gas industry.

This is investing in general innovation, not cleantech specifically, and will not bring us closer to Net Zero. Common sense has been overridden by faulty impact methodologies.

As cleantech investors we must avoid falling into the same trap that is draining the credibility from ESG investors, if we are to avoid being tarnished with the same brush. For them, it’s bad for business – for us, a community that is striving to create the technologies that could save the planet, it would be fatal.

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