Jed Emerson

Interview - Jed Emerson

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Written following the closing of Uhuru Capital Management around six months ago, Jed Emerson's recent paper *Beyond Good Versus Evil* has attracted unexpected criticism from those supportive of his previous work. Why is this, Caroline Hartnell asked him. How would he like to see capital markets develop following the financial crisis, and what role does he hope to play in this? For Jed Emerson, mainstreaming sustainable investment practices rather than developing more boutique sustainable funds has to be a key part of the way forward.

In the introduction to your paper, you say that until now critics have broadly agreed with the direction of papers and books you've written, but they now think you've gone a bit far. What have you said that's upsetting people so much?

The reaction to the paper actually reminds me of some of the conversations I got into 20 years ago when I was founding director of what became REDF [Roberts Enterprise Development Foundation] and we first started exploring how to use investment strategies to create community impact. I remember at the time many traditional foundation folks objected to the idea that you could use modified venture capital approaches within philanthropy to create some kind of positive good. When I was circulating the draft of this current paper, some readers were saying 'You really should not do this. Everybody knows that hedge funds are evil and pretty much the pinnacle of mercenary capitalism.' I was a little taken aback because to my mind they weren't really trying to understand the core of what I was exploring in the piece.

And then when I showed the paper to people in the hedge fund community, I got almost the opposite reaction. Their attitude was 'Are you kidding? Of course hedge fund investing is good!

It creates more efficiencies in capital markets and adds great value.' So I'm afraid I got stuck in the middle of folks on both sides!

As far as your non-profit critics are concerned, is it just that hedge funds are evil and you shouldn't have anything to do with them?

I think people look at certain practices of hedge funds and they see what they view as some very damaging things. If you look at what hedge funds have done, for example shorting banking institutions in the UK, one could argue that they exacerbated some of the problems in the recent capital market meltdown. But in my opinion there are also aspects of hedge fund investing that can actually be very positive if managed in the right way. So what I was trying to explore was whether it's possible to do sustainable investing through a hedge fund vehicle and what one would have to consider in attempting to do so.

In your paper, you suggest that traditional hedge fund investing and sustainable investing needn't be worlds apart. What do you mean?

During the capital market meltdown, Stefan Zellmer [at the time Chief Investment Officer of Uhuru Capital Management] and I found ourselves in a start-up firm in a very volatile market where nobody was investing in anything, so we had a lot of time to sit around the office and just talk. As Stefan spoke about the hedge fund investment approach he had developed for Uhuru, I was struck by the way he described good Fundamental investing. The words he used were very similar to many of the ideas that I had been exploring with other folks in the sustainable finance and investing arena.

Hedge funds are a very complicated asset class and often you have what you would think of as different strategies blended into one hedge fund approach, so you have to be very careful when you talk about this. With that caveat in mind, I was surprised to find that Fundamental hedge fund investment strategies often have a much longer timeline than one would imagine. They can also be conservative in terms of the use of debt and leverage, whereas you often hear of hedge funds taking on a massive amount of debt. And many Fundamental hedge fund managers are focused on having deep market knowledge and taking advantage of that knowledge to create a profit and generate returns for their investors over time. Clearly, hedge fund investing is not social finance, so I don't want people thinking I'm saying they are the same. However, they actually have a lot more in common than the popular media and many mainstream investors are aware.

Can you just say what you mean by sustainable investing?

For me, sustainable investing is an approach to investing that looks at how environmental and social factors affect financial performance and how the allocation of capital may be structured to generate environmental or social impacts and returns. It's an approach that looks at all three parts simultaneously and assesses the interaction between those parts relative to the future potential to create value.

So you're suggesting that rather than concentrating on creating a larger community of sustainable investment firms, it would have a greater social impact to try to embed sustainable investment practices in the capital market mainstream. Is that right?

A lot of my work over the years has looked at the larger idea of capital and capital markets, and how you can advance sustainable investing practices – and what sustainable means relative to an overall value proposition for capital and organizations. The role of emerging sustainable finance funds has been phenomenal over the last 20 years, and definitely moving in the right direction by pioneering an array of investment practices. However, we need to remember that the end goal here is not to create a pool of boutique funds operating on a small scale; what we really want to see is the transformation of capital and capital markets. The potential to infuse mainstream capital with sustainability considerations is really, to my mind, what we should be focusing upon.

If your goal is the transformation of mainstream capital markets, presumably you're not saying that hedge funds are the only area of the capital market where you'd like to see a greater focus on sustainable investing?

No, that's a good point. I approach a lot of my own work as a result of the journey that I've been on. I've moved through a wide spectrum of capital, including philanthropy, sustainable private equity, and five years as senior fellow with Generation Investment Management (a 'long-only' public equity firm); my time with Uhuru Capital Management was really one more step in that journey. I wanted to see how far you can go with some of these ideas and practices. I would argue that current thinking about sustainability has relevance to *each* asset class and *all* investment strategies –it's not just something you do with a small percentage of investable assets. And that the broad set of ideas and practices captured in 'sustainability' can inform all investing whether you're doing it with philanthropic capital or concessionary, below-market-rate capital or you're pursuing commercial market-rate returns.

How does your current thinking relate to the idea of Blended Value, which is probably what you're best known for at the moment?

When I think about Blended Value, what I'm thinking of is an over-arching framework within which all asset classes can be players, and through which we can understand the degree to which capital and company – whether for-profit or non-profit or hybrid organizations – can be structured to capture their full value potential. To my mind, this links to the idea of value being made up of a variety of components, which include economic performance and social or environmental impact. When I think about the implications of this work for the Blended Value Proposition, I view it as one more dot I'm connecting with a host of other data points related to how we may make the best use of capital in pursuit of performance and multiple returns.

What would you like to see happening next on the way to achieving your long-term goals for sustainable investing becoming mainstream?

To be frank, I would like to see less talk and more actual investment dollars moving into these areas. I realize that the capital markets' volatility over the last two or three years has been incredibly significant and we've seen the evaporation of millions – if not billions – of dollars that could otherwise have been directed to these areas.

Having said that, I have been disappointed at the degree to which many investors have retreated back into their financial foxholes, going back to the things that they think they 'know' about investing. They view the types of funds and instruments that are being advanced within this conversation as somehow still largely new and different and threatening: 'Gosh, we love the strategy, we love the team, but it doesn't look exactly like what I've got invested over in the other side of my balance sheet so I'm going to wait and see how things in the mainstream go forward and will then think about it...'

And that is a real shame. We're seeing the creation of some great funds, and some really solid teams are putting together some very significant track records, yet many asset owners and wealth advisers continue to feel greater comfort in strategies that in many ways started the troubles to begin with. The notion that some of these impact investment vehicles are more risky than traditional investments which cost them 30 and 40 per cent of their entire portfolio is a bit hard for me to get my head around ...

I would say that both life and investing are about taking informed risks and pursuing a vision of how to maximize not only the financial value of your assets but also the total value of your having lived. I think that what we'll see over time will be more and more of these funds securing the capital they need and being successful in the execution of their strategies. That's not going to be true across the board, of course – we'll have failures in the same way as some mainstream firms and investments have had failures.

Having said that, sustainable and impact investing take consideration of aspects that many traditional investors ignore, such as off balance sheet environmental liability, lack of transparency and sound governance practices that will help ensure good management of firms and companies. If we had actually been executing these practices at a higher level we might not have had the degree of mainstream capital crisis we currently have to suffer through. Recognizing that, I really hope in the short term we see investors lifting their heads out of their foxholes and getting back in the battle rather than trying to hide behind investing practices that really, to my mind, have been seriously called into question in recent years.

I think a lot of people, including me, thought the financial crisis would have the opposite effect – that people would see returns on mainstream investments were proving unappealing, so why not go for social returns instead. This doesn't seem to have happened – why do you think this is?

Well, again, being within a financial investment firm all the way through this crisis, I was taken aback by how people did not use it as an opportunity to reflect on the investment practices that got us into this situation. I thought we had an incredible window to revisit some of our discussions on risk and return in particular. If you consider the fact that many funds and foundations lost 20, 30, 40 per cent of their total asset base, it's pretty stunning to compare that with microfinance funds and even, at the outset, some affordable housing funds that were returning 3 to 7 per cent.

You have to be careful in making comparison like this, but at the same time I was expecting that trustees and investors would step back and say ‘What are we really trying to do here? What are we managing our funds for?’ If it’s simply to try to make more money, then that leads us in one direction, but if it’s to make a responsible return as well as leveraging other parts of value then we had a great opportunity to shift the conversation, and I feel we largely missed that opportunity.

What sort of role would you personally like to find now, in pursuit of realizing your short- and long-term goals?

Well, I’m torn because on the one hand I would love to get back and actually run a fund or foundation, executing strategies and putting ideas into practice. But at the same time, before I joined Uhuru I was fortunate enough to have a portfolio of engagements that allowed me to be involved in philanthropy and social enterprise and sustainable investing as well as thought leadership. I think that at least initially going back into advisory roles with funds and foundations may be the most logical place for me to go. But if I could find a foundation that really wanted to do something innovative and game-changing, that would be a hard opportunity to turn down.

What have you learned from the demise of Uhuru Capital Management?

I guess the first thing I learned is never launch an investment firm at the start of a 50-year capital crisis! I’m joking of course, but you can’t deny the fact that it was one of the key things that led to our demise. I suppose each of the partners would have their own perspective on our experience, but one of the things I was struck by in retrospect was actually a very basic issue. What we had was a set of extremely talented individuals – each of them brought significant expertise and great skills to the table. We could potentially have done a phenomenal amount of work together, yet despite that potential I don’t think we were ever really able to come together as the team we could have been. In light of the crisis, it comes back to that basic lesson we learn so many times in life, that you need to be able to build a solid team: it really doesn’t come down to individual expertise or vision or being ‘entrepreneurial’. You have to have a set of folks who are able to operationalize that vision. And I’m looking forward to having that opportunity at some point in the future.

Jed Emerson has played a leading role in some of the US’s leading venture philanthropy and social enterprises. His most recent role was Managing Director for Integrated Performance with Uhuru Capital Management, a commercial market fund of hedge funds group with an impact investing strategy. His website, www.blendedvalue.org, showcases many of his papers on sustainable investing, social capital markets and performance metrics. Email Jed at jed@blendedvalue.net