Features

Goldman Sachs Expects Big Returns from Going Green

By Ecosystem Marketplace

The investment giant announced an ambitious series of environmental goals, and found them directly in line with its primary goal of making money, Christopher Wright reports.

In November 2005 Goldman Sachs surprised many people in the financial sector when it announced an ambitious new environmental policy framework. [PDF] The slew of green measures included commitments to consider the environmental and social impacts of investments, encourage the development of environmental markets, and reduce the investment bank's overall climate footprint.

Now a little over a year later (and on the back of soaring profits) the investment giant is taking stock of its efforts. On January 21, 2007, it quietly released its year-end environmental report, [PDF] demonstrating that environmental commitments are indeed in line with Goldman's raison d'etre: making money.

"We tried to make the framework as business-oriented as possible, because we believe it would be the best way for us to have a positive impact on the environment," says Sonal Shah, vice president of corporate citizenship at Goldman Sachs. "We want to show that there is a way to make money on this."

Winds of Change

"Goldman Sachs really pushed the envelope with [its] policy framework," says Jon Sohn, a senior associate at the World Resources Institute. "They are sending a message that valuing the environment can go hand in hand with wealth creation."

In particular, Goldman Sachs chose to focus its efforts on the renewable energy sector in 2006, where it thinks profits may just be blowing in the wind. Due to strong demand and opportunity, it exceeded its original pledge to invest $1 billion in alternative energy by 50 percent. In June 2005 the investment bank acquired Horizon Wind Energy (formerly Zilkha Renewable Energy), and then acted as a joint book runner on the syndication of $263 million in project financing for the company in April 2006. Horizon says it will put the money to work constructing turbines capable of producing enough electricity (4,000 megawatts) for 1.2 million homes.

In addition to betting on wind, Goldman Sachs kicked in support for companies in the solar, biodiesel and ethanol businesses. The investment bank made a private equity investment in SunEdison LLC, a Baltimore-based company in the solar photovoltaic systems business, and arranged $217 million in debt financing for Northeast Biofuels. Reflecting its appetite for innovation, Goldman also purchased a minority stake in Iogen Corporation, which is attempting to pioneer the conversion of agriculture materials like straw, corn stalks, and switchgrass into ethanol.

Of course, environmental advocacy groups are quick to point out that upping investment levels in alternative energy addresses just one side of the climate change problem facing the current economy. Sohn argues, for instance, that Goldman's year-end report did not say enough about the nature and number of transactions it screened when making project investments in environmentally-sensitive industries.

"Investment banks need to carefully evaluate who they're doing business with, and the environmental and social impacts of the full range of financial services that they provide," says Dana Clark, global finance campaigner for the Rainforest Action Network. "They need to reduce their involvement with the dirtiest industries, and find ways to reduce the carbon intensity of their investments."

Goldman admits that controversies about project finance decisions may become more commonplace in the future, but argues it is difficult to turn down such investments in light of the growing demand for energy, and the current inability of alternative sources to meet it. According to Shah, investing in alternative energy and technology is not without its own problems. For example, wind farms sometimes face local not-in-my-backyard opposition, and there are still some unresolved questions with regards to the implementation of certain technologies.

So instead of an abrupt shift from fossil-fuel based to alternative energy, Goldman Sachs envisions a phased approach in which different sectors of the economy gradually become less and less dependent on coal and oil. In this context, Shah says Goldman Sachs will continue to make investments in proven alternative energy sources and will help develop the carbon market.

"Money is already flowing to alternative energy sources," says Sohn. "But with this policy, Goldman Sachs recognizes that markets have to be enhanced to significantly increase these flows globally and reduce our reliance on fossil fuels."

Making Markets

The investment bank's strategic investments in renewable energy are just one part of its market-making strategy.

Goldman Sachs purchased a 10.1 percent stake in the UK-listed Climate Exchange, the parent company of the European Climate Exchange (ECX), in September 2006. The investment formed part of the Climate Exchange's merger with the Chicago Climate Exchange (CCX), strategically positioning the company--and by extension Goldman Sachs--in two significant markets. Goldman liked this position enough to double its stake in the deal to 19 percent last week, fueling a five percent surge in Climate Exchange stock on January 19, 2007.

Goldman Sachs is also looking to stoke the fires of less established sectors of the carbon market. Just last month, the investment bank's new Center for Environmental Markets commissioned Resources for the Future, the World Resources Institute and the Woods Hole Research Center to research: policy options for federal greenhouse gas regulations in the United States; the promise of various clean technologies; and the value of avoided deforestation. The research will be made available to the public and discussed in a series of global conferences. The aim, says Shah, is to inform current policy debates about the potential of environmental markets in reversing environmental degradation.

Yet, in relation to other ecosystem services, such as the preservation of water-quality or biodiversity conservation, there was little progress to report. But Goldman Sachs says it is evaluating opportunities in relation to water and biodiversity, and may commission research or make investments in this area in the coming year.

"I would be disappointed if a market for valuing biodiversity does not emerge in the next 10-15 years," says Alice Chapple, director of sustainable financial markets at Forum for the Future, a UK-based organization. "I expect that financial institutions, alongside other companies, will begin to understand the role they play in both the extinction and protection of vulnerable species."

Long-Term Greed

Goldman Sachs has a history of making long-term strategic investments in new product lines. Gus Levy, its former legendary partner, famously conceded that the investment bank was greedy, but clarified, "long-term greedy." The fact that the powerhouse of capitalism is taking the plunge into environmental markets is perhaps the embodiment of this mantra, and the surest signal yet that there is money to be made on sustaining ecosystem services.

"People do perceive Goldman Sachs in a different way from other investment banks," says Chapple. "So when it released its environmental policy framework, some skeptics in the financial sector did reconsider their views on the commercial viability of green investments."

As with its investments more generally, thorough internal research will underpin Goldman Sachs' latest move. While the research grants provided to explore public policy options totaled $2.3 million, the investment bank's support for internal research is much more substantial. Last year, Goldman became a partner of ASSET4, a provider of non-financial data on corporations worldwide that incorporates environmental, social and governance (ESG) data into its investment research. The aim is to understand the relationship between ESG performance and share prices.

"We have done a lot of research on this and we feel we will become better investors," says Shah. "We are really trying to get to our clients and the investing audience out there, and demonstrate why these issues are important to think about."

If Goldman Sachs can drive interest in environmental markets, it would certainly be timely. According to the Millennium Ecosystem Assessment, approximately 60 percent of ecosystem services are being degraded or used unsustainably. Fortunately, Shah says the demand for advice on ESG issues is rising, particularly among corporations in Europe, and among utilities worldwide. But more importantly, as many clients will increasingly be exposed to such risks, Goldman Sachs wants to be in a position to help them.

The Hibernating Giant

A notable finding of Goldman Sachs' research is that the impact of pressures from NGOs and SRI funds, or single pollution incidences, impacts shareholder value much less than government regulation. Accordingly, the investment bank has strongly come out in favor of regulation that creates long-term value for greenhouse gas emissions reductions and new technologies. Voluntary action, it reasons, is insufficient.

"We are not advocating for any specific federal regulatory policy," says Shah. "Rather, we want to inform decision-makers of good market-principles that they should think about."

Chapple agrees with this approach: "The best input into policy that investment banks can provide is to conduct and present research to government and stakeholders that identifies the obstacles they face in expanding their investments into alternative energy and clean technologies," she says. In turn, government should set clear policy targets and stick to them, thereby providing regulatory certainty for investors.

Based on its financial standing and reputation, Goldman Sachs is a bellwether for investors. When it speaks, Wall Street listens. So given its endorsement of the sustainability agenda, are we seeing the contours of a green arms race in the financial industry?

Well, perhaps. Last October Morgan Stanley tripled Goldman's $1bn commitment, announcing plans to invest roughly $3bn in carbon credits and energy projects to reduce greenhouse gas emissions during the next five years. In the long run, however, only effective and stable federal regulation can put a robust price on carbon.

Market analysts have called the U.S carbon market a "hibernating giant." With Goldman Sachs leading the way, the conservative wing of Wall Street seems to have woken up. And so the question is: when will lawmakers on Capitol Hill follow suit?

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