

MORGAN STANLEY'S 1GT FUND TIES CLIMATE IMPACT TO INVESTMENT RETURNS

Vikram Raju of **Morgan Stanley Investment Management** discusses the evolution of climate investing, the 1GT fund's commercial discipline, carbon accounting and opportunities across energy efficiency, methane, transportation, AI and other climate markets.

Morgan Stanley Investment Management's 1GT strategy is designed to invest in commercially strong companies whose growth also produces measurable reductions in greenhouse-gas emissions. The fund does not rely on subsidies, carbon prices or environmental regulation as the foundation of its investment thesis. Instead, portfolio companies must offer products or services that customers will buy because they save money, improve efficiency, reduce risk or provide a superior solution. The strategy has set a target of avoiding or removing one gigaton of carbon-dioxide-equivalent emissions through the growth of its portfolio companies. Vikram Raju spoke with EBJ about the lessons of earlier cleantech investment cycles, the development of the 1GT strategy and the expanding universe of commercially viable climate technologies.

EBJ: How did you move from conventional finance into climate investing, and what lessons shaped your strategy?

Vikram Raju: I began in currency trading and emerging-market investing before working at McKinsey and later joining the International Finance Corporation, the private-sector arm of the World Bank. When I arrived at IFC in 2011, I had no formal environmental background. I inherited a portfolio of climate-related company investments at a time when many business models depended on carbon markets, subsidies or rapid changes in consumer behavior.

Some very intelligent people had backed ideas that did not survive commercial reality. Carbon markets did not scale as expected, policy support changed and adoption took longer than forecast. The central lesson was that climate investing must begin with a strong commercial product. We developed a simple test: Would the world's biggest climate skeptic still buy it? The customer should buy because it saves money, improves operations or reduces risk. The climate benefit should be embedded in every unit sold.

EBJ: How did that philosophy lead to the 1GT fund?

Raju: Morgan Stanley had already made a broad commitment to sustainability, but climate investing was still viewed skeptically by many institutional investors when

we began developing the strategy. We launched a pilot fund around 2018 and achieved several strong exits, including an energy-efficiency software company and a UK electric-vehicle charging network.

Those investments demonstrated that companies could produce both attractive financial returns and measurable environmental benefits. When we raised a larger fund, we wanted to distinguish it from the many climate funds entering the market. We therefore set a specific target of one gigaton of avoided or removed emissions. There is no magic to that number, but it is difficult, measurable and transparent.

EBJ: How are financial incentives linked to the carbon target?

Raju: The fund must deliver financial returns first. We do not earn carried interest simply because an investment has an environmental benefit. Once the required return is achieved, half of our potential carry is tied to financial performance and half to verified carbon performance. That structure requires us to invest in companies that are both successful businesses and meaningful contributors to emissions reduction.

EBJ: Do your investments depend on regulation, subsidies or carbon credits?

Raju: No. Those mechanisms can help, but they cannot be essential to the business case.

For example, methane-detection companies may benefit from emissions regulation, but operators also pay for those services because leaks represent lost product, infrastructure risk, worker-safety concerns and reputational exposure. The economic value exists even if the regulation changes. The same principle applies across the portfolio. The product must make commercial sense without assuming that government support will remain in place.

EBJ: Are all portfolio companies explicitly marketed as climate companies?

Raju: No. About half describe themselves that way and half do not. Methane monitoring is an obvious climate product. A plant-based nutritional drink sold at an airport or train station may not be perceived as one, but its growth can still displace more carbon-intensive food products. We care about the measurable impact of the product, not the label the company uses.

EBJ: How do you calculate progress toward one gigaton without overburdening portfolio companies?

Raju: We do not ask companies to build complex new carbon-reporting systems. Our team calculates the emissions impact associated with each product or service and combines that with the company's expected growth. The company provides its normal financial and operating data, together with a limited number of additional indicators. We perform the carbon analysis internally with support from Morgan Stanley's sustainability specialists. A large independent consulting firm reviews the methodology at underwriting, annually and again at exit.

EBJ: How do you address concerns about greenwashing or uncertain carbon-accounting standards?

Raju: Consistency and independent review are essential. Carbon-accounting standards will become more sophisticated over the life of the fund. We therefore use the same methodology and outside adviser across the portfolio so that each company is evaluated on a comparable basis. Our limited partners also have the right to appoint another independent expert when

the carbon-related carry is calculated. That expert can revise our assumptions and determine that the fund delivered less than one gigaton. Their conclusion determines the carbon-based incentive payment. We felt that was the clearest way to provide accountability.

EBJ: How do you source investments across such a broad climate market?

Raju: Almost any company can be in scope if it has the potential to generate strong returns and reduce emissions. We divide the market into subsectors and analyze them in depth. Our team attends industry conferences, speaks with academics, follows emerging technologies and develops relationships with companies long before they are ready for our capital.

Morgan Stanley's broader industry relationships help us identify smaller suppliers and technology companies within the ecosystems of large corporations. Venture investors are also important because they support companies at earlier stages than we typically can. We watch those companies as customer pilots become contracts and the management teams demonstrate that they can scale.

EBJ: Where does traditional environmental infrastructure fit within the strategy?

Raju: Large water, wastewater and waste infrastructure projects are often too capital-intensive for our investment model. However, companies serving those systems can be attractive.

Examples include software that improves wastewater-treatment efficiency, technology that optimizes waste-collection routes or systems that reduce maintenance requirements and energy use. We can invest in products, services or combinations of the two, provided the company fits our return, size and carbon-impact criteria.

EBJ: What distinguishes today's climate market from Cleantech 1.0?

Raju: Cleantech 1.0 included many subsidy-driven renewable projects, science experiments and businesses that assumed functioning carbon markets would make them viable.

Some of those investments were necessary and ultimately contributed to technological progress, but the losses created a perception that climate investing was not commercially disciplined.

From roughly 2018 through 2025, the market entered another period of strong capital inflows and high valuations. Some businesses proved themselves, while others did not. The current market is healthier. Technology has improved, costs have fallen and weaker business models are disappearing. Strong companies still command reasonable valuations, but the extreme froth has declined.

EBJ: Are climate, energy security and supply-chain resilience becoming part of the same investment thesis?

Raju: Increasingly, yes. One investor may call an opportunity climate technology, another may call it energy security and another may call it supply-chain resilience. The same company may address all three.

Over time, climate investing may become indistinguishable from conventional investing because every company must consider energy efficiency, physical resilience, operating risk and future technology trends. Institutional investors do not need to approach the market as a charitable or values-driven exercise. They need sensible investment opportunities.

EBJ: How is climate risk creating opportunities in insurance and infrastructure analytics?

Raju: Insurance companies are highly interested in technologies that protect assets and improve business continuity.

A system that identifies trees likely to fall onto a transmission line during a storm can prevent outages, repair costs and insurance claims.

That creates a clear financial case for better data, monitoring and predictive analytics.

Many technologies will support both emissions reduction and climate adaptation, particularly where they improve infrastructure performance and reduce disruption.

EBJ: What role is artificial intelligence playing in the portfolio and broader climate market?

Raju: AI creates both a challenge and an opportunity.

Data centers require enormous amounts of electricity and cooling, so we see many companies developing liquid cooling, more efficient server systems and cleaner energy solutions.

Within operating companies, AI is improving data analysis, routing, forecasting and automation.

XOCEAN, for example, uses uncrewed surface vessels to collect ocean-floor data. AI can process that information much faster and make it more valuable for subsea cables, offshore installations and marine infrastructure.

Another portfolio company uses decades of transportation and logistics data to optimize routes across ships, ports, railroads, warehouses and trucks.

Reducing transportation cost generally reduces fuel consumption, and reducing fuel consumption reduces carbon emissions.

EBJ: How do you view nuclear, hydrogen and carbon capture?

Raju: Nuclear is an important and underappreciated part of the climate solution, but its long development cycles and high capital requirements generally do not fit our strategy. We may invest in companies supplying technologies or services around the nuclear ecosystem.

Hydrogen also has significant potential, but the cost curve still needs to fall. Large amounts of patient capital may be required before many applications become commercially attractive.

We would be interested in scalable carbon-capture businesses that do not depend fundamentally on carbon credits. We have not yet seen many reach sufficient scale under that standard.

EBJ: Has the transition to electric vehicles lost momentum?

Raju: No. Progress varies by region, but vehicle range, efficiency and production continue to improve rapidly.

In the United Kingdom, long-distance electric travel is already practical with normal rest and charging stops. China and several other markets are moving at remarkable speed.

Our carbon forecasts assume that the overall economy becomes cleaner over time. As electricity and transportation decarbonize, each portfolio company may avoid fewer emissions relative to the incumbent system.

That makes the one-gigaton target harder to reach, but it is the outcome we want for the world.

EBJ: Does adaptation and resilience require a separate investment strategy?

Raju: Yes. Much more emissions reduction is required, but adaptation is already a major and growing investment need.

The 1GT fund is focused on avoiding and reducing emissions. A dedicated adaptation strategy would involve a different set of assets, time horizons and performance measures.

We may encounter relevant opportunities in data, insurance and infrastructure analytics, but resilience is a distinct investment proposition that will require substantial additional capital.

EBJ: What should climate and environmental companies understand when seeking institutional investment?

Raju: The company must solve a genuine commercial problem. Climate impact alone is usually not enough. The product must save money, improve performance, reduce risk or provide a superior customer experience.

Investors also need evidence that pilots are becoming contracts, that customers are returning and that the management team can scale. The most compelling climate companies are strong businesses whose commercial success automatically produces a better environmental outcome. ■